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Practice of Franchise Law

Massachusetts Federal Court Compares Franchising to a “Ponzi Scheme” and Labels Franchisees as Employees

In a ruling that already has sent shock waves through the franchisor community, a Massachusetts federal judge ruled in March that Coverall, a janitorial services franchisor, could not classify its franchisees as independent contractors. *Awuah v. Coverall North America*, 2010 U.S. Dist. LEXIS (D. Mass. Mar. 23, 2010). Instead, in granting the franchisees’ motion for partial summary judgment, the court found Coverall’s franchisees must be classified as employees. The opinion hinged on a single prong of Massachusetts’s employee classification test—whether or not the franchisees’ services were “performed outside the usual course of the [franchisor’s] business” and “independent, separate, and distinct [] from that of the [franchisor].”

In response to Coverall’s argument that it is in the *franchising* business, and not in the direct *cleaning* business, the court compared Coverall’s description of franchising to “a modified Ponzi scheme—a company that does not earn money from the sale of goods and services, but from taking in more money from unwitting franchisees to make payments to previous franchisees.” The court found that since “Coverall is the party billing all customers for the cleaning services performed,” “receives a percentage of the revenue earned on every cleaning service,” and “sells cleaning services, the same services provided by [franchisees,]” it “fails to establish that the franchisees are independent contractors.”

While this case addresses a very specific set of circumstances (plaintiff franchisees are individuals and not entities, and the franchisor, for the most part, controlled all aspects of the franchisees’ relationship with their customers), it may arguably apply to other systems. Franchisors should analyze their activity in Massachusetts carefully, and may want to consider revisions to their disclosure documents and agreements to better position themselves. The best solution, however, will likely be through legislation. The Massachusetts Attorney General has been working with the legislature to clarify the independent contractor law. The International Franchise Association is concerned that even the suggested approach will not completely protect franchise systems in Massachusetts from the argument that their franchisees are employees.