



California Lawyers Association

presents

Worker (Mis)classification: Industry Trends and Impact, Franchising and Other
Models

1.25 Hours MCLE

Saturday, September 23, 2023

10:00 AM - 11:15 AM

Speakers:

Emily Patajo

Jessica Rosen

Timothy G. Williams

Conference Reference Materials

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SAN DIEGO / SEPTEMBER 21- 23

ANNUAL MEETING

BREAKING BARRIERS

CALIFORNIA
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ASSOCIATION

#CLAAnnual

Worker (Mis)classification: Industry Trends and Impact, Franchising and Other Models

Saturday, September 23, 2023, 10:00 a.m. – 11:15 a.m.

Emily T. Patajo, *Epstein Becker & Green, P.C.*

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Jessica W. Rosen, *Lewitt Hackman*

Timothy G. Williams, *Berger & Williams, LLP*

Focus of Our Discussion Today:

Following *Dynamex*, the passage of AB5, and Proposition 22, California has fundamentally altered the landscape for classifying workers as employees, independent contractors, or “hybrid” workers. New laws are also on the horizon in the “fast food” industry to expand worker protections, as well as franchisee and franchisor liability. This presentation analyzes recent and pending legislation and case law in a discussion about developing trends in worker classification and expansion of employer responsibility, including the impact on franchising and other business models. The program will introduce non-employment law practitioners to worker misclassification law, and provide intermediate level discussion for business and employment attorneys.

Overview of Employee / Independent Contractor Issues

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Three Primary California Supreme Court decisions from 1946 until 2018:

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- ***S. G. Borello & Sons v. Department of Industrial Relations* (1989) 48 Cal.3d 341**
- ***Dynamex Operations West, Inc. v. Superior Court* (2018) 4 Cal.5th 903**

Overview of Employee / Independent Contractor Issues

Empire Star Mines Co. v. California Employment Commission (1946) 28 Cal.2d 33

Overview of Employee / Independent Contractor Issues

Empire Star Mines Co. v. California Employment Commission (1946) 28 Cal.2d 33

The most important consideration:

The “right to control the manner and means of accomplishing the result desired. If the employer has the authority to exercise complete control, whether or not that right is exercised with respect to all details, an employer-employee relationship exists.”

Overview of Employee / Independent Contractor Issues

Empire Star Mines Co. v. California Employment Commission (1946) 28 Cal.2d 33

In the absence of “complete control,” other factors to consider:

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In the absence of “complete control,” other factors to consider:

(a) whether or not the one performing services is engaged in a distinct occupation or business;

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(b) the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the principal or by a specialist without supervision;

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- (c) the skill required in the particular occupation;**

Overview of Employee / Independent Contractor Issues

Empire Star Mines Co. v. California Employment Commission (1946) 28 Cal.2d 33

In the absence of “complete control,” other factors to consider:

(d) whether the principal or the workman supplies the instrumentalities, tools, and the place of work for the person doing the work;

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(e) the length of time for which the services are to be performed;

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- (d) whether the principal or the workman supplies the instrumentalities, tools, and the place of work for the person doing the work;**
- (e) the length of time for which the services are to be performed;**
- (f) the method of payment, whether by the time or by the job;**

Overview of Employee / Independent Contractor Issues

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In the absence of “complete control,” other factors to consider:

(g) whether or not the work is a part of the regular business of the principal; and

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In the absence of “complete control,” other factors to consider:

(g) whether or not the work is a part of the regular business of the principal; and

(h) whether or not the parties believe they are creating the relationship of employer-employee.

Overview of Employee / Independent Contractor Issues

Empire Star Mines Co. v. California Employment Commission (1946) 28 Cal.2d 33

Following *Empire Star*:

While the right of control is the primary consideration, other factors are relevant and should also be considered.

***Malloy v. Fong* (1951) 37 Cal.2d 356; *Tieberg v. Unemployment Ins. App. Bd.* (1970) 2 Cal.3d 943.**

Overview of Employee / Independent Contractor Issues

S. G. Borello & Sons v. Department of Industrial Relations (1989) 48 Cal.3d 341

Overview of Employee / Independent Contractor Issues

S. G. Borello & Sons v. Department of Industrial Relations (1989) 48 Cal.3d 341

Restates the indicia of employment.

The right to control work details is the “most important” | “most significant” consideration.

But also endorses several “secondary” indicia of the nature of a service relationship.

The “secondary” indicia “cannot be applied mechanically as separate tests; they are intertwined and their weight depends often on particular combinations.”

Overview of Employee / Independent Contractor Issues

S. G. Borello & Sons v. Department of Industrial Relations (1989) 48 Cal.3d 341

Besides the “right to control the work” factor, other factors include:

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- (3) whether the service rendered requires a special skill;**

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- (2) the alleged employee’s investment in equipment or materials required for his task, or his employment of helpers;**
- (3) whether the service rendered requires a special skill;**
- (4) the degree of permanence of the working relationship; and**

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- (2) the alleged employee’s investment in equipment or materials required for his task, or his employment of helpers;**
- (3) whether the service rendered requires a special skill;**
- (4) the degree of permanence of the working relationship; and**
- (5) whether the service rendered is an integral part of the alleged employer’s business.**

Overview of Employee / Independent Contractor Issues

Post-Borello:

For the next 30 years, California courts used the common law, multifactor analysis for determining whether a worker should be classified as an independent contractor or an employee.

Yet, in *Ayala v. Antelope Valley Newspapers, Inc.* (2014) 59 Cal.4th 522, 533, the Supreme Court re-emphasized that:

“As the parties and trial court correctly recognized, control over how a result is achieved lies at the heart of the common law test for employment. (*Borello, supra*, 48 Cal.3d at p. 350, 256 Cal.Rptr. 543, 769 P.2d 399.) . . .”

Overview of Employee / Independent Contractor Issues

Dynamex Operations West, Inc. v. Superior Court (2018) 4 Cal.5th 903

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Dynamex Operations West, Inc. v. Superior Court (2018) 4 Cal.5th 903

Alters the employee/independent contractor test.

Held that employee status could be determined by a so-called “ABC test” adopted from other states.

Under the ABC test, all workers are *presumed to be employees* and may only be classified as independent contractors if *the employer proves each of three factors*.

Overview of Employee / Independent Contractor Issues

Dynamex Operations West, Inc. v. Superior Court (2018) 4 Cal.5th 903

The ABC test:

Overview of Employee / Independent Contractor Issues

Dynamex Operations West, Inc. v. Superior Court (2018) 4 Cal.5th 903

The ABC test:

(1) the worker is free from the control and direction of the hirer in connection with the performance of the work, both under the contract for the performance of such work and in fact;

Overview of Employee / Independent Contractor Issues

Dynamex Operations West, Inc. v. Superior Court (2018) 4 Cal.5th 903

The ABC test:

- (1) the worker is free from the control and direction of the hirer in connection with the performance of the work, both under the contract for the performance of such work and in fact;**
- (2) the worker performs work that is outside the usual course of the hiring entity's business; and**

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- (2) the worker performs work that is outside the usual course of the hiring entity's business; and**
- (3) the worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed for the hiring entity.**

Post-*Dynamex* Legislation

California Labor Code Section 2775, *et. seq.*

Enacted and effective September 4, 2020

Codified and expands *Dynamex*:

Requires courts to apply the ABC test to claims arising under the Wage Orders and the Labor Code generally, but it has numerous exemptions. Has been substantially updated and amended multiple times since 2019, including expanding list of professions exempt from the ABC test to include additional occupations and industry areas, such as freelance writers, musicians, film support, etc. More legislation to amend it is pending.

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Statutory ABC test:

Post-*Dynamex* Legislation

California Labor Code Section 2775, *et. seq.*

Statutory ABC test:

(A) The person is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact.

Post-Dynamex Legislation

California Labor Code Section 2775, *et. seq.*

Statutory ABC test:

(A) The person is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact.

(B) The person performs work that is outside the usual course of the hiring entity's business.

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Statutory ABC test:

- (A) The person is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact.**
- (B) The person performs work that is outside the usual course of the hiring entity's business.**
- (C) The person is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.**

Post-Dynamex Legislation

California Labor Code Section 2775, *et. seq.*

Statutory ABC test does *not* apply if:

- **A court finds that the ABC test cannot be applied to a particular context based on grounds other than an exception to employment status;**
- **A bona fide business-to-business contracting relationships;**
- **Relationships between a referral agency and a service provider;**
- **Contracts for professional services; or**

Post-*Dynamex* Legislation

California Labor Code Section 2775, *et. seq.*

Statutory ABC test does *not* apply if:

- **Relationships between two individuals where each is a sole proprietor, partnership, limited liability company, limited liability partnership, or corporation performing work under a contract providing services at the location of a single-engagement event.**

Post-*Dynamex* Legislation

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Statutory ABC test *also* does *not* apply to exempted occupations:

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- **In the construction industry, relationships between a contractor and an individual performing work under a subcontract;**

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- **In the construction industry, relationships between a contractor and an individual performing work under a subcontract;**
- **California licensed physicians and surgeons, dentists, podiatrists, psychologists, veterinarians, who perform professional or medical services provided to or by a health care entity;**

Post-*Dynamex* Legislation

California Labor Code Section 2775, *et. seq.*

Statutory ABC test *also* does *not* apply to exempted occupations:

- **Individuals who hold an active license and is practicing one of the following recognized professions: lawyer, architect, engineer, private investigator, or accountant;**
- ***And many more...* In those instances, the *Borello* multi-factor test applies.**

Post-*Dynamex* Legislation

California Labor Code Section 2775, *et. seq.*

Court challenges to the exceptions in AB5 / Lab. Code § 2775, *et seq.*

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California Labor Code Section 2775, *et. seq.*

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- ***California Trucking Association v. Bonta* (9th Cir. 2021) 996 F.3d 644, *cert. denied sub nom. California Trucking Association, Inc. v. Bonta* (June 30, 2022) 213 L.Ed.2d 1115**

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- ***Olson v. California* (9th Cir. 2023) 62 F.4th 1206**

Proposition 22

Protect App-Based Drivers and Services Act

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In 2020, individuals and rideshare and delivery network companies (Uber Technologies, Inc., Lyft, Inc., and DoorDash, Inc.) proposed Proposition 22.

An app-based driver is:

A person who works as a driver or courier for transportation or delivery network companies, which are businesses that operate transportation or delivery services using an electronic application or platform to connect passengers seeking transportation or customers seeking delivery of goods to drivers or couriers willing to provide those services with their personal vehicles.

Proposition 22

Protect App-Based Drivers and Services Act

Purpose—create a new type of independent contractor for app-based drivers:

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(1) protect the basic legal right of Californians to choose to work as independent contractors with rideshare and delivery network companies;

Proposition 22

Protect App-Based Drivers and Services Act

***Purpose*—create a new type of independent contractor for app-based drivers:**

- (1) protect the basic legal right of Californians to choose to work as independent contractors with rideshare and delivery network companies;**
- (2) protect the individual right of every app-based rideshare and delivery driver to have the flexibility to set their own hours for when, where, and how they work;**

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- (2) protect the individual right of every app-based rideshare and delivery driver to have the flexibility to set their own hours for when, where, and how they work;
- (3) require rideshare and delivery network companies to offer new protections and benefits for app-based rideshare and delivery drivers; and

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- (2) protect the individual right of every app-based rideshare and delivery driver to have the flexibility to set their own hours for when, where, and how they work;**
- (3) require rideshare and delivery network companies to offer new protections and benefits for app-based rideshare and delivery drivers; and**
- (4) improve public safety by requiring criminal background checks, driver safety training, and other safety provisions to help ensure app-based rideshare and delivery drivers do not pose a threat to customers or the public.**

Proposition 22

Protect App-Based Drivers and Services Act

***Castellanos v. State of California* (2023) 89 Cal.App.5th 131 (Apr. 12, 2023)**

In the *trial court*, Prop. 22 was invalidated because:

- (1) It intrudes on the Legislature's exclusive authority to create workers' compensation laws;
- (2) It limits the Legislature's authority to enact legislation that would not constitute an amendment to Proposition 22; and
- (3) It violates the single-subject rule for initiative statutes.

Proposition 22

Protect App-Based Drivers and Services Act

Castellanos v. State of California (2023) 89 Cal.App.5th 131 (Apr. 12, 2023)

Affirmed in part, reversed in part, and remanded with instructions.

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Protect App-Based Drivers and Services Act

Castellanos v. State of California (2023) 89 Cal.App.5th 131 (Apr. 12, 2023)

Affirmed in part, reversed in part, and remanded with instructions.

Proposition 22 does not:

- Intrude on the legislature's workers' compensation authority under the State Constitution; and
- Violate single-subject rule.

Proposition 22

Protect App-Based Drivers and Services Act

Castellanos v. State of California (2023) 89 Cal.App.5th 131 (Apr. 12, 2023)

Affirmed in part, reversed in part, and remanded with instructions.

Proposition 22 does:

- **Intrude voters' initiative power.**
- **Intrudes on the judiciary's authority to determine what constitutes an amendment to Proposition 22, and therefore is facially invalid on separation of powers grounds.**

Proposition 22

Protect App-Based Drivers and Services Act

***Castellanos v. State of California* (2023) 89 Cal.App.5th 131 (Apr. 12, 2023)**

Supreme Court has now intervened. On June 28, 2023, a Petition for Review was granted. *Castellanos v. State of California* (Cal. 2023) 309 Cal.Rptr.3d 725

The court ordered the issue to be briefed and argued in this case limited to the following: Does Business and Professions Code section 7451, which was enacted by Proposition 22 (the "Protect App-Based Drivers and Services Act"), conflict with article XIV, section 4 of the California Constitution and therefore require that Proposition 22, by its own terms, be deemed invalid in its entirety?

Opening brief is due.

Fast Food Industry

FAST Recovery Act (*Fast Food Accountability and Standards Recovery Act*)

AB 257, signed into law by Gov. Gavin Newsom on Sept. 5, 2022, to take effect Jan. 1, 2023.

Would amend Lab. Code § 96 and create new Lab. Code §§ 1470-1473.

Fast Food Industry

FAST Recovery Act (*Fast Food Accountability and Standards Recovery Act*)

AB 257, signed into law by Gov. Gavin Newsom on Sept. 5, 2022, to take effect Jan. 1, 2023.

Would amend Lab. Code § 96 and create new Lab. Code §§ 1470-1473.

Stated purpose:

To create a 10-member Fast Food Council within the Department of Industrial Relations to establish sector wide minimum standards on wages, working hours, and other working conditions related to the health, safety, and welfare of, and supplying the necessary cost of proper living to, fast food restaurant workers, as well as effecting interagency coordination and prompt agency responses in this regard.

Fast Food Industry

FAST Recovery Act (*Fast Food Accountability and Standards Recovery Act*)

Prior to Gov. Newsom signing the bill into law, the Fast Act was amended and removed franchisor-franchisee joint liability.

- **December 30, 2022, Sacramento Superior Court blocked implementation of the new law.**
- **January 24, 2023, California Secretary of State certified that there were enough signatures to approve a referendum on this law. The referendum will be on voters' ballots on November 5, 2024.**

Franchising

The Franchise Business Model

Franchising has “existed in this country in one form or another for over 150 years.”

--Patterson v. Domino’s Pizza, LLC (2014) 60 Cal. 4th 474, 489.

The Supreme Court noted:

- *Franchising, especially in the fast-food industry, has become a ubiquitous, lucrative, and thriving business model. This contractual arrangement benefits both parties. The franchisor, which sells the right to use its trademark and comprehensive business plan, can expand its enterprise while avoiding the risk and cost of running its own stores. The other party, the franchisee, independently owns, runs, and staffs the retail outlet that sells goods under the franchisor’s name. By following the standards used by all stores in the same chain, the self-motivated franchisee profits from the expertise, goodwill, and reputation of the franchisor.*

Franchising

The Franchise Business Model

Typical Franchise Relationship—

- Franchisee is given a license to use the franchisor's trade name and operating system.
- Franchisees become small business owners who usually live in the community, and are in charge of day-to-day operations, including all employment decisions related to the franchised business' employees, such as hiring, firing, wages, and benefits.
- Franchise agreements generally (if not always) contain provisions that the franchisee is an independent contractor of the franchisor and that the franchisee, not the franchisor, is responsible not only for its own employment decisions but with complying with all applicable city, county, state and federal laws, including employment and labor laws.

Franchising

The Franchise Business Model

Patterson v. Domino's Pizza, LLC (2014) 60 Cal. 4th 474

- In 2014, the Supreme Court issued *Patterson v. Domino's Pizza, LLC*, holding that although Domino's "imposes comprehensive and meticulous standards for marketing its trademarked brand and operating its franchises in a uniform way," it cannot be held vicariously liable as an "employer" or "principal" in a sexual harassment lawsuit filed by an employee of a Domino's franchisee. (emphasis added.)
- *Patterson* interpreted to shield franchisors from vicarious liability for employment and tort claims brought by their franchisees' employees, unless they exercise control over the manner and means by which their franchisees hire, fire, discipline, or manage their employees.

Franchising

Post-*Dynamex* / ABC Test

***Vazquez v. Jan-Pro Franchising* (9th Cir. 2019) 923 F.3d 575, 594 (9th Cir. 2019) reh'g granted, opinion withdrawn, 930 F.3d 1107 (9th Cir. 2019), opinion reinstated in part on reh'g, 939 F.3d 1050 (9th Cir. 2019).**

- **A three-tier franchise structure for cleaning and janitorial services:**
 - **Jan-Pro, as franchisor, enters into "Master Franchise Agreements" with regional master franchisees, who purchase franchises for exclusive operations in a given regional area. Master franchisees do not typically perform any cleaning services.**
 - **Unit franchisees, who enter into agreement with regional master franchisees, generally provide the cleaning services. Regional master franchisors submit bids for cleaning services to unit franchisees who can accept or reject the bid. Unit franchisees may also solicit for their own accounts.**

Franchising

Post-*Dynamex* / ABC Test

***Vazquez v. Jan-Pro Franchising* (9th Cir. 2019) 923 F.3d 575, 594 (9th Cir. 2019) *reh'g* granted, *opinion* withdrawn, 930 F.3d 1107 (9th Cir. 2019), *opinion reinstated in part on reh'g*, 939 F.3d 1050 (9th Cir. 2019).**

- Putative class of unit franchisees against Jan-Pro, seeking a determination whether workers were independent contractors or employees under California wage order laws.
- District Court dismissed action at summary judgment, finding *Patterson* precluded misclassification claims.
- Ninth Circuit reversed. The “franchise context does not alter the *Dynamex* analysis, and the district court need not look to *Patterson* in applying the ABC test.” A franchisor could be found to be a “hiring entity” because “hiring entity” is meant to be expansive.

Franchising

Post-*Dynamex* / ABC Test

***Fleming v. Matco Tools Corp.*, No. 19-cv-00463-WHO, 2021 WL 673445, 2021 U.S. Dist. LEXIS 33513 (N.D. Cal. Feb. 21, 2021)**

***Salinas v. Cornwell Quality Tools Co.*, ___ F.Supp.3d ___, No. 5:19-cv-02275-FLA-SPx 2022 U.S. Dist. LEXIS 203156, at *12 (C.D. Cal. Oct. 17, 2022)).**

- **Class certification to franchisees claiming misclassification by franchisors as independent contractors rather than employees.**
- ***Jan-Pro* court did not suggest that the type of franchised business matters when applying the ABC Test. Look to whether the franchisor's franchise structure mirrored an employee-employer relationship.**

Franchising

Post-*Dynamex* / ABC Test

***Haitayan v. 7-Eleven, Inc.*, Nos. 21-56144, 21-56145, 2022 U.S. App. LEXIS 34048 (9th Cir. Dec. 9, 2022)**

- **Four 7-Eleven franchisees brought putative diversity class action. The district court denied class certification and entered judgment in favor of the franchisor, 7-Eleven, finding the franchisees engaged in a distinct business, a different course of business than 7-Eleven, and held themselves out to be business owners.**
- **Affirmed. Ninth Circuit found district court erred by refusing to consider claims that accrued after 2020 under the ABC test since such claims are governed by AB 5, but that the error is harmless because the district court made extensive factual findings that all three parts of the ABC test are met.**

Franchising

Challenges to *Dynamex* / ABC Test (AB 5)

The International Franchise Association ("IFA") and several franchisee associations, including Supercuts Franchisee Association ("SFA") and Dunkin Donuts Independent Franchise Owners Association ("DDIFO") filed a declaratory and injunctive relief action challenging AB 5 on November 17, 2020, alleging in part, that AB 5 / § 2775(b)(1) has and will "disrupt[] ongoing commercial franchise relationships in the state of California so that both franchisors and franchisees must operate with uncertainty as to their rights and obligations toward one another if the employment relationship is forced upon them by operation of law." (Id. ¶ 49.) Plaintiffs further alleged that "the application of the ABC Test frustrates their organizational missions," diverts their resources, and interferes with their contractual relations. (Id. ¶¶ 50, 51.)

Franchising

Challenges to *Dynamex* / ABC Test (AB 5)

Action dismissed January 2022.

The Southern District of California dismissed the action in January 2022, finding in part that “the FAC alleges nothing more than a general threat of application of Section 2775(b)(1) to franchises, and the alleged source of the threat is the mere existence of the statute.”

***Int'l Franchise Ass'n v. California*, No. 20-cv-02243-BAS-DEB, 2022 WL 118415, 2022 U.S. Dist. LEXIS 6479, at *10 (S.D. Cal. Jan. 12, 2022).**

Franchising

AB 1228: The Fast Food Franchisor Responsibility Act

Introduced February 16, 2023, would add § 2810.9 to the Labor Code.

“This bill would require that a fast food restaurant franchisor share with its fast food restaurant franchisee all civil legal responsibility and civil liability for the franchisee’s violations of prescribed laws and orders or their implementing rules or regulations. The bill would authorize enforcement of those provisions against a franchisor, including administratively or by civil action, to the same extent that they may be enforced against the franchisee.”

Passed the Assembly on May 31, 2023.

Sent to Senate, but delayed after its proponents pulled the bill from a Senate Judiciary Committee hearing on July 14, 2023.

Thank you!

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