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Franchising and the Extraction of Surplus Value: Excavating the Legal Boundary Between Franchisees and Employees

Abstract: Nearly one in ten Canadians in the private sector works in the franchised sector of the economy. For the most part, franchisors operate as rentiers, extracting value from franchisees for the use of their brand. Research has demonstrated that this arrangement puts additional pressure on franchisees to extract surplus value from their employees that tend toward substandard and unlawful working conditions. In this scenario, franchisors benefit from but are only indirectly involved in the extract of surplus value. In some cases, however, the vertical controls exercised by “franchisors” over “franchisees” are so extensive, and the financial contribution of “franchisees” is so limited, that the franchisor becomes involved in directly extracting surplus value from franchisees. We explore this latter phenomenon through an excavation of the history of the legal distinction in Canadian business-format franchising in Canada and detailed studies of two recent Canadian cases in which “franchisees” successfully claimed employment status.

Keywords: franchising; employment; rentier; surplus value; Canada

I. Introduction

The Canadian franchise industry generated 1.5 million full-time equivalent jobs in 2017 (Canadian Franchise Association 2018, 16–17). By our estimates, over one in ten Canadians employed in the private sector worked in the franchised sector of the economy (Canadian Franchise Association 2018; Statistics Canada 2023, Table 14-10-0027-01). Yet, despite its size, there are only a few Canadian studies that consider its significance and impact, practically or theoretically. This leaves a major gap in the literature, since the growth of franchising as a business form has been shown to create some unique challenges for the labor and employment law regime, both in terms of its coverage and efficacy. Indeed, creating these challenges may be one of its attractions to franchisors. Research has demonstrated that franchising as a form of rentier capitalism pressures franchisees as employers to minimize wages and maximize the work effort of their employees (Krueger 1991; Ji and Weil 2015;

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Elmore 2018; Easton et al. 2020; Hardy 2020; Callaci 2021).¹ In addition, at the bottom end of the franchising industry, the controls that franchisors exercise over franchises enables them to directly extract value from their labor in a manner that troubles the legal boundary between self-employed franchisees and employees. The latter phenomenon is the focus of this article.

Problems with the legal status of franchisees emerged in Canada in the 1960s as franchising became more widespread and some individuals whose contracts described them as franchisees or self-employed store managers sought to be covered by protective labor and employment law. A slow but steady flow of cases followed, but then tapered off until the issue re-emerged in a 2019 Supreme Court of Canada judgment, *Modern Concept Cleaning*, and a 2017 Ontario Labour Relations Board decision, *Canada Bread*.² The status and treatment of franchisees has also become both an academic and a political question, resulting in suggestions that even if franchisees are not employees covered by labor and employment laws, they suffer economic subordination that entitles them to employee-like protections, including a protected right to associate (Arthurs 2013; Coiquad and Martin 2017).

The article develops as follows. We begin with an examination of the law and economics of franchising through a political economy lens to identify the reasons why boundary-keeping between franchisees and employees can become problematic. We then examine the legal and political response to the boundary problem as it arose in the 1960s and continued through the 1980s as franchising expanded in Canada but took a variety of forms, some of which essentially involve labor-only “franchising.” Finally, we look at the two recent, high-profile cases where capital used franchising contracts rather clumsily to avoid incurring the obligations of an employer. Policing the bottom end of the franchising model arguably limits this kind of abuse but leaves analogous relations of economic subordination outside of labor and employment law, and subject to a different, less protective legal regime. Thus, the article contributes to the literature on franchising in two ways. First, it is the only sociolegal study of the boundary problem between franchisees and employees in Canada and their legal resolution. Second, by using a political economy lens, it sheds light on modes of extracting and allocating surplus value in the particular sub-sector of business-format franchising industry.

Before beginning our analysis, a few franchising basics. There are primarily two franchise models: product distribution and business-format systems. The first form of franchising was pioneered in North America by companies such as Singer Sewing Machines and McCormick Harvesters. These companies realized it was less expensive to license other companies to market (and in some cases manufacture) their products rather than to distribute the products themselves. Other industries adapted this model to their needs, including beverages (most famously, Coca-Cola), automotive sales, and petroleum distribution (Gurnick and Vieux 1999; Elmore 2014; Birkeland 2022).

Business-format system franchising developed later, rapidly expanding in the 1950s in the US and a bit later in Canada (Penfold 2008, 98-99). At its core, this form of franchising involves a relationship in which the franchisee obtains the right to use a brand name and a process or system from its owner, the franchisor, in exchange for royalty payments and a share of the profits generated by the franchisee’s business. In addition, the franchise contract includes extensive vertical controls or

¹ The franchised context also creates enormous challenges to the efficacy of collective bargaining laws. Organizing the individually owned franchised outlets one by one is practically a mission impossible, especially when the franchisor cannot be forced to the bargaining table as a joint employer (Milloy 2012).

² *Modern Cleaning Concept Inc. v. Comité Paritaire de l'Entretien d'Édifices Publics de la Région de Québec*, 2019 SCC 28; *Milk and Bread Drivers, Dairy Employees, Caterers and Allied Employees, Local 647, affiliated with the International Brotherhood of Teamsters v Canada Bread Company Limited*, 2017 CanLII 62172, para. 106.

operating procedures that enable the franchisor to ensure that the franchisee operates according to its stipulations (Felstead 1991, 39-40). While some vertical controls are also present in product distribution franchising, they are far more pervasive in business-format franchising, and it is because of these controls that the boundary between franchising and employment may become permeable. For that reason, the arrangements reviewed in this article all arise in business-format franchising, which is what we refer to hereinafter when we speak of franchising.

II. The Law and Economics of Franchising Through a Political Economy Lens: The Significance of Vertical Controls

Law and Economics scholars have long recognized that franchising and employment exist on a continuum. For example, Frank Mathewson and Ralph Winter (1985) begin their study of franchise contracts by stating, “As an organizational arrangement, the franchise contract lies between anonymous price-mediated exchange and centralized intrafirm employment” (503).³ They go on to elaborate the ways in which franchise contracts differ from conventional market exchange by listing the extensive vertical controls the contract creates to enable the franchisor to exercise considerable influence over the franchisee’s business. They also differentiate a franchise contract from employment, in that franchise agreements provide for profit-sharing and leave the franchisee with considerable freedom for independent decisionmaking (Mathewson and Winter 1985, 503). However, they do not attempt to explain how they reconcile extensive vertical controls by the franchisor with the existence of considerable independent decisionmaking by the franchisee. And therein lies the source of the legal boundary problem.

The English scholar Alan Felstead deepened the analysis by identifying three strategic dimensions of franchise contracts that create a paradoxical situation from a legal and organizational perspective. The first dimension is control. Franchisees operate without direct close supervision, but within detailed procedures imposed by the franchisor that are subject to unilateral change. The second dimension is profits. Franchisees appropriate the profits of their business, but only after making turnover-related payments to the franchisor. The third dimension is ownership of the means of production. Franchisees own or lease the means of production but are subject to tight restrictions on how they are used, both during and after the expiration of the agreement. From this analysis, Felstead concludes that franchise agreements create “controlled self-employment” (Felstead 1991, 38–39). However, he does not discuss the possibility that these arrangements may go further and be employment.

More recently, Brian Callaci (2021a) examined the continuum between employment and franchising by contrasting the legal and economic relations that ideally characterize markets and firms, and then specifying those relations in franchising. In markets, Callaci writes, economic relations between the parties are notionally equal and discrete, and legal relations between the parties are contractual. He contrasts this with firms, where economic relations within the firm are authoritarian and open-ended, and legal relations are defined by property and employment. A word of explanation is required here, since employment is normally classified as contractual. However, employment contracts are distinct from market contracts insofar as they bring the employee inside the firm, subject to command of the employer. Hence, employment contracts are incomplete and provide the employer with an open-

³ In an earlier article, Paul Rubin (1978) argued that the franchise relationship existed on the same margin, blurring the boundary of the firm.

ended power to direct the employee, with the correlate that an employee is under an open-ended duty to obey.⁴

Callaci argues that franchise agreements are arranged to extend the economic boundaries of the firm beyond its legal boundaries through the imposition of extensive vertical controls. The result is something of a hybrid arrangement. As Callaci argues, “while franchise agreements are independent contracting arrangements in legal form, the franchisor-franchisee relationship in its economic aspects is in key respects authoritarian and open-ended like an employment relationship” (Callaci 2001a, 6; also see Felstead 1993). However, he too does not explore the possibility that the extension of vertical controls may as a matter of law produce employment in certain situations.

Finally, Urwana Coiquad and Isabelle Martin (2017) also explore some of the legal and economic characteristics of franchising, and like others consider it to lie on the employee-market contracting continuum. In particular, they elaborate on the similarities between franchisees and employees, including the duty of personal performance, the duty to report, the duty to follow administrative policies, and economic dependency. While they briefly note the potential for franchisees to be considered employees under the law, they do not explore the conditions under which that might happen, but rather note that courts have not shown much appetite for making such a finding, and instead consider other mechanisms that might better protect the interests of franchisees.

Before exploring Canadian courts and tribunals’ appetites for finding franchisees to be misclassified employees, it is important to examine the reasons why franchise contracts take this form. Conventional Law and Economics literature emphasizes that franchising may be preferable to intrafirm vertical integration for several reasons. From the lead firm/franchisor’s perspective, expansion through franchising constitutes one form of low or non-equity modes of production that enables firms to expand with less capital investment (Erramilli, Agarwa, and Dev 2002). In addition, franchising arguably reduces monitoring costs since the franchisee, who is entitled to the residual profit, should be more highly motivated to extract value from the operation than a manager who is a salaried employee. Finally, the locally based franchisee may be more responsive to area conditions than head office managers. From the franchisee’s perspective, buying a franchise may be preferable to starting one’s own business because of the value of the brand and the customer base it attracts, access to a proven business system and training, and the lower capital investment involved (Krueger 1991; Blair and LaFontaine 2006).

However, the alignment of incentives between franchisors and franchisees is imperfect. Franchisors have a significant investment in maintaining the value of the brand and, as a result, it is crucial to them to maintain quality standards across franchisees so that customers can expect the same positive experience regardless of which franchise entity they engage with. Franchisees, however, may be tempted to free-ride on the brand name by shirking on quality. For franchisees, keeping operating costs low is crucial because of franchisor controls over the purchasing of inputs and the product pricing and because royalties to the franchisor are often calculated on sales volume, not profits. Thus, because operating savings tend to go into the franchisee’s pockets, they are tempted to scrimp in ways that undermine the brand (Blair and LaFontaine 2006). Extensive vertical controls in the franchise contract are a response to the misalignment of incentives that endanger the efficiency of the franchise

⁴ We recognize that we are identifying ideal types of characteristics and that in reality the power of employers to command is subject to express and implied limits, as is the duty of the employee to obey.

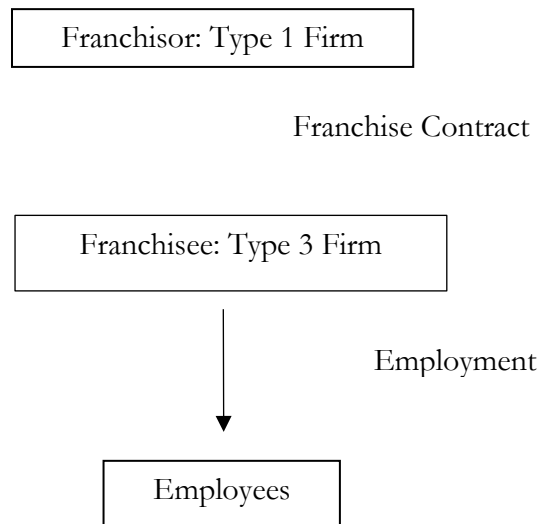
system and, we might add, the ability of franchisors to extract value from the operations of unit franchisees (Mathewson and Winter 1985, 505).

We can deepen our understanding by looking at franchising through a political economy lens concerned with analyzing how surplus value is extracted, appropriated, and distributed (Resnick and Wolff 1987). Unlike conventional Law and Economics, which ignores unequal power relations, a political economy lens views the market transaction between franchisors and franchisees, whose subject is the production and distribution of surplus value, as being shaped to a great degree by the relative power of the parties (Bowles and Gintis 1990). It starts from the premise that under capitalism economic activity is undertaken with the goal of, and systematic compulsion to, make a profit. In advanced capitalist countries, this is primarily done through wage labor. In Marx's classic formulation, after entering into an employment contract, the employer and the worker descend into the employer's abode of production where the employer extracts and appropriates more value from the worker than the worker's cost. However, this basic model of surplus value extraction fails to provide an adequate framework for understanding the political economy of franchising, in which there is typically a tripartite relation between franchisor, franchisee, and employees (although as we shall examine more closely, the boundary between franchisee and employee may be artificial). Therefore, it is useful to draw on Resnick and Wolff's work, which unpacked and highlighted the importance of "subsumed class processes" within which surplus value, extracted in the "fundamental class process," is distributed across a range of other actors and classes, often for purposes of preservation or maintenance of the fundamental class process. Thus, we may consider the somewhat more complex work relations and value flows within franchising relations as being intimately involved in contestation over the production and distribution of surplus value (Resnick and Wolff 1987).

As noted earlier, the franchise relationship is essentially one in which the franchisor rents the use of an asset (the brand) to the franchisee. The growth of franchising as a business model is part and parcel of what some political economists have identified as an important shift from productive to rentier capitalism, in which the aggregate size of rent collection enabled through asset ownership has grown substantially in proportion to more direct productive activity (Christophers 2020; Sayre 2014). Rentiers appropriate profits by charging monopoly rent for the use of their assets, principally intellectual property.

Mark Schwartz has characterized rentiers as Type 1 firms (see Figure 1), and he includes franchising as a prime example precisely because franchisors are able to charge monopoly rents to subordinate firms that are prepared to pay for the use of the brand (Schwartz 2022; see also Callaci 2021a). Brett Christophers describes this arrangement quite well: "Economic rent, not food is Subway's business; it owns and constantly fine-tunes an asset in the form of the concept of the Subway restaurant, and what such a restaurant should look and feel like and offer to its customers; and it sells privileged access to that concept to those who want to mobilize it" (Christophers 2020, 141–43). Franchisors as rentiers must secure, protect, and sweat the asset in order to maximize the profit that can be appropriated from it. This drives them to impose extensive vertical controls on franchisees to protect the asset's value and maximize their rents by ensuring that franchisees live up to their obligations (Christophers 2020, 40; Callaci 2021a).⁵

⁵ For discussions of the role of power in franchising, see Felstead (1993); Davidson (1994); and Argyes and Bercovitz (2015). Sweated franchisees must, in turn, extract value from the production of goods and services sufficient to pay the rent and retain a profit for themselves. This creates an environment that is prone to labor exploitation and violations of labor standards (Weil 2014, 122–158).

Figure 1. Classic Franchise Arrangement

Franchisees generally fit Schwartz’s Type 3 enterprise, which are mostly small- and medium-sized enterprises engaged in labor-intensive production that relies primarily on low-skill labor. Because they tend to operate in the competitive sector of the economy lack control over other inputs and pay rents to Type 1 firms, Type 3 firms are under pressure to hyper exploit the workers in their abodes of production or to self-exploit their own labor or that of family members (Schwartz 2022).⁶ Moreover, as Callaci (2021a) shows, franchisors take advantage of their market power by imposing vertical controls to further restrict and block franchisee access to other market activities in the management of their “enterprise.” For example, franchisors often define and constrain the nature of business or entrepreneurial activity that the franchisee may undertake. They may exercise significant control over strategic decisions related to the franchisee’s prices and costs as well as the flow of capital in financial transactions with other actors. Vertical controls may stipulate turnover targets that if not met could ultimately result in the forfeiture of the franchise at the discretion of the franchisor. The franchisor may run sales promotions that require franchisees to provide products or services at reduced rates to increase sales for the franchisor’s benefit, even though it reduces profit margins for the franchisee. Finally, vertical controls may allow for extensive monitoring of franchise operations to enforce the terms of the contract under the threat of forfeiture. All of this forces the franchisee to focus on extracting more value from the labor they hire, a portion of which is distributed to the franchisor as rent (Callaci 2021a; Tucker forthcoming).

However, as Schwartz (2022) emphasizes, his typology is populated by ideal types. In reality, there are variations within each type as well as hybrids that combine elements of different firm types. This is particularly important when examining franchise arrangements, for as we shall see, they vary considerably. For example, some franchisors’ brands are weaker than those of others, which limits their ability to appropriate monopoly rents. As well, in some circumstances, franchisors may seek to directly extract and appropriate surplus value from the work of franchisees, and so operate as a hybrid Type 1/Type 3 firm. Franchisees also vary considerably, ranging from archetypical Type 3 firms that

⁶ Schwartz’s third category, Type 2 firms, include traditional manufacturing firms where rent could be realized because high capital costs or specialized knowledge limited competition.

hire and manage their own workforces to putative franchisees who only provide their labor and sit at the boundary between two modes of subordination—wage labor and self-employment.

All of this returns us to the problem of drawing and patrolling the legal boundary between a franchisee and an employee, or the point at which protective labor/employment law enters the scene to protect the franchisee as employee. We will return to the Canadian test and how it evolved and was applied in the sections that follow, but economic dependence and control are always factors considered by tribunals and courts in drawing the distinction. We do not have data on the comparative capitalization of franchisors and franchisees, but it would be safe to assume that in most cases the difference is huge. For example, McDonalds has an estimated global brand value of about 200 billion US dollars, while the average investment in a US franchise is between one to two million dollars (Statista 2023; Fox Business 2018). The scale of this economic inequality undoubtedly produces asymmetrical power relations, but the existence of a substantial investment by the franchisee will almost certainly preclude them from being classified as an employee.

Rather, to enter the zone of legal contestability between franchisee and employee status, we have to descend toward the bottom end of the industry where we are more likely to find weaker brands contracting with individuals whose capital investment is not only small relative to the value of the franchisor but is small in absolute terms. While we do not know how large that bottom end is, the CFA reported in 2022 that initial investments range from less than \$10,000 to more than \$1 million. While the average franchisee has a bank loan of \$570,000, according to Sherry McNeil, president and CEO of the CFA, “There’s a wide variety of franchise ownership opportunities. . . . There really is a franchise for everyone” (Canadian Franchise Association 2022).

In addition, the existence of substantial vertical controls that severely limit the freedom of franchisees to exercise control over their business will not allow franchisees to claim employee status, although it may lead us to adopt Felstead’s (1991) characterization of the relationship as “controlled self employment” or to use Joellen Riley’s description of franchisees as “indentured entrepreneurs” (2012). As vertically controlled as she may be, the franchisee remains a self-employed entrepreneur in law—until she isn’t.

While Coiquad and Martin (2017) may be correct that there is not a great appetite for finding franchisees to be employees as a matter of law, the sociolegal history of that distinction in the franchising context has not been excavated in Canada.⁷ In what follows, we begin with the first group of cases to come before courts and adjudicators at the formative stage of business-format franchising in Canada in the 1960s, when we see a variety of arrangements being used, some more successfully than others. As a more standardized franchise model emerges, employment status claims recede. We then consider two recent cases, one in Quebec under their decree system of collective bargaining, and the other in Ontario under its collective bargaining law, where the boundary between franchisee and employee is troubled once again by the revival of essentially labor-only franchising. We conclude with some brief observations on the contradictions of franchising when it assumes hybrid forms at its bottom end that drive it up against protective labor and employment law.

⁷ There is a modest American literature on this point. See, for instance, Callaci (2021b) and Weil (2014, 197-99).

III. Experiments in Hybridity: The Failed Attempts to Thread the Needle between Franchise Rents and Wage Labor

The early growth of business-format franchising in Canada in the 1960s often did not take its classic legal and economic form, but rather was based on hybrid arrangements, only sometimes labelled as franchises. Perhaps we might think of these arrangements as existing on a spectrum that begins on one end with the classic form of business-system franchising in which the franchisee makes a substantial capital investment and hires workers to operate the franchise and ending on the other in traditional employment. The in-between or hybrid arrangements are where employment status was mostly litigated. These cases often involved an agreement between an individual who contracted to operate a single store of a branded business as an independent businessperson. While these operators did not formally own a franchised business, the contracts they signed bore a family resemblance to franchise contracts, but also imposed such extensive vertical controls that they resembled employment contracts. Thus, when so called independent operators or joint venturers claimed employee status, adjudicators faced the task of trying to decide which category best fit their situation, often focusing on the inequality of bargaining power and the extent of control (Karp 1975, 390-393).

Even more standard business-format franchising, however, was not without its critics, including some franchisees who felt victimized by one-sided contracts that operated as a mode of subordination that should be legally regulated. The first Canadian lawsuit involving the franchise system was brought against an early franchisor in the iconic Canadian donut industry, Mister Donut. The franchisee alleged that the franchisor had obtained secret profits or rebates through its control over the sale of ingredients and supplies to the franchisee and demanded an accounting. In the absence of precedent on the legal nature and incidents of the franchise relation, Justice Stark held there was a fiduciary relationship between the parties and that, in this case, the franchisor's actions constituted "constructive fraud."⁸

A month after the court issued its judgment in July 1970, Bert Lawrence, the Ontario Minister of Financial and Commercial Affairs formed a ministerial committee to study a variety of sales practices, including franchising. Samuel Grange, then a lawyer in private practice, headed the Committee, which Arthur Wishart continued after he replaced Lawrence as minister (Globe and Mail 1970).

The Committee held open- and closed-door sessions in January 1971. Most of its attention was focused on unfair advantage taking by franchisors, including testimony from Fred Catzman, the lawyer representing the franchisee in the Mr. Donut litigation, who characterized the contract as "legalized serfdom" (Globe and Mail 1971). In its report, the Committee identified the underlying problem in franchising to be "contractual inequality" and noted that "large corporations are by their very nature the chief offenders":

The truth is that franchisors grant the franchises on contracts drawn for and in the interests of the franchisor . . . [T]he inequality of bargaining power does produce inequitable contracts almost inevitably, and even where honest attempts have been made to redress the balance

⁸ *Jirna Ltd. v. Mister Donut of Canada Ltd.*, 1970 CanLII 515. The judgment was reversed on appeal (1971 CanLII 42) and the SCC upheld the ONCA's judgment (1973 CanLII 31). Subsequent courts have held that the franchisor owes a duty of good faith toward the franchisee based on the unequal bargaining power of the parties, the fact that the franchise agreement is a contract of adhesion and the information asymmetry between the parties. However, these circumstances do not give rise to a fiduciary duty. For example, see *Shelanu Inc. v. Print Three Franchising Corp.*, 2003 CanLII 52151.

between the parties, there remain too many opportunities for repression that would not exist if the franchisee could freely contract his own bargain. (Grange Committee 1971, 38)

While the Committee did not characterize franchising per se as a mode of subordination, it recognized the great potential for abuse and made numerous recommendations to regulate the industry (Grange Committee 1971, 38–65). The Committee (1971, 49) also addressed what it called “The Becker Problem.”

Frank Bazos founded the Becker Milk Company in 1957 with the goal of creating an extensive network of convenience stores throughout the province. His business model was innovative at the time since the great majority of convenience stores were independently owned and operated, the prototypical “mom and pop” small business. His was perhaps the first chain of convenience stores in the province, combining both company-owned and “franchised” outlets. Stores were open fourteen hours a day, seven days a week, and sold milk in returnable jugs. The format proved enormously popular, and the business grew to 500 stores, although it is not clear how many were franchised outlets (Becker’s 2023).⁹

However, there was a wrinkle. Becker did not operate a classic franchise system. Rather, individuals entered into contracts with Becker that identified them as store managers. They put down a deposit for good performance and managed the store, including hiring staff and purchasing stock from suppliers designated by Becker. The stock remained the property of Becker and Becker paid the wages of store help but deducted the amount from the manager’s remuneration, which was based on a share of the total revenue. Numerous former managers appeared before the Committee alleging mistreatment, presumably on the understanding that they were franchisees and thus within the Committee’s purview (Globe and Mail 1971). Becker did not appear, but instead submitted a brief denying that it ran a franchise operation and characterized the store managers as independent businesspeople, not franchisees.¹⁰

The Becker arrangement received extensive consideration in the Grange Committee Report. First, the Committee defined a franchise and distinguished it from employment.

In our view, a franchise is essentially the grant of a right to operate a business, which business involves the use of the grantor’s trademark or trade operation . . . it is the element of control that distinguishes, in our view, a franchise from either a bare license or an employment contract [I]n an employment contract, there is almost complete control. ([Grange Committee 1971, 36])

In its discussion of “The Becker Problem,” the Committee ultimately agreed with Becker that its store managers were not franchisees. However, it conceded that:

There may be an argument that the relationship is one of franchise, and certainly Beckers at one time advertised on a basis akin to the disposition of a franchise, but in our view the relationship is no more than an employment contract with a deposit for good behaviour and

⁹ Becker was acquired by its rival Mac’s Convenience Stores in 1996 and its assets were purchased by Alimentation Couche-Tard in 1995. The Becker brand was revived in 2013 (Becker 2023).

¹⁰ The relationship between Becker and its managers is described in the Grange Committee Report (1971, n.p.), and *Re Becker Milk Co. Ltd.* (1973), 1 L.A.C. (2d) 337 (D.D. Carter).

provisions for the forfeiture of that deposit in certain circumstances. Grange Committee 1971, 49)

Becker's claim that its managers were independent businesspeople who were operating the stores on their own account but not as franchisees raised a rather fine distinction to say the least, especially when the stores operated under the Becker brand and trademark. But by finding the relationship to be employment, the Grange Committee avoided the problem of having to clarify the distinction between franchises and other kinds of independent contracting.

Viewed through a political economy lens, we might think of Becker as an emergent Type 1 firm, in the sense that at the time of the inquiry it was building its brand in a market with low barriers to entry, a situation that limited its ability to extract rents from aspiring small-business owners. Yet if it operated as a Type 3 firm, it faced the difficulty of managing a widely dispersed workforce in hundreds of small settings. Thus, it attempted to operate as a hybrid, with relations structured somewhere between franchising and employment, by engaging notionally self-employed store managers who notionally paid a rent to Becker (Becker's share of the revenues), who exploited their own labor and, perhaps, that of family members, and who were incentivized to extract value from other employees. This attempt to construct a unique mode of subordination, however, failed in the eyes of the Grange Committee, which viewed the arrangement as disguised employment. The Committee's view on this question, however, was not legally binding.

That soon changed. In early winter 1972, four ex-Becker store managers, all of whom became managers after the Committee report was issued in July 1971, claimed they were employees covered by the recently enacted Employment Standards Act (ESA). Becker objected and the then-Minister of Labour, Fern Guindon, appointed Don Carter, a professor of labor law at Queen's University and an arbitrator, to conduct an inquiry and determine their legal status.

The ESA's definition of employee was circular and of little help. Basically, it provided that that an employee includes any person who performs work or supplies services to an employer, and it defined employer as any person directly or indirectly responsible for the employment of a person.¹¹ Therefore, Carter turned to the common law. The leading case at the time, *Montreal Locomotive*, adopted a four-factor test (control, ownership of the tools, chance of profit, and risk of loss) to determine whether the person was carrying on a business for themselves or on behalf of a superior as an employee.¹² Applying this test, Carter found that the store managers were employees:

[I]t must be concluded that the four store managers were not acting as independent businessmen. The degree of control asserted by the company, the absence of any real chance of profit or risk of loss, and the absence of any ownership of the tools of the trade can lead to no other conclusion.

Carter reached this conclusion notwithstanding the fact that the managers were authorized to hire help. In Carter's view, the extensive control exercised over the help by Becker made them Becker's employees, not the employees of the managers.¹³

¹¹ Employment Standards Act RSO 1970, c 147, s 1(c)-(d).

¹² *Montreal v. Montreal Locomotive Works*, (1947) 1 D.L.R. 161.

¹³ Becker Milk pursued an unsuccessful judicial review application. *Re Becker Milk Co. Ltd. and Director of Employment Standards of the Ontario Ministry of Labour et al.*, (1973) 41 DLR (3d) 503.

The Becker model was not unique. Mac's Milk, a competitor, used a similar arrangement of hiring store managers as independent contractors. In 1972, an Alberta court found that Mac's Milk had contravened an order requiring it to pay a store manager vacation and termination pay under the province's employment standards legislation. Mac's Milk appealed. Again, the term "franchisor" was not used in the contract. The matter was resolved with a determination that the store manager was an employee, and the conviction was upheld.¹⁴

Mac's Milk also operated in Ontario, where by 1975 it had 350 stores. However, by then, and perhaps because of the growing strength of the brand, it had begun using the franchise model to extract rents. Nonetheless, this transition was in its early stages and 250 of its stores were still operated by so-called independent contract operators. It was these workers who the Ontario Workmen's Compensation Board (WCB) determined were employees, and its decision was upheld by a reviewing court.¹⁵ Decision in other jurisdictions reached the same result and presumably discouraged further attempts to use this label.¹⁶

However, the practice of outsourcing the management of retail stores to operators who did not make a capital investment was attractive for some hybrid firms, and some began to label these arrangements as franchises. Results were mixed. In one case, where the "franchisee" was found to be an employee, the court noted "[a]s franchises go, this franchise would seem to have the managers on the low end of the totem pole" and concluded, "on the scale of franchise relations generally, [the claimant] had very little influence as a franchisee."¹⁷ However, in another case in which the facts closely resembled those in the Becker and Mac's Milk cases, the adjudicator rejected the putative franchisee's claim to be an employee on the basis that she hired helpers and was able to keep the profit from sales of bus tickets and small craft items.¹⁸

In any event, subsequent claims by putative franchisees that they were employees were largely unsuccessful. In part, this was because the plaintiffs were in more traditional franchise arrangements involving the purchase of a franchise and a significant capital investment. In addition, the courts and adjudicators were becoming more familiar with and accepting of the franchise model, including the necessity of franchisors maintaining a high level of vertical control over franchisees without that arrangement turning the franchisee into an employee, unless the control went too far.¹⁹

¹⁴ *R. v. Mac's Milk Limited*, [1973] 12 CCC (2d) 537.

¹⁵ *Re Mac's Milk Ltd. and Workmen's Compensation Board of Ontario*, (1977) 76 DLR (3d) 179. The WCB presumably did not consider the franchisees to be employees since there was no discussion of their status.

¹⁶ *Semenoff v. Saskatoon Drug & Stationery Co.*, (1988) 49 DLR (4th) 102.

¹⁷ *Head v. Inter Tan Canada Ltd. (Gen. Div.)*, (1991) 5 OR (3d) 192.

¹⁸ *Spic and Span-Valetor-Cash Cleaners, Application for Review, Case 22039*, (1983), unreported. The adjudicator, Professor Michael Bendel did not cite the *Becker* and *Mac's Milk* cases, both of which involved situations in which managers notionally hired other workers. It is not clear why, since he had recently discussed them in an article criticizing the enactment of a "dependent contractor" provision in many of Canada's labor relations statutes. This provision extended collective bargaining rights to workers who were not employees but were in positions of economic dependence more closely resembling the situation of an employee than an independent contractor (for example, see Labour Relations Act, SO 1995, c. 1, sched. A, s. 1(1)). Ironically, much of Bendel's criticism of the provision was based on the argument that labor boards already enjoyed the interpretive power to apply the term "employee" purposively and expand its reach as appropriate (Bendel 1982).

¹⁹ For a discussion of other potential liabilities arising from extensive vertical controls, see Vesely (1977). It is noteworthy that by this time in the US, the franchise model had gained widespread legal acceptance. Extensive vertical controls were held to not violate antitrust law and did not make franchisors employers or joint employers of their franchisees' employees (Callaci 2021b).

We can see these factors at work in *Re Groulx*, an employment standards case in which Mr. Groulx claimed to be an employee of Loeb, a grocery chain.²⁰ Groulx had been a store manager for Loeb, but in 1983 he signed a franchise agreement pursuant to which he continued to operate the store. The adjudicator recognized that the popularity of the franchise model had grown, so that at the time of the hearing there were 75,000 franchise units operating in Canada and they generated one-quarter of all retail sector revenues. She also accepted that while a standard franchise agreement suggests a business relation between two independent parties, in some cases a franchisee might be subject to such extensive controls that the reality of the relationship was closer to that of a “glorified manager, carrying out the franchisor’s mandate.”²¹ However, in Groulx’s case, she found he had a substantial investment in the store, owned all the equipment and inventory and made key decisions, albeit within the framework of the franchise agreement. In other words, the arrangement fell within the bounds of a franchise model. She recognized that franchisors needed to ensure that franchisees were operating their stores according to system standards, which required extensive vertical controls.²²

There were few reported Ontario cases in the decades after Groulx in which “franchisees” claimed employment status and none were successful. For example, in another donut shop case, the trial court’s holding that the arrangement created an employment relation was reversed on appeal. The appeals court held:

Inevitably, there are some provisions of the franchise agreement according to which Coffee Time exercises control over the franchisee. Such provisions are regular and expected inclusions in a franchise agreement. Franchise agreements by nature “entail some degree of control by the franchisor, even though the franchisee is generally an independent business person operating the franchise.”²³

In sum, these cases point to an evolution in legal models used by capital to extract value, whether through monopoly rents or through direct exploitation of labor. Firms like Becker and Mac’s Milk were at the cutting edge of franchising in Ontario, but the relatively weak value of such brands due to their novelty and low barriers to entry limited their ability to extract monopoly rents. Alternatively, extracting value from employee-operated stores was complicated by the high costs of supervision. This led them to adopt the hybrid form of independent business operator, notionally a *sui generis* mode of subordination. However, the extent of vertical controls exercised over the operator, the operator’s lack of a capital investment, and the limited scope for entrepreneurial activity by the operator made the model vulnerable to courts classifying operators as employees.

Attaching the franchise label to these agreements did not necessarily change the outcome. However, when combined with real changes in the structure of the relationship, including a meaningful capital investment by the putative franchisee, the label increased the likelihood that the arrangement would be upheld. Of course, the franchisee’s investment of capital did not make them equal partners with the franchisor and the economic subordination of franchisees sometimes involved abusive practices and unfair advantage taking, resulting in calls for regulation and representation or even coordination

²⁰ *Groulx (Re)*, [1992] O.E.S.A.D. No. 176.

²¹ *Ibid.* 6–7.

²² *Ibid.* 7.

²³ *Coffee Time Donuts Incorporated v. Tosbi Enterprises Ltd.*, (2008) 246 OAC 17, at para. 15 (citation omitted). See also *Murray v. TDL Group Ltd.*, 2002 CanLII 23609 (ON SC), <https://canlii.ca/t/1bvt7>, and *France v. Kumon Canada Inc.*, 2014 ONSC 7181 (CanLII), <https://canlii.ca/t/gfltp>.

rights for franchisees, but it severely reduced the likelihood of franchisees getting legal remedies based on being employees.

IV. The Revival of Labor-Only Franchising?

While the hybrid strategies for extracting value from convenience and donut store chains largely failed to create new modes of subordination, classic franchising remained an option, as did direct ownership and management. Still, in the drive to maximize value extraction and appropriation where barriers to entry were low and/or the cost of remote labor supervision was high, branded firms still occasionally pursued hybrid strategies in the twenty-first century in the guise of franchising. However, labels are never legally determinative and where the putative franchisee's chief contribution was their labor power, the arrangement remained vulnerable to legal challenge, whether by the putative franchisees themselves or by unions or regulators. In this part of the article, we explore two such arrangements and the legal challenges they faced, the first in commercial contract cleaning and the other in bread delivery.

A. *Modern Concept Cleaning*

Lacking an historical study of the Canadian commercial cleaning industry, the following account is necessarily a bit speculative, but the available evidence suggests that for many decades institutions like schools, hospitals, and commercial real estate owners hired their own janitors as employees. In some sectors, particularly public institutions, janitors unionized and improved their terms and conditions of employment and job security. However, as ownership and management of commercial real estate came to be increasingly dominated by finance capital, and as governments embraced neoliberal practices, janitorial work was frequently contracted out. Where this occurred, janitors faced declining working conditions and growing precarity. For example, in the private sector, it became quite common that when cleaning contracts ended, they were not routinely renewed but rather put out for open bids. This put cleaning contractors under relentless pressure to cut costs in order to win a bidding war for the work. Moreover, if the current contractor lost the contract, its employees would lose their jobs and face the choice of either reapplying for their old jobs with the new contractor or seeking work elsewhere (Aguilar 2006; Cohen 2006).²⁴

While larger institutions often contracted out their cleaning services to major multinational service corporations such as Aramark and Sodexo, smaller businesses, branch offices, and commercial buildings contracted with small firms with employees or self-employed janitors. This low end is the larger segment of the industry in Canada, where nearly two-thirds of cleaning industry establishments are non-employing sole proprietorships (Gonzales 2020, 9).²⁵ As with convenience stores and donut shops, this is the kind of economic environment where extracting monopoly rents is difficult, as is extracting surplus value from a widely dispersed workforce. This makes hybrid forms potentially attractive.

According to Michael Seid (2016), the originator of franchised cleaning services is Jim Cavanaugh, who founded Jani-King in Norman, Oklahoma in 1969. While working as a night auditor at a Holiday Inn, Cavanaugh befriended a janitorial contractor whose crew cleaned the motel and a number of other locations he had under contract. The contractor complained he did not have enough time to

²⁴ For a discussion of similar trends in janitorial services in the US, see Weil (2014, 132–142).

²⁵ The same pattern prevails in other advanced capitalist countries. For example, see Ryan and Herod (2006).

line up additional contracts and Cavanaugh saw a business opportunity, initially to find work in exchange for a finder's fee. Cavanaugh later opened his own cleaning company and sought to expand his business without outside investors. Franchising was his answer. In 1974, he set up a system whereby he sold regional master franchises to franchisees who then found individual franchisees who did the work of cleaning. This allowed Cavanaugh to grow a Type 1 business, essentially a brand, without significant capital costs and without employees who would be costly to supervise across widely dispersed worksites. As the strength of the brand grew, Jani-King would be able to attract clients who might pay a bit more (a small rent) in the belief that the quality of the service would be better, and that their costs of supervision were reduced since franchisees would have a direct stake in satisfying the customer and would use the franchisor's system. Finally, cleaners would also agree to become franchisees and pay a rent to the franchisor in the belief that the brand could help them secure more cleaning contracts than they could get on their own, and that there might be an opportunity for them to subcontract and extract value from other cleaners' labor.²⁶

Jani-King began operations in Canada in 1986, and by 2019 had over 70 master franchisees in Canada who oversaw the work of franchisee owner-operators. Master franchisees enter into two-year agreements to operate in a defined territory and make an initial investment of around \$100,000 in US dollars. No information is available on the cost of a "unit" franchise. However, indicative of the highly fragmented market for commercial cleaning services, Jani-King's Canadian market share is 0.3% (Gonzales 2020, 11).

According to Gonzales (2020, 9-10), the largest janitorial services company operating in Canada is GDI Integrated Facility Services Inc., with a market share estimated at just under 10% in 2020. GDI serves both the large institutional sector and the small business market. The majority of its revenue is generated from its institutional sector which services clients with premises larger than 100,000 square feet. Here, GDI operates as a Type 2 firm that hires and supervises around 17,000 employees who perform this work. GDI also operates a subsidiary, Modern Concept Cleaning Inc. (MCC), which services clients with smaller premises of less than 100,000 square feet. Many of these clients are banks and other large business that have multiple branches. Here, instead of hiring employees to perform this work, however, it operates through franchises, and thus also purports to run a Type 1 business. By 2020, MCC had expanded to approximately 600 franchisees across Canada. However, its franchisees do not fit the model of a Type 3 business, but rather are individuals who have little or no capital investment and do not have employees. Thus, the arrangement is, at best, a hybrid, where the people who do the work sit somewhere between employment and independent contracting as franchisees.

Like Jani-King, MCC trades on its brand to secure cleaning contracts for smaller premises, hoping to out-compete mom and pop operators based on its reputation while still offering a competitive price. Of course, the price need not be the lowest, since it may include a small premium (rent) for the added assurance that the work will be performed to the client's standards, and with lower transaction and contract compliance costs for business with multiple branches.

MCC "franchisees" in Quebec challenged their status, claiming to be employees.²⁷ Testimony in the litigation established that MCC negotiated the cleaning contracts with client firms and received payment from them. The clients agreed in advance that the contract will be assigned to a franchisee,

²⁶ According to Weil (2014, 133–134), the Jani-King model is widely used in US janitorial service franchising.

²⁷ *Comité Paritaire de l'Entretien d'Édifices Publics de la Région de Québec c. Modern Concept d'Entretien Inc.*, 2016 QCCQ 1789.

but that MCC remained responsible for its performance. MCC drew cleaners into what they described as “micro-franchise” contracts by holding out the promise they would secure more contracts and increase their income beyond what would be the case if they worked on their own account, even after MCC deducted its share of the cleaning contract before paying the franchisee. That share was not small. The franchisee agreed to pay the following fees: up to 25% of the value of the first two contracts, royalties of seven percent of gross revenues, an administration fee of between 10 to 11.5%, assistance costs at fixed prices, and 1% of gross revenue for advertising by the franchisor.

The case challenging MCC’s franchise model arose in the context of Quebec’s decree system, which allows for the terms of a collective agreement to become binding on all employers in a particular industry and region, whether or not the employees are unionized. The goal of the decree system was to support unionization in highly competitive sectors by reducing the economic incentive of companies to remain union free.²⁸ When a decree applies, it establishes the minimum terms in all workplaces covered by it, including wages, hours of work, holiday, and overtime.²⁹ A decree with respect to building services in the Montreal region was first adopted in 1974, based on a collective agreement between the Service Employees International Union, Local 800, and the Association des Entrepreneurs de Services d’Édifices Publics Inc., which represents many of the sector’s largest employers. The contracting parties petitioned for a decree which was issued by the Quebec Minister of Labour (Jalette 2006).³⁰

The decree is enforced by the contracting parties who form a Parity Committee (Comité) which appoints inspectors and can bring enforcement actions, which is how the case originated. In 2014 the Comité commenced proceedings against MCC claiming that it was bound by the Decree and in violation of its terms, having underpaid a unit franchisee, Mr. Bourque, less than was required by the decree.³¹ The outcome of the case hinged on whether the decree applied to MCC, which depended on whether its unit franchisees were legally MCC’s employees. The case was litigated all the way to the Supreme Court of Canada.³²

A complication in the case is that the Decrees Act defines employers and employees in a somewhat idiosyncratic way. The act covers “professional employers” defined as “an employer who has in his employ one or more employees covered by the scope of the application of a decree,” while “employee” means any apprentice, unskilled labourer or workman, skilled workman, journeymen, artisan, clerk or employee, working individually or in a crew or in partnership.³³ Supreme Court of Canada Justice Rosalie Silberman Abella’s majority opinion took the view that the Act applies “to *any* contract in which one can conclude that an individual is in a relationship determined to be that of ‘employee’ within the meaning of the *Act*.”³⁴ The unique definition of “employee” however resulted in the court becoming embroiled in a discussion of the meaning of “artisan” and the distinction between an artisan

²⁸ On the history and challenges of the decree system, see Jean Charest and Guylaine Vallée (2001).

²⁹ *Act Respecting Collective Agreement Decrees*, CQLR, c. D-2 (Decrees Act). On the history of the decree system and its operation, see Bernier (1993), Bergeron and Veilleux (1996), and Charest and Vallée (2001).

³⁰ Jalette (2006) argues that employer acceptance of the Decree system is based on how it provides a comparative institutional advantage relative to its higher labor costs. What the MCC case indicates, however, is that if and when those institutional advantages dissipate, firms will seek to exit the decree system and opt for a deregulated labor market, in this case through labor-only franchises.

³¹ MCC, paras. 1–17.

³² *Modern Cleaning Concept Inc. v. Comité Paritaire de l’Entretien d’Édifices Publics de la Région de Québec*, 2019 SCC 29.

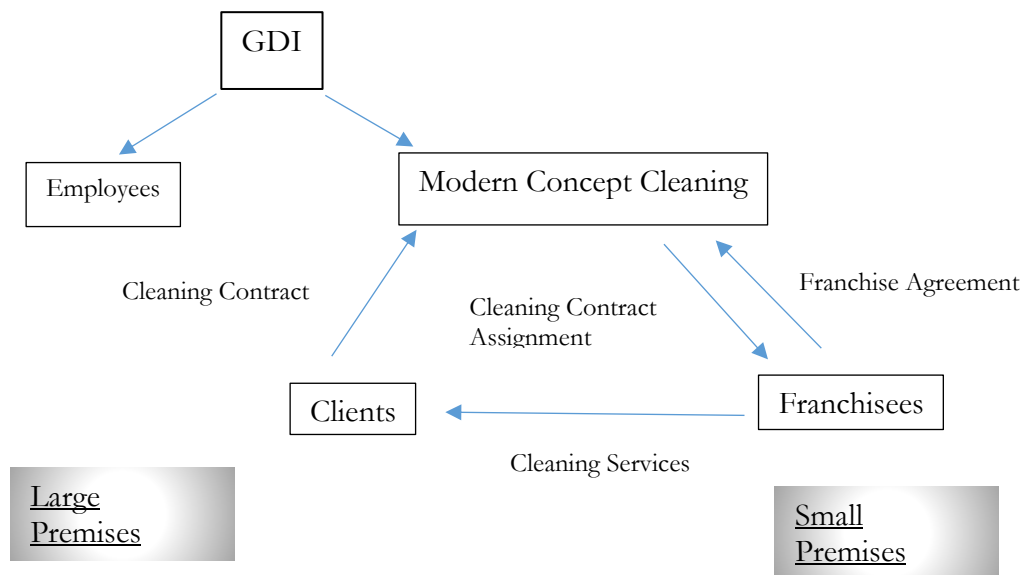
³³ Decrees Act, ss 1(g)(f).

³⁴ MCC, para. 25.

and an independent contractor, which creates some debate over whether the case has any application outside of Quebec.³⁵ Nevertheless, as we shall see, the test articulated by the court to distinguish between artisan and independent contractor is closely aligned with the approach it takes to determining who is an employee in other legal contexts.

As noted, under its business model, MCC enters into cleaning contracts with its clients and then “assigns” these contracts to its franchisee cleaners who clean the client’s premises.

Figure 2. Modern Concept Cleaning



Because MCC remains responsible to the client for contract performance, it includes an indemnity clause in its franchise agreements. It also imposes extensive vertical controls over the performance of the work and over the “business” of the franchisee. The cleaner/franchisee is required to document the work and provide MCC access to client locations serviced by the cleaners. In addition, the franchisee/cleaner is not allowed to compete against the overall MCC network. For example, MCC franchisees cannot expand their business by entering directly into contracts with new clients but rather must have those new clients enter into contracts with MCC, which will then assign those contracts to the franchisee. MCC also controls client billing and remits to franchisees their share of revenues after first deducting its fees. On the other hand, the franchisees are required to supply tools and equipment at their own expense.³⁶

³⁵ For example, see *GDI Services (Canada) LP v Modern Cleaning Concept GP Inc./Commandité Modern Concept d'Entretien Inc.*, 2021 BCLRB 88.

³⁶ MCC, paras. 11–13.

In its judgment, the Supreme Court of Canada drew on Quebec precedents that emphasized the critical factors distinguishing artisan from independent contractor as the risk of loss and chance of profit. While acknowledging the possibility of a distribution of risks to some degree between the parties, as in many contracting arrangements, the Court emphasized the importance of determining who assumed the overall “risk of the business . . . and the attendant prospect of making a profit.”³⁷ In answering this question, the majority relied heavily on the fact that MCC remained responsible for the work performed by franchisees, emphasizing that this arrangement was an “imperfect assignment.” The majority further reasoned that this imperfect assignment of risk was “inexorably linked” to the array of vertical controls imposed by MCC.³⁸ On the basis of this reasoning, the court concluded that MCC, not the franchisee cleaners, bore the business risk and had the ability to profit, resulting in the cleaners being found to be “artisans,” and thus “employees” under the Decrees Act who were entitled to the terms and conditions set out in the building cleaning services decree.³⁹

As noted, the test applied in *MCC* was formulated in the context of the Decrees Act, which contains a definition of “employee” that includes the word “artisan.” While the court noted that the inclusion of “artisan” indicated a legislative intent to expand the category of employee to workers who might not otherwise fit, the court nevertheless heavily relied on a chance of profit/risk analysis that is a fundamental part of the common law test for who is an employee. The court found the extensive vertical controls imposed by MCC meant that its franchisees did not in fact assume the business risk and had no meaningful opportunity to make a profit, and thus were not independent contractors.⁴⁰

More broadly, the case opens a window to the revival of labor-power franchising in contexts where capital believes it can extract more value using hybrid arrangements than it can through classic employment or franchising structures. In that regard, we should recall the structure of *GDI's* operations. It services larger clients with large premises by acting as a Type 3 firm hiring its own employees, presumably on the basis that it believes this structure maximizes its profits. For clients with smaller premises, a different model for maximizing profits suggests itself, but it is not classic franchising. Rather, it is a hybrid, designated by MCC as a “micro-franchise” that attempts to thread the needle between employment and franchising, based on a tripartite relationship between MCC, client, and franchisee. The imperfect assignment of the contract was a consequence of MCC wanting it both ways; it wants to extract rent as franchisor/rentier and also to exercise extensive controls over the work and economic activity of the micro-franchisee. This attempt to produce a *sui generis* mode of subordination left at least some micro-franchisees worse off than employees, which motivated the Parity Committee, on behalf of the franchisees, to bring them within the fold of protective labor and employment law. Like the hybrids in *Becker and Mac's Milk*, all essentially built on labor-only franchises, they sat in a liminal legal space where they were vulnerable to being legally constructed as employment.

³⁷ MCC, para 36–37.

³⁸ MCC, para 48–54.

³⁹ MCC, para. 26–56.

⁴⁰ MCC, para. 25–38. In an earlier MCC case, the Manitoba Appeal Commission found that cleaner/franchisees were “workers” or “employees” and not “independent contractors.” See *Manitoba Appeal Commission Decision No. 99/2011* (unreported 20 July 2011).

B. *Canada Bread*

The Canada Bread (CB) story is significantly different from the ones we have been telling insofar as it begins with a company that initially incorporated the sales and delivery of bread within the firm, hiring its own employees to perform this work. Here, we encounter a true fissuring, where a Type 2 company tries to externalize a non-core part of its business by granting or selling franchises to notionally independent businesspeople who will fulfill this function. But like in MCC, these are not truly independent Type 3 companies that make significant capital investment in their businesses and hire their own employees. Rather, these involve individual workers in a hybrid relationship subject to significant vertical controls that sit somewhere between classic employment and classic franchising.

According to Canada Bread's (CB) website (Canada Bread 2023), CB is Canada's largest commercial bakery and has been in business for more than 100 years. Its website states that it sells more than eighteen brands and in 2017 had sales of \$1.3 billion. In 2014, it was purchased by Grupo Bimbo, the world's largest baking company with operations in 32 countries. CB operates nineteen bakeries in Canada, with over 4,850 associates (presumably employees), and has 1,240 delivery routes with 1,125 independent operators. While many of its "associates" employed in its bakeries are unionized, its so-called independent operators/route delivery drivers-sales persons currently are not.⁴¹

This was not always the case.⁴² Previously, CB employed unionized delivery-sales drivers, but terminated them. The effect of this measure was to move a portion of CB's workforce outside of the existing bargaining unit and beyond the reach of future unionization. At the time, the union negotiated the best terms it could for its affected members rather than trying to stop this reorganization⁴³—that is, until 2015 when the Milk and Bread Drivers, Dairy Employees, Caterers and Allied Employee, Local 647, filed certification applications for "franchisee" delivery drivers in five Ontario municipalities.⁴⁴ The claim was that the franchisee drivers/salespeople were dependent contractors who are deemed employees for the purposes of the Labour Relations Act.

The dependent contractor provision was created in the 1970s, precisely to capture hybrid arrangements between independent contracting and employment where "the dependent contractor is in a position of economic dependence upon, and under an obligation to perform duties for, that person more closely resembling the relationship of an employee than that of an independent contractor."⁴⁵ The dependent contractor category clearly could include "dependent" franchisees and this provided the basis for challenging whether CB's "franchisees" "were "in any meaningful sense independent businesspeople operating viable, independent businesses."⁴⁶

⁴¹ For example, see the 2016 collective agreement between Canada Bread and the Teamsters covering southern Ontario. <https://sp.ltc.gov.on.ca/sites/mol/drs/ca/Manufacturing%20%20Consumables/311-23973-20.pdf>.

⁴² For example, in 1963, the Retail, Whole & Department Store Union (RWDSU), Local 461 successfully grieved on behalf of CB "salesmen" regarding the calculation of their commissions. See *Re Retail, Wholesale & Department Store Union, Local 461, and Canada Bread Co. Ltd* (1963) 14 Labour Arbitration Cases 298.

⁴³ For example, in Saskatchewan, CB entered into an agreement with the union that represented its drivers, Retail, Wholesale & Department Store Union Saskatchewan, that provided for severance benefits for the sales/delivery staff, who were terminated effective on March 20 1998. *Canada Bread Company, Limited v. Retail, Wholesale and Department Store Union*, 1999 CanLII 19552 (SK LA), <https://canlii.ca/t/ft3md>.

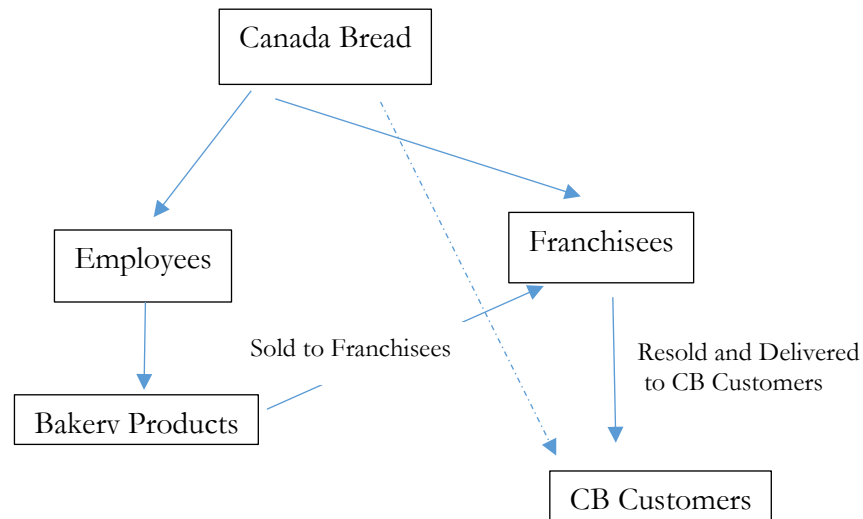
⁴⁴ *Milk and Bread Drivers, Dairy Employees, Caterers and Allied Employees, Local 647 v Canada Bread Company Limited*, 2015 CanLII 25099 (ON LRB), <https://canlii.ca/t/ghkl3>.

⁴⁵ Labour Relations Act, 1995, S.O. 1995, c. 1, sched. A, s. 1(1). For additional discussion, see Langille and Davidov (1999).

⁴⁶ *Milk and Bread Drivers, Dairy Employees, Caterers and Allied Employees, Local 647, affiliated with the International Brotherhood of Teamsters v Canada Bread Company Limited*, 2017 CanLII 62172 (ON LRB), para. 106, <https://canlii.ca/t/h67xj>.

The Ontario Labour Relations Board's (OLRB) answer was no. In a nutshell, driver/franchisees deliver and supply bread to CB customers, while engaging in a controlled process of notionally purchasing this bread from CB and re-selling it to CB customers (see Figure 3). Some of the CB customers are large retail chains, while others are smaller retail stores.

Figure 3. Canada Bread Model



Vertical controls of two main types defined the relationship. First, there were various kinds of quasi-supervisory controls that defined the labor process, including restrictions relating to quality and manner of work performance. Second, there were other, what may be called “enterprise” controls, that more deeply structured and limited the scope and nature of the “business” that the franchisee ostensibly owned and operated.

The OLRB found that, in terms of labor process controls, the franchise arrangement created various tools that enabled the franchisor, CB, to monitor and enforce quality standards in work performance.⁴⁷ CB trained the drivers and applied work rules and procedures outlined in a Standards of Operations Manual. Other than the truck, CB provided a crucial technology, a “hand-held” computer, that managed all transactions. CB supervised work performance and standards through various performance review and disciplinary systems, including meetings with supervisors known as Territory Managers. Poor performance reviews may result, inter alia, in a disciplinary response akin to termination in that CB may exercise a right to buy back the driver’s delivery route.

In terms of the enterprise controls, the franchise agreement required drivers to set up corporations that were formal parties to the franchise contracts, and drivers were referred to as the “principals” of the franchisees. The agreement contained comprehensive restrictive covenants, including non-competition clauses. Drivers effectively undertook delivery work only for CB, deliver to a set route

⁴⁷ Ibid.

consisting of CB customers assigned and/or approved by CB and this customer list was considered proprietary to CB. Among other payments, drivers paid certain franchise fees at the outset, and certain ongoing royalty fees throughout. Driver/franchisees were required to purchase/lease a delivery truck and were responsible for absorbing all related truck expenses. However, despite this, drivers needed CB's permission to use their truck for purposes other than the delivery of CB products. The composition of a driver/franchisee's customer (route) list was effectively controlled and approved by CB. Large clients (grocery stores) were defined as direct accounts of CB, and driver/franchisees could not solicit them as clients. Options for adding new customers was limited due to incentives built into the pricing structure for small customers to simply purchase their bread from large grocery chains.

Further, in the notional process of re-selling Canada Bread products, CB fixed both the price charged to the driver and to the customer (and thus the drivers' overall "markup"). CB also controlled the flow of payments. CB charged the customer for the bread, and then also paid the driver their markup (the difference between the prices it charged the customer and driver for the bread). Under the agreement, CB allowed drivers to return some portion of unsold bread that they ordered, without penalty.

Additionally, a scheme of "alternative distribution methods" gave CB a default right to unilaterally adjust a driver's delivery route (meaning his or her customer list). While there is some potential compensation for this, it solidifies CB's control over route re-engineering and increases the driver's risk of a loss of business, thereby reducing the value of their franchise in any potential future sale.

Lastly, a portion of the drivers in these franchise arrangements employed "helpers," and this appeared to be at the discretion of the driver-franchisee, and CB did not appear to be involved in restricting or controlling these activities.⁴⁸

The OLRB found that this arrangement aligned sufficiently with the definition of "dependent contractors" provided in the Act and case law.⁴⁹ The Board acknowledged there was some residual degree of business-like activities with some minimal entrepreneurial content, including the right to hire helpers, ownership of a vehicle, and the right of drivers to sell their routes between themselves. However, the Board found that, except for drivers who hired full-time helpers, the arrangement on balance crossed a boundary making it more akin to employment than franchising, particularly insofar as the drivers could not sell their services of CB products to the market generally, they were completely integrated into the business of CB, and their work was not highly specialized.⁵⁰

In sum, CB, like MCC, wanted to have it both ways. In political economy terms, CB wanted to spin off a portion of its operations into a Type 1 firm as a franchisor/rentier to increase the value it could extract from the people who actually performed the delivery and sales work. As a franchisor, their workers were no longer employees but franchisees who were outside protective labor and employment law, including collective bargaining. Furthermore, as franchisors they externalized the cost of owning and maintaining a fleet of vehicles, and incentivized driver/franchisees to work harder than employees. On the other hand, they also wanted to maintain extensive controls over the delivery and sales business through vertical controls that sharply limited the economic freedom of drivers to use their vehicles for other purposes and kept the drivers under the watchful eyes of supervisory employees. It turned out that this strategy drove them across the legal boundary separating franchisors/rentiers from

⁴⁸ *Milk and Bread Drivers*, 2017, paras. 9-86.

⁴⁹ See especially *Algonquin Tavern*, [1981] OLRB Rep. 1057.

⁵⁰ *Milk and Bread Drivers*, 2017, paras. 108-131.

employers. In Law and Economics terms, this kept the drivers within the boundaries of the firm as “dependent contractors” because they were “in a position of economic dependence upon, and under an obligation to perform duties for [the firm] more closely resembling the relationship of employee than that of an independent contractor.”⁵¹

In both the CB and MCC contexts, the hybrid characteristics of the organizational structure—such as the lack of significant capital investment by the franchisees, together with severe vertical controls restricting the labor process and putative “business” of the franchisee set them apart from the more standard franchising arrangements widely used after the initial experimentation period of the 1960s and 70s. As a result, it could not be convincingly argued that the drivers were, in reality, operating small, type 3 businesses that had entered into a franchise agreement.

V. Conclusion: Protective Labor Law Confronts the Contradictory Imperatives of Franchisors

Law and Economics scholars have long recognized that franchisees and employees exist on a continuum due to the internal dilemma that franchisors face, on the one hand of constructing themselves as the owners of a brand and, on the other, of policing the brand to protect its value and to ensure that franchisees generate revenue for the brand. Therefore, they impose vertical controls that extend downward. Normally, extensive vertical controls are permissible in franchise contracts, but if they become too extensive and the franchisee’s major investment is their own labor, then the arrangement is a hybrid that exists in a liminal space between franchises and employment. However, the law is largely intolerant of liminal spaces and assigns the arrangement into a legible legal category, which may result in putative franchisees being held to be employees for the purposes of protective labor and employment law.

A political economy lens deepens our understanding of the forces that generate the contradictory pressures within the franchising model. Rentier capitalism in which owners of assets extract value produced elsewhere has become the dominant means through which profits are accumulated. Franchisors ideally seek to position themselves as rentiers, who having created brands and business systems, now sell privileged access to their intellectual property, extracting rent principally in the form of an initial franchise fee and ongoing royalties calculated as a percentage of net sales. The extractive model itself puts pressure on franchisees to increase the surplus value they must produce from their own operations, creating an environment prone to workers’ rights violations.

But there is another side to the story, the one we have told here, of putative franchisors who use the franchise model primarily to extract surplus value more directly from the labor of their franchisees and only secondarily to extract small rents. This is an attractive strategy in some circumstances for several reasons. Most obviously, it avoids the cost of the legal obligations owed by employers to employees and reduces or eliminates their access to collective bargaining. It is also a strategy for reducing the cost of managing employees who are dispersed whether in fixed locations, like small stores, or mobile, as in the case of cleaners and delivery drivers, by creating economic incentives to work harder, faster, or more diligently. While there is certainly nothing illegal about the use of franchise agreements for these purposes, or for that matter other forms of independent contracting, there is a legal boundary that separates employment from these other arrangements which allows franchisees to

⁵¹ LRA, s. 1(1).

challenge their status. While the precise location of that boundary is elusive and may vary depending on the legal context in which it arises, it nevertheless can impose a real limit on the use of franchise agreements primarily as a means to extract surplus value more intensely and directly.

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