Franchisee or Employee and Vicarious Liability of Franchisors – the UK Perspective

Vicarious liability is a common law principle of strict, no fault liability for wrongs committed by another person – it is a form of secondary liability and arises only where there is an employment relationship between the parties.

In the United Kingdom the courts have been very reluctant to extend vicarious liability to apply to types of relationship other than between an employer and an employee unless the relationship is so close in character to an employer/employee relationship that it was just and fair to hold the "employer" vicariously liable (JGE v Trustees of Portsmouth Roman Catholic Diocesan Trust [2012] IRLR 846 (CA)).

In the United Kingdom the issue of whether franchisees are employees of the franchisor has received very little judicial attention. With the possible exception of the Autoclenz case, discussed subsequently, there have been no cases in which the courts have had to establish whether franchisees were employees of the franchisor.

The test for assessing the status of an individual was established in Ready Mixed Concrete v Minister of Pensions and National Insurance [1968] 1 All E.R. 433 where the court had to consider whether an owner driver was an employed person for the purposes of the National Insurance Act 1965. The Ready Mixed Concrete's owner driver scheme contained features analogous to a franchise.

The case established the following principles in deciding whether a contract of service exists and therefore whether a person is an employee:

1. There must be a wage or other remuneration in return for personal service. This first principle can be split further into two requirements: (a) mutuality of obligation; and (b) personal service.

    a. Mutuality of obligation is the obligation on the employer to provide work and the obligation on the individual to accept work. The significance of mutuality of obligation is that it determines whether there is a contract in existence at all (Stephenson v Delphi Diesel Systems Ltd [2003] ICR 471).

    b. In determining what is meant by personal service, the case law has focused on whether the individual has the power to provide a substitute because employees typically have no right to provide a substitute whereas substitution would be entirely consistent where a person is doing work on a self-employed basis. Having said that, just because a contract allows the individual to provide a substitute does not in itself mean that the individual is not an employee. In MacFarlane and another v Glasgow City Council [2001] IRLR 7, the Employment Appeal Tribunal held that a gym instructor was still an employee even though he had the right to provide a substitute. It is important to note that in that case the right to provide a substitute was limited to instances when the gym instructor was unable to work and it was for the gym instructor to arrange and pay for the substitute. In a later case, Staffordshire Sentinel Newspapers Ltd v Potter [2004] IRLR 752, the Employment Appeal Tribunal clarified that where the right of substitution was present the deciding factor in determining whether the individual was an employee or a self-employed person was whether the right of substitution was limited or unqualified. In the case of the former, the individual could still be an employee, whereas the latter pointed towards a self-employed status.

2. Control – this includes the power of deciding what needs to be done, the way in which it shall be done, the means employed in doing it, the time when and the place where. All these aspects of control must be considered. Historically, a great deal of weight was placed on the level of day to day control over the individual – the less control the individual had over his own work the less likely he was to be self-employed. More recently the courts have accepted that these days many individuals, such as skilled professionals for example, have a great deal of autonomy in the way they carry out work even though they are employees (White & Anor v Troutbeck SA [2013] UKEAT 0177/12).

3. The first two factors have been referred to as "the irreducible minimum", i.e. without these being present there can be no contract of employment. However, in addition to these elements the courts also consider other factors. These "other factors" may include not only things like ownership of equipment or tools used by the person in question, the degree of financial risk adopted by each party, who benefits from the profits of the business but also an analysis of other provisions of the contract and whether these are consistent with it being a contract of service. The courts' approach in looking at other factors emphasises that the process is not a mechanical exercise of simply running through items on a checklist but instead a picture has to be painted from the accumulation of detail and not all details are of equal weight or importance in all situations (Hall (HM Inspector of Taxes) v Lorimer [1994] IRLR 171).

Looking at each of the above in a franchising context:

1. Franchisees are not paid a wage, instead, it is franchisees who pay continuing fees to franchisors, so on the face of it the first requirement of an employment contract is not satisfied. As far as mutuality of obligations is concerned the franchisor in most franchise systems is not under any obligation to provide franchisees with work. Many franchisors provide national account work but even then, franchisees are expected to go out and find business for themselves.

2. The requirement of personal service also does not, on the face of it, apply to franchisees because most franchisees use employees or have the ability to do so.

3. The element of control can often be found in the franchisor/franchisee relationship because inherent in franchising is the requirement that franchisees operate their business in accordance with the franchisor's system. Having said that, franchisees are expected to be responsible for the day to day operation of their business. Whether the element of control which is often found in a franchise relationship is more or less than that found in an employer/employee relationship is unclear and will vary from franchise to franchise.

In view of the above in a true franchisee/franchisor relationship it is most unlikely that a franchisee would be considered to be an employee. This was tested in the case of Autoclenz Ltd v Belcher and others [2008] UKEAT 0160/08/0406 (Employment Appeal Tribunal), [2009] EWCA Civ 1046 (Court of Appeal), [2011] IRLR 820 (Supreme Court).

The claimants in this case were a group of valeters who were engaged by Autoclenz to provide car-cleaning services at one of its depots. They were all engaged under contracts which described them as independent sub-contractors. The valeters were provided with the equipment and materials including sponges and chemicals and two sets of overalls, and they were paid weekly on a piecework basis. The valeters paid their own tax and national insurance and in a review carried out by the Inland Revenue in 2004, the Inland Revenue concluded that on balance the valeters were self-

employed rather than employed for tax purposes. The valeters claimed that notwithstanding the terms of their contracts they were in fact "workers" and were therefore entitled to be paid in accordance with the National Minimum Wage Regulations 1999 and to receive statutory paid leave under the Working Time Regulations 1998.

Unlike the Ready Mixed Concrete case, the court here was asked to determine not whether the valeters were employees but whether they were workers, a new status which was introduced in 1996 by virtue of section 230 (3) of Employment Rights Act 1996. Workers have less statutory protection than employees. All employees are workers but not all workers are employees. The statutory definition of a worker is as follows:

> "... 'worker' … means an individual who has entered into or works under …
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> (a) a contract of employment which means that the individual is an employee; or
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> (b) any other contract, whether express or implied and (if it is express) whether oral or in writing, whereby the individual undertakes to do or perform personally any work or services for another party to the contract whose status is not by virtue of the contract that of a client or customer of any profession or business undertaking carried on by the individual."

The Court of Appeal concluded that there are four basic requirements which must be fulfilled in order for an individual to be an employee falling within limb (a) of the definition of worker. These are as follows:

1. The employer must have undertaken to provide work for pay;
2. The employee must have undertaken to perform work for pay;
3. The employee must have undertaken to perform work personally; and
4. The employee has agreed to be subject to the control of the employer.

If an individual is a worker but not an employee, the requirements of limb (b) are as follows:

1. There must be a contract for work or services – it can be express or implied, oral or in writing but there must be remuneration paid in return for services and the basic terms on which the work is to be carried out.
2. The individual must have undertaken to do or perform the work personally.
3. The other party must not, by virtue of the contract, have the status of a client or customer.

The employment tribunal concluded that the valeters were workers on the basis that they were employees employed under contracts of employment within limb (a) and that they were working pursuant to contracts within limb (b). On appeal, the Employment Appeals Tribunal held that they were not employees within limb (a) but workers within limb (b). The Court of Appeal restored the Employment Tribunal's judgment that the valeters fell within both (a) and (b) and this was further confirmed by the Supreme Court.

In reaching its conclusion the Court of Appeal stated that where the terms of the contract between the parties are clear then the starting point is to establish whether (as already established in the Ready Mixed Concrete case) the individual is under an obligation to provide personal service because if this first requirement is not satisfied then the individual will be neither a worker nor an employee. If the requirement of personal service is present, then according to the Court of Appeal the work

must not be done for the other party in the capacity of client or customer. This criteria is important because a self-employed person could be providing a personal service as a self employed contractor to a customer of his business. So the important element of distinction between a self employed contractor and a worker is to look at the capacity of the party to whom the services are being provided. If that party is a customer then the individual providing the services cannot be a worker.

However, where the terms of the contract are not clear, the court must first make findings as to the true contractual terms before the above test can be applied.

The general position is that where contractual terms are in writing and where both parties have signed the contract, they will usually be taken as reflecting the agreement between the parties (L'Estrange v F Graucob Ltd [1934] 2 KB 394). Autoclenz here argued that the contract clearly set out the terms on which the valeters were engaged and that it also clearly stated that the valeters were independent sub-contractors. Unhelpfully to Autoclenz, the court in Street v Mountford [1985] AC 809 stated that the fact that the parties to a contract describe the effect of their contractual arrangements in a particular way is not conclusive of the actual effect of the contractual arrangements. The same conclusion was reached in the case of Launahurst Ltd v Larner UKEAT/0188/09 where the employment judge held that, notwithstanding the fact that the parties signed a contract supply agreement which portrayed Mr Larner as an independent contractor, this did not reflect the reality and Mr Larner was in fact an employee. In Protectacoat Firthglow Ltd v Szilagyi [2009] IRLR 365 Lady Justice Smith stated that ordinarily the documents would be regarded as the starting point but the question to ask is whether the parties ever realistically intended or envisaged that the terms of the contract would be carried out as written. And if an express term of the contract does not reflect the true intentions of the parties, should it be disregarded? According to Lady Justice Smith in Autoclenz, yes it should. In her own words:

> "it matters not how many times an employer proclaims that he is engaging a man as a self-employed contractor; if he then imposes requirements on that man which are the obligations of an employee and the employee goes along with them, the true nature of the contractual relationship is that of employer and employee."

Both the Court of Appeal and the Supreme Court decided that notwithstanding the fact that the agreement described car valeters as independent sub-contractors, they were in fact employees. Although the agreement purported to allow the valeters to appoint substitutes (thus avoiding the mutuality of obligations requirement) having considered the evidence such as the fact that the valeters were expected to turn up for work unless they had given the appropriate amount of prior notice and the fact that some valeters were not even aware of their right of substitution, both courts held that the express contractual provisions did not reflect the actual legal obligations of the parties.

The Court of Appeal concluded that the essential contractual terms between Autoclenz and the valeters were as follows:

a. The valeters agreed to perform the services defined in the contract for Autoclenz within a reasonable time and in a good and workmanlike manner.

b. The valeters would be paid for that work.

c. The valeters were obliged to carry out the work offered to them and Autoclenz undertook to offer work.

d. The valeters had to perform the work personally and could not provide a substitute.

It is clear from the above that there was a contract to provide personal work in exchange for payment. The next question was therefore the capacity of Autoclenz and, again, the court concluded that the valeters were not businessmen on their own account, they had no control over the way in which they did their work, no real control over hours which they worked, no real economic interest in the way in which the work was organised, they could not source material for themselves, they had no say in the terms upon which the work was performed, rates of pay were determined by Autoclenz and therefore Autoclenz was not their client or customer. As such the valeters fell within limb (b) of the definition of workers.

The Court of Appeal then considered the element of control as outlined by the Ready Mixed Concrete case and concluded that the degree of control exercised by Autoclenz was such that the valeters were clearly employees.

As far as franchising is concerned the facts of the Autoclenz case are most unlikely to be replicated in true business format franchises and therefore it is most unlikely that franchisees will be treated as employees. The risk of franchisees being considered to be employees in practice exists, if it exists at all, only when franchisors convert company owned outlets to franchises and the previous employees become franchisees but continue to perform precisely the same services in precisely the same way that those services were performed as an employee.

Since, as shown above, a franchisee/franchisor relationship is unlikely to be considered sufficiently close in character to an employer/employee relationship, vicarious liability is most unlikely to arise.

Whether vicarious liability can arise in circumstances other than where there is an employment relationship or a relationship so close in nature to an employment relationship that it would be just and fair to impose vicarious liability remains an open question.