# California Franchise Owners Beware: State Cracking Down on Use of Business Model to Avoid Higher Minimum Wage Pay

Insights
10.09.23

A recent multimillion dollar wage theft citation against a California franchise operation should put fast-food businesses and other franchise models on notice that your business model could be the next target. The California Labor Commissioner's Office's Bureau of Field Enforcement recently took aim at businesses that don't organize as large employers but instead operate their locations as separate legal entities and thus avoided paying workers a higher minimum wage. What do you need to know about this recent activity and what can you do to minimize your legal risk?

**The Backstory**

Until recently, California law required larger employers (employers with 26 or more employees) to pay a higher minimum wage hourly rate than small employers (employers with 25 or fewer employees). For example, in 2022, small employers were required to pay a minimum wage of $14/hour to their employees, whereas large employers were required to pay a minimum wage of $15/hour.

Why does this matter to employers who own and operate a franchise business? For ease of operations, an employer who owns and operates franchise businesses usually creates a single entity for each individual franchise purchased. The employer then calculates the minimum wage rate using the number of employees hired by each entity, even if the employer's total number of employees across their multiple entities exceeded 25.

Typically, this practice was thought to comply with California labor law. However, a recent multimillion dollar citation demonstrates that the Labor Commissioner's Office now thinks differently.

**$3 Million Citation Shows State Means Business**

The Labor Commissioner's Office just fined a franchised fast-food business more than $3 million for paying employees the small-employer minimum wage rate, when the state says it was supposed to pay the large-employer minimum wage rate. The employer in question owned multiple franchises of a single concept and operated each separate franchised location as a separate legal entity. In doing so, it kept the total number of employees employed on paper by each legal entity under 25 – which entitled the employer to pay all of its employees at the lower minimum wage even though the

entitled the employer to pay all of its employees at the lower minimum wage even though the employer had well over 25 employees across all locations. The employer thought it was playing within the rules – but the Labor Commissioner's Office unfortunately thought differently.

What was the evidence supporting this finding? When staffing levels were low at one location, the state says the employer would "borrow" employees from another location, even though the other locations were separate and distinct legal entities. Unfortunately for the employer, the Labor Commissioner's Office determined that this practice blurred – and in fact eliminated – the separation created by operating the various locations as separate legal entities.

As a result, the Labor Commissioner's Office held that the employer should have used the minimum wage rate should have been calculated using the total number of employees hired by the employer across all its business locations, regardless of the number of employees hired by each single entity. As such, it levied a massive fine against the employer, despite the employer's good faith attempt at complying with the law.

**What Should You Do?**

While it is true that all employers regardless of size must now pay their employees a minimum of $15.50/hour as of January 1, 2023, the Labor Commissioner's Office's actions here show that it is willing to enforce minimum wage violations that go back several years.

If you're having trouble figuring out whether your minimum wage practices are currently compliant with California law or that your pre-2023 activity might be susceptible to legal challenge, you should contact your wage and hour counsel to assess the situation and help determine your options.

Please contact your Fisher Phillips attorney, the author of this Insight, or any attorney in one of our six California offices for more information. Make sure you are subscribed to Fisher Phillips' Insight System to get the most up-to-date information on this and other employment topics directly to your inbox.

## *Related People*

**Benjamin M. Ebbink**
Partner
916.210.0400
Email

**Alden J. Parker**
Regional Managing Partner
916.210.0404
Email

**Zachary Princi**
Associate
949.798.2172
Email

**Tyler Woods**
Partner
949.798.2117
Email

## *Service Focus*

Wage and Hour

## *Industry Focus*

Hospitality