Franchisee or employee in disguise?

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Franchising, Canada

Introduction

Franchising communities in Quebec and elsewhere in Canada have been eagerly awaiting the Supreme Court of Canada's decision in *Modern Cleaning Concept Inc v Comité paritaire de l'entretien d'édifices publics de la région de Québec* (for further details please see "To be an employee or not to be – that is once again the question").

The judgment was finally rendered by the Supreme Court of Canada on 3 May 2019. The majority upheld the Quebec Court of Appeal's decision confirming that Francis Bourque – an unincorporated franchisee operating a two-person cleaning services business in Quebec as part of a cleaning services franchise network – qualified as an 'employee' pursuant to the Act Respecting Collective Agreement Decrees (Quebec). By reason of previous case law interpreting this statute, the court applied the 'risk and profit' test, pursuant to which a worker will not be deemed an 'employee' under the statute if they have:

- assumed the business risk associated with their work; and
- an opportunity to make a profit as a result of assuming said risk.

Overview

In the case at hand, Modern Cleaning Concept Inc (the franchisor) had structured a tripartite business model whereby it would enter into an initial service contract with a client which had multiple locations to be cleaned and the contract would then be assigned, as to each location of the client, to that specific franchisee whose area of service included such location of the client. The court found that, despite the assignment of these service agreements to its franchisees, the franchisor remained wholly liable for the non-performance of the services under the contracts. The court reiterated that, as a result of this assignment without novation (ie, without a release of the franchisor), the franchisor had assumed the business risk associated with operating the franchised business. In addition, the franchisee had little to no opportunity to generate profit given his lack of

autonomy and the various controls which had been exercised by the franchisor. In light of these factors, the court ruled that the franchisee was an employee of the franchisor under the statute (as opposed to an independent contractor) and accordingly entitled to the wages and benefits claimed on his behalf.

Moreover, in keeping with Quebec's longstanding contextual approach to contract interpretation, the court emphasised that it is substance, not form, that is determinative of the relationship between the parties and that a franchise agreement cannot serve to disguise an otherwise validly formed employer-employee relationship. **(1)**

Facts

The franchisor managed a janitorial services franchise network for public and quasi-public buildings in Quebec. In the course of its operations, the franchisor used a two-step business model whereby it first entered into a service contract with a client, which was then assigned – with the client's consent but without release of the franchisor – to a designated franchisee by way of a franchise agreement. The franchisees were not involved in negotiating the service contract between the franchisor and the client.

In 2012 the franchisor entered into a service agreement with the National Bank of Canada for the maintenance of its offices across Quebec. It also concluded a substantially similar contract with Quebec's liquor board, the *Société des Alcools du Québec* (collectively with the National Bank of Canada, the clients). Both contracts provided for their eventual assignment by the franchisor to one or more franchisees in the franchised network in respect of the various locations of the customers that required cleaning.

In 2014 the franchisor entered into a franchise agreement with the franchisee, which assigned both clients' service contracts to the franchisee in respect of the clients' offices which were situated in the franchisee's territory. For approximately five months, the franchisee performed its maintenance obligations under the service contracts.

After months of operating at a loss, the franchisee terminated the franchise agreement in May 2014. Thereafter, the *Comité paritaire de l'entretien d'édifices publics de la région du Québec,* a public organisation tasked with representing maintenance workers in Quebec, applied to the Court of Quebec on the franchisee's behalf, alleging that the franchisee qualified as an employee pursuant to the Act Respecting Collective Agreement Decrees and was therefore entitled to certain unpaid wages and benefits owed by the franchisor.**(2)**

Decision

In a six-to-three majority decision, the Supreme Court of Canada upheld the Quebec Court of Appeal's decision, confirming that the trial judge had made a palpable and overriding error in failing to consider the tripartite nature of the franchisor's business model. In its reasoning, the court assessed the nature of the relationship between the parties by considering which party:

- had assumed the business risk; and
- had an opportunity to make a profit as a result of same.**(3)**

The court began its analysis by highlighting the fundamental distinction between the risks assumed by all workers relating to their working conditions and business risk. According to the court, the fact that an employee assumes some degree of risk does not entail that they bear the risk of the business, in the sense of being able to organise their business venture in order to make a profit.**(4)**

In determining which of the parties assumed the business risk, the court examined the assignment without novation by the franchisor in this case. The court noted that since the clients had not consented to the franchisor's release from the initial services contracts, the franchisor remained entirely liable towards the clients for any potential breach of said contracts by the franchisee. Further, the court concluded that the franchisor's business model could not be understood without considering both the initial services contracts and the franchise agreements, which the court considered as being inextricable from one another.**(5)**

The court also assessed the controls imposed by the franchisor in order to supervise the performance of the service contracts by the franchisee and found that such controls not only went beyond those normally employed by franchisors to protect their brand and network, but were also intended to mitigate the franchisor's risk (both curatively and preventatively) under the assigned services contract in case of any breach by the franchisee thereunder – for example:

- the franchisee could not transfer his cleaning contracts to third parties, either by sale or assignment;
- any new cleaning contracts independently sought by the franchisee required the approval of the franchisor and the execution thereof between the franchisor and the franchisee's client;
- during the first three years of the franchise term the franchisor was entitled to:
    - unilaterally withdraw any of the franchisee's customer service contracts from him and re-assign said service contracts to another franchisee; and
    - assign another customer service contract to such franchisee within a reasonable period not to exceed 90 days;
- the franchisee did not receive direct payments from clients; instead, he was paid directly by the franchisor through direct deposits after the deduction of various royalties, fees and service charges (in some cases totalling 43% of the clients' payments); and
- the franchisor deducted a penalty from the franchisee's pay without discussing the matter with him following a service quality complaint from one of the clients.

In the court's opinion, the extensive nature of the controls exercised by the franchisor had hindered the franchisee's ability to expand his franchise business for profit.**(6)**

Accordingly, the court dismissed the appeal and concluded that the franchisee was an 'employee' within the meaning of the act.**(7)**

However, notably, the Supreme Court's decision was not unanimous. The dissent's view was that:

- the assignment without novation had not diminished the franchisee's liability;
- the franchisee had ultimately assumed the business risk; and
- the franchisor had not exercised the requisite control over the working conditions of the independent contractor to be considered an employer under the statute.**(8)**

Comment

While the Supreme Court of Canada's ruling may be worrisome to franchisors in certain industries, there are several mitigating factors to consider. As was the case in the Quebec Court of Appeal decision, the court emphasised that the tripartite business model used by the franchisor in this case was distinct from classical franchise models. In traditional franchise arrangements across Canada, the franchisee has a direct and autonomous relationship with its clients and bears the business risk associated with the franchised business. In this matter, the significant controls on the franchised operations imposed by the franchisor, which were considered to have been intended to manage the risks of non-performance of the client service contracts

assigned without novation by the franchisor, contributed to the majority's view that the legal relationship resembled more one of employment than a franchise with an independent business person. Moreover, the majority of the court characterised this case as being highly fact-specific; therefore, its application beyond the specific circumstances of this case is questionable.

Notwithstanding the foregoing, in light of this decision, franchisors that may be tempted to use comparatively disproportionate controls over the conduct of the franchised business and its client relationships should err on the side of caution. In particular, when dealing with unincorporated franchisees, franchisors should aim to circumscribe their control over franchisees' daily operations and avoid restricting franchisees' ability to seek out new clients for their franchised business or attempting to significantly manage the risk of non-performance of customer contracts by such franchisees.

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Endnotes

(1) *Modern Cleaning Concept Inc v Comité paritaire de l'entretien d'édifices publics de la région de Québec,* 2019 SCC 28, Paragraphs 37 to 38.
(2)*Ibid*, Paragraphs 1 to 18.

(3) *Ibid*, Paragraphs 37 to 38.

(4) *Ibid*, Paragraphs 44 to 48.

(5) *Ibid*, Paragraphs 42 to 43.

(6) *Ibid*, Paragraphs 49 to 54; *Comité paritaire de l'entretien d'édifices publics de la région de Québec v Modern Concept d'entretien inc,* 2017 QCCA 1237, Paragraphs 24 and 197.

(7) *Modern Cleaning Concept Inc v Comité paritaire de l'entretien d'édifices publics de la région de Québec*, 2019 SCC 28, Paragraphs 60 to 61.

(8) *Ibid*, Paragraphs 62 to 115.

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