Background: IFA Lawsuit

On November 17, the International Franchise Association filed a complaint in the U.S. District Court for the Southern District of California that challenges AB 5 as applied to the franchise business model, specifically arguing that this law is preempted by the Federal Trade Commission (FTC) Franchise Rule and federal Lanham Act, the primary federal trademark law. These federal statutes are sacrosanct to the franchise business model and the nation's 733,000 franchise businesses, which together directly employ more than 8 million workers and represent more than 3.5 percent of GDP.

IFA's lawsuit would declare California's AB 5 preempted by federal law and grant a permanent injunction prohibiting the enforcement of the ABC test to the relationship between franchisors and California's 75,800 independent franchised businesses.

This legal action follows IFA's support for statutory exemptions to AB 5 in 2019 and 2020 that were ultimately unsuccessful, largely due to opposition by organized labor. In 2019, nearly 100 California franchisees met with lawmakers requesting a common-sense exemption from AB 5, and in February 2020, more than 160 franchise brands made the same request via a letter to the California legislature.

Additionally, the lawsuit follow's California voters' choice to exempt certain gig-economy workers from the wide-ranging new law.

What Is the ABC Test Under AB 5?

The proffered goal of AB 5 extends employee classification status to gig workers. However, under its three-pronged ABC test, a franchisee or other business to business relationships are presumed to be employment relationships unless all three prongs of the ABC test are satisfied.

As currently written, the ABC test fundamentally fails to recognize the unique nature of the franchise model. In fact, in Massachusetts, the state with the most analogous ABC test, a federal court examined the same issue and ruled in favor of exempting franchises. In the ruling in *Patel et al v. 7-ELEVEN, INC. et al* the judge noted that applying the ABC test to a franchise relationship would "eviscerate the franchise business model."

Here's how:

Prong A of the ABC test requires a hiring entity to show that a worker is free from its direction and control. This prong fails to take into consideration the basic franchise model. To lawfully and successfully maintain franchises, a franchisor is ***required*** to exert a substantial degree of control over the operations and business practices of its franchises. That level of control ensures the quality and consistency that consumers expect.

California's ABC test risks converting all franchises, as defined by the FTC Franchise Rule and the Lanham Act, into employment relationships. Under AB 5, owners of local establishments or franchisees may be deemed employees of brands, making the economic model no longer viable based on the new regulatory obligations.

How Can the ABC Test Affect Franchises?

The franchise industry supports the goal of AB 5; in fact, many franchise businesses have led the way on worker employment. However, through its codification and wide-ranging application of the ABC test, AB 5 could turn franchise owners – local entrepreneurs who license a name and operating system from an established brand – into employees of the company from which they license their brand. This would erode the franchise model and hurt franchise business owners across the Golden State. Recently, franchise brands including 7-Eleven have announced they will no longer franchise in California as a consequence of AB 5.

Choosing to license a brand name and invest in starting a franchise business should not mean these entrepreneurs are treated like employees of a corporation. In fact, they are independent risk takers and job creators who employ more than 700,000 Californians. The complaint put forth by IFA offers a resolution for franchisees whose livelihoods are currently at risk due to the unclear guidelines currently in place under the ABC test of AB 5.

###