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14 INTERNATIONAL FRANCHISE ASSOCIATION,
15 ASIAN AMERICAN HOTEL OWNERS
16 ASSOCIATION, THE SUPERCUTS
FRANCHISEE ASSOCIATION, and the
DD INDEPENDENT
FRANCHISE OWNERS ASSOCIATION

17
18 **UNITED STATES DISTRICT COURT**
19 **SOUTHERN DISTRICT OF CALIFORNIA**

20
21 INTERNATIONAL FRANCHISE
ASSOCIATION, ASIAN AMERICAN
22 HOTEL OWNERS ASSOCIATION,
23 SUPERCUTS FRANCHISEE
ASSOCIATION, and the DD
24 INDEPENDENT FRANCHISE OWNERS
ASSOCIATION,

25
26 Plaintiffs,

27 v.

CASE NO.

**COMPLAINT FOR
DECLARATORY AND
INJUNCTIVE RELIEF**

1 STATE OF CALIFORNIA; XAVIER
2 BECERRA, IN HIS OFFICIAL
3 CAPACITY AS ATTORNEY GENERAL
4 FOR THE STATE OF CALIFORNIA;
5 JULIE SU, IN HER OFFICIAL
6 CAPACITY AS LABOR
7 COMMISSIONER OVER THE DIVISION
8 OF LABOR STANDARDS
9 ENFORCEMENT; LILIA GARCIA-
10 BOWER, LABOR COMMISSIONER OF
11 THE CALIFORNIA DEPARTMENT OF
12 INDUSTRIAL RELATIONS; KATIE
13 HAGEN, DIRECTOR OF THE
14 DEPARTMENT OF INDUSTRIAL
15 RELATIONS; and PATRICK HENNING,
16 DIRECTOR OF THE EMPLOYMENT
17 DEVELOPMENT DIVISION,

Defendants.

15 Plaintiffs, the International Franchise Association (the “IFA”), the Asian
16 American Hotel Owners Association (“AAHOA”), the Supercuts Franchisee
17 Association (“SFA”) and the DD Independent Franchise Owners Association
18 (“DDIFO”), as and for their Complaint against Defendants, allege as follows:

19 **INTRODUCTION**

20 1. The IFA, AAHOA, SFA and DDIFO (collectively, “Plaintiffs”) bring this
21 lawsuit to enforce its federal rights as provided by federal statute and guaranteed by
22 the Supremacy Clause of the United States Constitution. The Plaintiffs seek
23 declaratory and injunctive relief prohibiting Defendants from enforcing against
24 franchisors and franchisees (as those terms are defined under 16 C.F.R. § 436.1(i) and
25 (k)) California’s new test for determining whether a worker is an employee or
26 independent contractor, as interpreted by the California Supreme Court in *Dynamex*
27 *Operations West, Inc. v. Superior Court*, 4 Cal. 5th 903 (2018) (“*Dynamex*”) and
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1 subsequently codified by the California Legislature through Assembly Bill 5 (“AB-
2 5”) and Assembly Bill 2257 (“AB-2257”) (“California’s ABC Test”).

3 2. Franchising has “existed in this country in one form or another for over
4 150 years” (*Patterson v. Domino’s Pizza, LLC*, 60 Cal. 4th 474, 489 (2014)), and,
5 more recently, has “become a ubiquitous” and “thriving business model.” *Id.* at 477.
6 Under this business model, the franchisor, “sells the right to use its trademark and
7 comprehensive business plan” to franchisees who “independently own[], run[], and
8 staff[] the retail outlet that sells goods under the franchisor’s name.” *Id.*

9 3. Franchised businesses currently operate in more than a hundred different
10 business sectors. In addition to industries in which franchising has long been
11 prevalent, such as automotive repairs and services, hotels and motels, quick-service
12 and full-service restaurants, tax preparation businesses and real estate brokerages,
13 franchised industries also include, among many others, home health care and senior
14 care, home repair and remodeling, package shipping, hair care, fitness, financial
15 services, childcare, tutoring, and swim schools.

16 4. The entities that choose to operate franchised businesses are as varied as
17 the types of businesses that have chosen to franchise their business models. While a
18 large segment of franchisees are individual entrepreneurs seeking to own and operate
19 their first business, many franchisees have grown into immense operations with tens
20 of thousands of employees and hundreds of locations. Many operate multiple brands.
21 Still other franchisees are public companies. In light of its enormous growth,
22 franchising has a profound effect on the economy, both nationally and in the State of
23 California. In 2019, in California alone, there were more than 82,600 independently
24 owned and operated franchised businesses. These franchised businesses collectively
25 generated more than \$82.9 billion in economic output.

1 5. Further, franchisees are significant job creators in their communities. In
2 2019, franchisees in this State employed almost 827,000 people, and collectively
3 generated \$35.3 billion in payroll.

4 6. Franchisors and franchisees share the common goals of success and
5 survival. Matters which restrict or undermine franchisors will invariably have an
6 equal or greater detrimental effect on franchisees (who rely heavily on the franchisor's
7 brand and systems for operation) and the nearly 827,000 people employed by
8 franchised businesses in this State.

9 7. Franchising offers a wide array of individuals the opportunity to develop,
10 own, and operate their own businesses and, as such, franchising represents for many
11 Americans a piece of the American Dream. This is especially true for those whose
12 education level or other characteristics could pose barriers in other industries.

13 8. Franchising is also a statutorily recognized and permissible method of
14 doing business. Without exception, all of the statutes that regulate franchising
15 recognize that the relationship between a franchisor and its franchisees is a
16 commercial relationship, not an employment relationship. Importantly, the Federal
17 Trade Commission ("FTC"), which authorizes and regulates the sale of franchises in
18 the United States, defines a "franchise" in part as "any continuing *commercial*
19 *relationship or arrangement*" whereby the franchisor promises that the franchisee
20 "will obtain the right *to operate a business* that is identified or associated with the
21 franchisor's trademark ..." 16 C.F.R. § 436.1(h)(1). (16 C.F.R. § 436 *et seq.* is
22 hereinafter the "Franchise Rule").

23 9. The FTC Franchise Rule defines a "franchise" as "any continuing
24 commercial relationship or arrangement, whatever it may be called, in which the
25 terms of the offer or contract specify, or the franchise seller promises or represents,
26 orally or in writing, that ... [t]he franchisor *will exert or has authority to exert a*
27 *significant degree of control* over the franchisee's method of operation, or provide
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1 significant assistance in the franchisee's method of operation.” 16 C.F.R. § 436.1
2 (emphasis added).

3 10. Likewise, the FTC Franchise Rule requires that a franchisee receive from
4 the franchisor “the right to operate a business that is identified or associated with the
5 franchisor’s trademark, or to offer, sell, or distribute goods, services, or commodities
6 that are identified or associated with the franchisor's trademark.” 16 C.F.R. § 436.1.
7 And, the federal statute which permits the licensing of trademarks (the Lanham Act)
8 *mandates* that trademark licensors maintain control over the use of their trademarks.
9 *See* 15 U.S.C. §1127 (2000). In fact, “[w]here a licensor fails to exercise adequate
10 quality control over a licensee, a court may find that the trademark owner has
11 abandoned the trademark, in which case the owner would be estopped from asserting
12 rights to the trademark.” *Barcamerica Int’l v. Tyfield Importers, Inc.*, 289 F.3d 589,
13 595 (9th Cir. 2002).

14 11. These controls, however, are not just intended to protect a franchisor’s
15 system or the value of its trademarks. Because “uniformity of product and control of
16 its quality cause the public to turn to franchise restaurants” (*Burger King Corp. v.*
17 *Stephens*, 1989 WL 147557, at *12 (E.D. Pa. Dec. 6, 1989)), the value of the brand a
18 franchisee chooses to affiliate with is directly impacted by a franchisor’s ability to
19 maintain consistency and quality. “By following the standards used by all stores in
20 the same chain, the self-motivated franchisee profits from the expertise, goodwill, and
21 reputation of the franchisor.” *Patterson*, 60 Cal. 4th 477. A satisfactory experience
22 in one franchised location may encourage a consumer to visit that location again, or,
23 critically, other locations in the system that offer the same satisfactory experience.
24 Conversely, consumer dissatisfaction with an experience at a single franchised
25 location can be attributed to the franchise system as a whole. Therefore, the standards
26 a franchisor is required to establish greatly impact and help protect a franchisee’s
27 investment and the equity it has built in its business.

1 12. Franchisors, franchisees, and franchisees' employees who work in
2 franchised businesses all derive mutual benefit from this unique, controlled, and
3 codified "business relationship". See, e.g., Cal. Corp. Code §31001; §31005(a)(2);
4 and §31011.

5 13. A franchisor's controls over system standards help protect the interests
6 of consumers. By establishing and enforcing standards for operational matters like
7 cleanliness, food storage and preparation, and safety, franchisors not only protect the
8 expectations of consumers who choose to patronize franchised businesses, but help
9 ensure that guidelines are put in place to protect their health and safety.

10 14. The FTC Franchise Rule is logically consistent in treating franchise
11 relationships and employment relationships as mutually exclusive – *i.e.* a franchise is
12 not an employment relationship.

13 15. The California Legislature has enacted two statutes to regulate franchise
14 relationships in this State (the California Franchise Investment Law [the "CFIL"] and
15 the California Franchise Relations Act [the "CFRA"]). These statutes have co-existed
16 with the Lanham Act for almost 50 years because they contain similar definitions of
17 the "franchise" relationship and, thus, are legally compatible. Like the FTC's
18 Franchise Rule, these enactments repeatedly characterize franchises as "businesses"
19 and describe the relationship created between a franchisor and a franchisee as a
20 "business relationship." See, e.g., Cal. Corp. Code §31001 (disclosures are designed
21 to give a better understanding of the parties "business relationship"); §31005(a)(2)
22 ("[t]he operation of the franchisee's business" must be substantially associated with
23 the franchisor's trademark); §31011 (franchise fee is the amount paid "for the right to
24 enter into a business under a franchise agreement").

25 16. For clarity, it is not suggested in any manner that the CFIL, the CFRA or
26 any other state statute that deals with franchising is somehow preempted, or
27 inconsistent with, the FTC Franchise Rule or the Lanham Act.

1 17. California's ABC Test, however, is irreconcilable with the federal laws
2 that regulate franchising and the trademark license underlying all franchised
3 businesses. The ABC Test impermissibly impinges on the essential feature of the
4 franchise model—control over brand-specific systems and business models. Without
5 control, franchisors would be forced to abandon their required support and system
6 oversight, resulting in harm to both franchisees and consumers.

7 18. Prong A of California's ABC Test, which requires a showing that workers
8 are entirely free from the control of the hiring entity in connection with the
9 performance of work both under contract and in fact, threatens to convert all franchise
10 relationships into employment relationships, and thus conflicts with and undermines
11 the federally approved franchise business model.

12 19. Specifically, under Prong A of the ABC Test, a person may not be
13 classified as an independent contractor unless that person is "*free* from control and
14 direction in connection with the performance of the service, both under his contract
15 for the performance of service and in fact." Cal. Labor Code § 2775(b)(1) (emphasis
16 added). As such, the ABC Test, if strictly interpreted to apply to a franchisor-
17 franchisee relationship, would have the perverse effect of converting all franchise
18 relationships, which necessarily require some element of control as defined by the
19 FTC Franchise Rule, into employment relationships despite those relationships being
20 arms' length and governed by contract.

21 20. Similarly, under Prong B of the ABC Test, a person may not be classified
22 as an independent contractor unless that person "performs work that is outside the
23 usual course of the hiring entity's business." Cal. Labor Code 2775(b)(1)(B). By
24 definition all franchisees are granted the right to operate a business that is identified
25 or associated with the franchisor's trademark." 16 C.F.R. 436.1(h). If operating a
26 business identified or associated with the franchisor's trademark (or offering, selling,
27 or distributing goods, services, or commodities that are identified or associated with
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1 the franchisor's trademark) is considered performing work that is within the usual
2 course of the franchisor's business, and the ABC test otherwise applies to franchisees,
3 then franchisees (under federal law) would be employees under the ABC Test.

4 21. Recently, this dissonance between the ABC Test and the franchise
5 business model was emphasized by the United States District Court for the District of
6 Massachusetts. In the case of *Dhananjay Patel v. 7-Eleven, Inc.*, No. 1:17-cv-11414-
7 NMG. (Sept. 10, 2020), the District Court correctly identified the "inherent conflict"
8 between the FTC Franchise Rule and Massachusetts' version of the ABC Test, which
9 mirrors California's version of the ABC Test. The Court stated that: "It cannot be the
10 case, as plaintiffs suggest, that, in qualifying as a franchisee pursuant to the FTC's
11 definition, an individual necessarily becomes an employee. In effect, such a ruling
12 by this Court would eviscerate the franchise business model, rendering those who are
13 regulated by the FTC Franchise Rule criminally liable for failing to classify their
14 franchisees as employees." *Patel*, 2020 U.S. Dist. LEXIS 165057, at *24.

15 22. As noted above, Prong A of California's ABC Test requires that a person
16 be "*free from control and direction in connection with the performance of the service,*
17 *both under his contract for the performance of service and in fact.*" Cal. Labor Code
18 § 2775(b)(1) (emphasis added). This cannot be reconciled with the FTC Franchise
19 Rule. Specifically, the FTC Franchise Rule precludes satisfaction of Prong A exactly
20 in the manner identified by *Patel* because the FTC Franchise Rule *defines* a franchise
21 as a relationship in which "the franchisor *will exert or has authority to exert a*
22 *significant degree of control over the franchisee's method of operation*". *Patel*,
23 2020 U.S. Dist. LEXIS 165057, at *19 citing 16 C.F.R. § 436.1 (emphasis added).

24 23. The ABC Test thus stands as an obstacle to the accomplishment and
25 execution of the full purposes and objectives of Congress, including the authorization
26 and regulation of the sale of franchises and the licensing of trademarks in connection
27 therewith.