IN THE SUPREME JUDICIAL COURT
COMMONWEALTH OF MASSACHUSETTS

No. SJC-13166

DHANANJAY PATEL, *et. al.*,
Plaintiffs-Appellants,

v.

7-ELEVEN, INC.,
Defendant/Third-Party Plaintiff-Appellee.

On Certified Question From the United States Court of Appeals for the First Circuit

BRIEF OF THE FEDERAL TRADE COMMISSION AS *AMICUS CURIAE* IN SUPPORT OF NEITHER PARTY

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INTEREST OF *AMICUS CURIAE*

The Federal Trade Commission is an agency of the United States charged, among other things, with preventing businesses from engaging in unfair or deceptive acts or practices. *See* 15 U.S.C. § 45(a). Pursuant to that authority, the Commission issued the Franchise Rule in 1978, *see* 43 Fed. Reg. 59,614 (Dec. 21, 1978), and amended it in 2007, *see* 72 Fed. Reg. 15,444 (Mar. 30, 2007). This Rule, codified at 16 C.F.R. Part 436, makes it an unfair or deceptive act or practice for a franchisor to fail to provide disclosures specified in the rule to a prospective franchisee in connection with the offer or sale of a franchise to be located in the United States or its territories, and also contains various additional prohibitions. 16 C.F.R. §§ 436.2, 436.9. The Commission enforces the Franchise Rule through administrative and judicial proceedings. Its staff has also published a compliance guide and regularly issues advisory opinions to assist the public in interpreting the Rule. Because this case involves issues relating to the Franchise Rule, the Commission files this *amicus curiae* brief to clarify the Rule's scope and effect.[1]

[1] No party or counsel for a party authored this brief in whole or in part or contributed money that was intended to fund preparing or submitting it. No person other than the Commission and its counsel contributed money that was intended to fund preparing or submitting the brief. Neither the Commission nor its counsel represents or has represented any party to the present appeal in another proceeding involving similar issues, or was a party or represented a party in a proceeding or legal transaction that is at issue in the present appeal.

BACKGROUND

A. The Franchise Rule

The Commission adopted the Franchise Rule in 1978 in response to evidence of widespread deception in the sale of franchises, including both material misrepresentations by franchisors and nondisclosure of material facts. 43 Fed. Reg. at 59,625. These unscrupulous tactics included misrepresenting the costs to purchase a franchise and the terms and conditions under which it would operate, using false or unsubstantiated earnings claims to lure prospective franchisees into making a purchase, and failing to honor refund provisions. *Id.* at 59,627-37. The problems were compounded by the fact that many prospective franchisees are relatively unsophisticated. *Id.* at 59,625-26.

To address these problems, the Commission required franchisors to disclose certain material information to prospective franchisees prior to sale, using a prescribed form. In 2007, the Commission conducted a thorough review of the Franchise Rule, concluded that it still served a useful purpose, and decided to retain it with some revisions. 72 Fed. Reg. at 15,447-49.

The core of the Franchise Rule, as amended, is 16 C.F.R. § 436.2, which makes it an unfair or deceptive act or practice for a franchisor to fail to make specific disclosures to a prospective franchisee in connection with the offer or sale of a franchise to be located in the United States or its territories. In particular, the

franchisor must provide the prospective franchisee with a disclosure document in a prescribed form at least 14 days before any binding agreement is signed or payment is made to the franchisor or its affiliates in connection with the proposed sale. *Id.* § 436.2(a). Additionally, the franchisor may not unilaterally and materially alter the terms and conditions of the basic franchise agreement or related agreements attached to the disclosure document without providing the prospective franchisee a copy of the revised agreement at least seven days before it is signed. *Id.* § 436.2(b).

The Rule's requirements apply primarily to entities meeting the definition of "franchisor."[2] A "franchisor" is "any person who grants a franchise and participates in the franchise relationship." *Id.* § 436.1(k). The Rule defines "franchise" broadly as:

> any continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that:
>
> (1) The franchisee will obtain the right to operate a business that is identified or associated with the franchisor's trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor's trademark;

[2] Some provisions also apply to "franchise sellers," which includes but is not limited to "franchisors." A "franchise seller" is "a person that offers for sale, sells, or arranges for the sale of a franchise," and "includes the franchisor and the franchisor's employees, representatives, agents, subfranchisors, and third-party brokers who are involved in franchise sales activities." 16 C.F.R. § 436.1(j).

(2) The franchisor will exert or has authority to exert a significant degree of control over the franchisee's method of operation, or provide significant assistance in the franchisee's method of operation; and

(3) As a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate.

Id. § 436.1(h). Any person who is granted a franchise is a "franchisee" under the Rule. *Id.* § 436.1(i).

Most of the rest of the Franchise Rule describes in detail the content of the mandatory disclosures, provides instructions for preparing and updating them, and sets forth certain exemptions. 16 C.F.R. §§ 436.3-436.8. The Rule also deems several additional practices in connection with the sale of franchises unfair or deceptive acts or practices—*e.g.*, making statements that contradict the mandatory disclosures, making unsubstantiated financial performance representations, failing to make promised refunds, and using fictitious references, or "shills," to mislead prospective franchisees. *Id.* § 436.9. The Rule, however, states that the "Commission does not approve or express any opinion on the legality of any matter a franchisor may be required to disclose by part 436," and, further, that "franchisors may have additional obligations to impart material information to prospective franchisees outside of the disclosure document under Section 5 of the Federal Trade Commission Act." *Id.* § 436.10.

Under the terms of the FTC Act, franchisors who violate the Franchise Rule—*e.g.*, by failing to make required presale disclosures or violating the

additional prohibitions—may be liable for civil penalties or consumer redress and may be subject to either an injunction issued by a court or a cease-and-desist order issued by the Commission itself. 15 U.S.C. §§ 45(b), (m); 53(b); 57b.

The Franchise Rule also expressly addresses its relationship to state law. It states that "[t]he FTC does not intend to preempt the franchise practices laws of any state or local government, except to the extent of any inconsistency with [the Franchise Rule]," and that "[a] law is not inconsistent with [the Rule] if it affords prospective franchisees equal or greater protection, such as registration of disclosure documents or more extensive disclosures." 16 C.F.R. § 436.10(b). In both 1978 and 2007, the Commission carefully considered proposals to give the rule a broader preemptive effect (*e.g.*, preempting all state franchise law). 43 Fed. Reg. at 59,719-21; 61 Fed. Reg. at 15,537-38 (Apr. 8, 1996) . But it ultimately rejected these proposals and concluded that the Rule should preempt only state laws offering less protection to prospective franchisees.

The Commission has also provided general guidance to the public on the proper interpretation of the Franchise Rule requirements in two forms. First, in 1979, the Commission published an interpretive guide to the rule in the *Federal Register*. 44 Fed. Reg. 49,966 (Aug. 24, 1979). Second, in 2008, the Commission staff published a compliance guide to the Rule as amended. FTC Staff, *Franchise Rule Compliance Guide* (May 2008), *available at* https://www.ftc.gov/tips-

advice/business-center/guidance/franchise-rule-compliance-guide.[3] Additionally, Commission staff regularly provide advisory opinions on compliance with the Rule upon request. *See* 16 C.F.R. § 1.1(b).

B. This Litigation

This case presents the question whether an individual who is a "franchisee" under the Franchise Rule may be deemed an "employee" of the franchisor under Massachusetts wage laws. The complaint was filed in federal district court as a putative class action by individuals who operate franchises of 7-Eleven stores in Massachusetts, on behalf of themselves and other similarly situated persons. Plaintiffs contend that 7-Eleven has misclassified them as "independent contractors" rather than "employees" for purposes of Massachusetts wage laws. *See, e.g.*, Mass. Gen. L. c. 149, § 148 (requirements for timely payment of wages); Mass. Gen. L. c. 151, § 1 (minimum wage requirement). We will assume for purposes of this brief (and it appears undisputed) that 7-Eleven is a "franchisor" and that the plaintiffs are "franchisees" within the meaning of the Franchise Rule.

Massachusetts law provides that for purposes of Chapters 149 and 151 (the Labor and Industries and Minimum Fair Wage laws), "an individual performing

[3] The *Compliance Guide* represents the view of FTC staff responsible enforcing the Franchise Rule, but unlike the 1979 interpretative guide it has not been formally adopted by the Commission.

any service… shall be considered to be an employee under those chapters unless" three criteria are satisfied. Mass. Gen. L. c. 149, § 148B(a)("Section 148B"). Those criteria (sometimes referred to as the "ABC test") are:

> (1) the individual is free from control and direction in connection with the performance of the service, both under his contract for the performance of service and in fact; and
>
> (2) the service is performed outside the usual course of the business of the employer; and,
>
> (3) the individual is customarily engaged in an independently established trade, occupation, profession or business of the same nature as that involved in the service performed."

Id. Failure to properly classify an individual as an employee under this statute may result in criminal or civil liability. *Id.* § 148B(d).

Before the district court, 7-Eleven moved for summary judgment, arguing that because it is subject to the Franchise Rule, the three-factor test of Section 148B should not be applied. 7-Eleven "concede[d] that it does exercise some level of control over its franchisees," but argued that it was "bound to do so" by the Franchise Rule. *Patel v. 7-Eleven, Inc.*, 485 F. Supp. 3d 299, 307 (D. Mass. 2020). It relied on this Court's decision in *Monell v. Boston Pads, LLC*, 471 Mass. 566 (2015), which held that a Massachusetts statute authorizing real estate salespersons to be employees or independent contractors was in conflict with and controlled over Section 148B. *Id.* at 574-78.

The district court granted the summary judgment motion. It held that the second prong of the Rule's definition of "franchise"—which states that a franchise

is an agreement or relationship where "[t]he franchisor will exert or has authority to exert a significant degree of control over the franchisee's method of operation, or provide significant assistance in the franchisee's method of operation"—was in "direct conflict" with the first prong of Section 148B, which requires that an independent contractor be "free from control and direction." *Patel*, 485 F. Supp. 3d at 308. The court concluded that it "cannot be the case … that, in qualifying as a franchisee pursuant to the FTC's definition, an individual necessarily becomes an employee" and that such a ruling would "eviscerate the franchise business model, rendering those who are regulated by the FTC Franchise Rule criminally liable for failing to classify their franchisees as employees." *Id.* at 310. The court held that "[t]he franchise-specific regulatory regime of the FTC governs over the general independent contractor test in Massachusetts," and accordingly that Section 148B did not apply to 7-Eleven. *Id.*

On appeal, the First Circuit agreed that "there appears to be a conflict between [Section 148B] and the 'exerting control' prong of the FTC Franchise Rule. *Patel v. 7-Eleven, Inc.*, 8 F.4th 26, 28 (1st Cir. 2021). The court concluded that it would be "difficult, if not impossible, for a franchisor to satisfy the FTC Franchise Rule's requirement that the franchisor 'exert or ha[ve] authority to exert a significant degree of control over the franchisee's method of operation' and simultaneously rebut [Section 148B's] employee presumption by demonstrating

that each franchisee is 'free from control and direction in connection with the performance of the service.'" *Id.* The court noted, however, that "a franchisor may not exert any degree of control and instead may 'provide significant assistance in the franchisee's method of operation,'" and that "[s]uch a franchising model may or may not implicate any of the concerns at issue in this case." *Id.* Because this Court had not previously considered the interaction of Section 148B and the Franchise Rule, and because of Massachusetts' "unique policy interests" in the issue, the First Circuit certified the following question to this Court.

> (1) Whether the three-prong test for independent contractor status set forth in Mass. Gen. Laws ch. 149 § 148B applies to the relationship between a franchisor and its franchisee, where the franchisor must also comply with the FTC Franchise Rule.

Id. at 29.

ARGUMENT

THE FRANCHISE RULE DOES NOT RESOLVE WHETHER FRANCHISEES MAY BE EMPLOYEES UNDER MASSACHUSETTS WAGE LAWS

The Commission takes no position on whether the plaintiffs should be classified as employees or independent contractors under Massachusetts wage laws. We file this brief to clarify that the Franchise Rule does not resolve that issue. The Franchise Rule is a presale disclosure rule that applies to any entity that meets its definition of a "franchisor." *See* 16 C.F.R. § 436.2. Section 148B is an employment law that, by its terms, applies only "[f]or the purpose of this chapter [Mass. Gen. L. c. 149] and chapter 151" and determines who is "an employee

under those chapters." Mass. Gen. L. c. 149, § 148B(a) (emphasis added). The provisions serve fundamentally different purposes and therefore may define the relationship between the plaintiffs and the defendant differently as demanded by their policies.

The plaintiffs in this case may or may not be classified as "employees" under the state statute, but either way 7-Eleven can still make the disclosures required by the Franchise Rule and adhere to its other requirements, while also complying with any obligations it may have under the Massachusetts wage and hour or labor laws. The two regimes do not conflict.

1. As a preliminary matter, neither the district court nor the First Circuit assessed federal preemption law. The district court relied on *Monell*, which involved two inconsistent Massachusetts statutes, and concluded that "the specific trumps the general." *Patel*, 485 F. Supp. 3d at 310. The Commission believes that the interaction between the Franchise Rule and Section 148B is more properly analyzed using the principles of preemption, since a general federal rule will trump even a highly specific state law if the two are in conflict. Nonetheless, to the extent that the question under *Monell* is whether it is "impossible" to satisfy both laws, *see* 471 Mass. at 575, then the analysis may be the same. For the reasons set forth below, the Franchise Rule does not preempt Section 148B because if both regimes apply to 7-Eleven, it can comply with both.

In the circumstances of this case, the Franchise Rule could preempt only if Section 148B "actually conflicts with federal law" in the sense that "it is impossible for a private party to comply with both state and federal requirements, or where state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *English v. Gen. Elec. Co.*, 496 U.S. 72, 79 (1990) (cleaned up).[4] For example, where federal law prohibited a drug manufacturer from altering the label on its drug, a state law duty to strengthen the label's warnings was preempted, because the manufacturer could not possibly comply with both laws. *Mut. Pharm. Co. v. Bartlett*, 570 U.S. 472, 479-80 (2013).

A franchisor can comply with both the Franchise Rule and Section 148B. Any person who meets the Rule's definition of a "franchisor" must provide the prescribed disclosures to prospective franchisees in accordance with 16 C.F.R. § 436.2 and comply with the Rule's additional requirements, unless an exemption applies.[5] If the franchisee is deemed an employee (rather than an independent

[4] The Supreme Court has recognized two other means of preemption, but neither applies here. First, "Congress can define explicitly the extent to which its enactments pre-empt state law." *English v. Gen. Elec. Co.*, 496 U.S. 72, 78 (1990). Second, "in the absence of explicit statutory language, state law is pre-empted where it regulates conduct in a field that Congress intended the Federal Government to occupy exclusively." *Id.* at 79.

[5] As noted above, some of the Rule's provisions apply more generally to "franchise sellers."

contractor) under Section 148B, then the franchisor may separately have obligations under Massachusetts wage laws, such as the payment of minimum wages. *See* Mass. Gen. L. c. 151, § 1. But compliance with those obligations (if they apply) does not make it impossible for the franchisor to provide the disclosures required by the Franchise Rule or comply with its other provisions.

Indeed, the plain text of the Franchise Rule provides that "[t]he FTC does not intend to preempt the franchise practices laws of any state or local government, except to the extent of any inconsistency with [the Rule]," and that "[a] law is not inconsistent with [the Rule] if it affords prospective franchisees equal or greater protection." 16 C.F.R. § 436.10(b). The Commission set a floor but not a ceiling for protection of franchisees.

2. Under the Franchise Rule, "employee" and "franchisee" are mutually exclusive categories, but states are free to adopt different definitions.

In adopting the 2007 amendment, the Commission stated that employer-employee relationships "do not satisfy the definitional elements of the term 'franchise.'" 72 Fed. Reg. at 15,530.[6] The *Compliance Guide* therefore advises (at

[6] As originally adopted in 1978, the Franchise Rule expressly provided that the term "franchise" did not include any "continuing commercial relationship created solely by … [t]he relationship between an employer and an employee." 43 Fed. Reg. at 59,620. The Commission eliminated this language from the Rule in 2007 on the grounds that it was unnecessary. 72 Fed. Reg. at 15,530;

15) that bona fide employer-employee relationships are outside the scope of the Rule. But that approach to franchise disclosure requirements does not bind the states when they are enacting statutes for different purposes.

Indeed, the Commission assesses whether a person is an employee under a test different from the one set forth in Section 148B. The Commission applies the traditional "right of control" test to determine whether an employer-employee relationship exists. *Compliance Guide* at 15; 44 Fed. Reg. at 49,968. This test, rooted in the common law of agency, considers multiple factors to determine whether the hiring party has the "right to control the manner and means by which the product is accomplished," with no one factor being dispositive. *Cmty for Creative Non-Violence v. Reid*, 490 U.S. 730, 751-52 (1989); *see also* Restatement (Second) of Agency § 220(2) (1958).[7] Massachusetts chose not to utilize that test in Section 148B. Instead, an individual performing a service is presumed to be an employee unless an employer establishes that all three statutorily prescribed criteria for independent contractor status are satisfied. A person thus may be

[7] The factors the Commission deems germane for purposes of the Franchise Rule include "(1) whether the employer pays a salary or definite sum of money as consideration for the work; (2) whether the employee can be discharged or his employment terminated without liability on the part of the employer; and (3) whether the 'employee' must invest money in the business before being 'hired.'" *Compliance Guide* at 15; 44 Fed. Reg. at 49,968.

deemed a non-employee under the common-law approach utilized by the Commission but still be deemed an employee under Section 148B.

The use of different definitions of "employee" to serve different statutory purposes is not unusual. For example, "employee" has its common-law meaning under the Employee Retirement Income Security Act, whereas the Fair Labor Standards Act "stretches the meaning of 'employee' to cover some parties who might not qualify as such under a strict application of traditional agency law principles." *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 326 (1992). The California Supreme Court has similarly recognized that "when different statutory schemes have been enacted for different purposes, it is possible … that a worker may properly be considered an employee with reference to one statute but not another." *Dynamex Operations W. v. Superior Court*, 416 P.3d 1, 29 (Cal. 2018).

3. 7-Eleven argues that the Franchise Rule *requires* it to exercise control over its franchisees. 7-Eleven Br. at 20. The First Circuit similarly characterized the Rule as imposing a "requirement that the franchisor 'exert or ha[ve] authority to exert a significant degree of control over the franchisee's method of operation.'" *Patel*, 8 F.4th at 28. This characterization conflates the Rule's definitions with its requirements. The Franchise Rule does not *require* a franchisor to exercise control over the franchisee's method of operations. Rather, it *defines* a "franchise" as a relationship or arrangement in which the franchise seller

"promises or represents … that … [t]he franchisor will exert or has authority to exert a significant degree of control over the franchisee's method of operation, or provide significant assistance in the franchisee's method of operation." 16 C.F.R. § 436.1(h). In other words, control over the franchisee's method of operations is one factor relevant to determining whether a relationship or arrangement is governed by the Franchise Rule. What the Rule *requires* is that anyone who meets its definition of a franchisor provide the mandatory presale disclosures in the prescribed form and comply with the additional prohibitions. *Id.* §§ 436.2, 436.9. The definitions determine to whom the Rule's provisions apply, not whether such a company is in compliance with those provisions. If a party is a "franchisor" as defined, then it must comply with the Rule, whether the franchisee is classified as an employee or independent contractor under state wage laws.

CONCLUSION

For the foregoing reasons, the Franchise Rule does not answer the question whether a franchisee is an employee or an independent contractor under Massachusetts law.

Respectfully submitted,

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December 2, 2021

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CERTIFICATE OF SERVICE

Pursuant to M.R.A.P. 13(e), I, certify under the penalties of perjury that on December 2, 2021, a copy of this document was served on counsel for both parties by electronic service through the eFileMA system.

I further certify that all parties required to be served have been served.

December 2, 2021

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CERTIFICATE OF RULE 16(k) COMPLIANCE

Pursuant to M.R.A.P. 16(k), I hereby certify that we have complied with the Massachusetts Rules of Appellate Procedure pertaining to the filing of amicus briefs, including but not limited to M.R.A.P. 17(a), 17(b), 17(c), and 20.

I further certify that this brief complies with the applicable length limitation in M.R.A.P. 20 because it is produced in the proportional font Times New Roman at size 14, and contains 3,638 words, total non-excluded as counted using the word count feature in Microsoft Word, edition 2102.

December 2, 2021

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