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Commonwealth of Kentucky

Court of Appeals

NO. 2010-CA-000283-WC

UNINSURED EMPLOYERS' FUND — APPELLANT

v.

PETITION FOR REVIEW OF A DECISION OF THE WORKERS' COMPENSATION BOARD ACTION NO. WC-00-00924

TONDA MICHELLE BROWN; WATASH, UBC (DBA SUBWAY); DOCTORS' ASSOCIATES, INC.; HON. JOHN B. COLEMAN, ADMINISTRATIVE LAW JUDGE; AND WORKERS' COMPENSATION BOARD — APPELLEES

OPINION
REVERSING AND REMANDING

** ** ** ** **

BEFORE: MOORE AND THOMPSON, JUDGES; WHITE,[1] SENIOR JUDGE.

[1] Senior Judge Edwin M. White sitting as Special Judge by assignment of the Chief Justice pursuant to Section 110(5)(b) of the Kentucky Constitution and Kentucky Revised Statute(s) (KRS) 21.580.

MOORE, JUDGE: The Uninsured Employers' Fund appeals from an opinion and order of an Administrative Law Judge (ALJ), and the affirming opinion of the Board of Workers' Claims. In their respective opinions, the ALJ and Board each found that Doctors' Associates, Inc. (DAI), is not liable to provide benefits, pursuant to KRS 342.610(2)(b), to Tonda Michelle Brown, because DAI is a franchisor, and Brown was an employee of DAI's franchisee, Watash, UBC. After a careful review of the record, we reverse and remand for further findings not inconsistent with this opinion.

Tonda Michelle Brown sustained work-related injuries on May 17, 2000, while working at a Subway sandwich shop owned and operated by Watash, UBC. At the time, Watash carried no workers' compensation insurance. Accordingly, Brown's medical expenses and temporary total disability benefits, as well as a full and final settlement amount, were paid by the Uninsured Employers Fund. As part of that settlement, however, the Fund reserved the right to seek indemnity from DAI, the franchisor of the Subway sandwich shop chain, provided it was found to qualify as an up-the-ladder employer of Brown pursuant to KRS 342.610(2)(b). Accordingly, DAI was joined as a party-defendant to the proceedings.

Many of the details of the nature of DAI's business and its relationship with Watash were the subject of discovery. The franchise agreement between DAI and Watash recites that DAI "is the owner of proprietary and other rights and interests in various service marks, trademarks, trade names, and

goodwill used in its business including the trade name and service mark "SUBWAY."[2] However, it describes the nature of its business in Part "B" of the "RECITALS" section of the agreement as follows: "The Company [DAI] operates, and franchises others to operate sandwich shops under the trade name and service mark SUBWAY using certain recipes, formulas, food preparation procedures, business methods, business forms and business policies it has developed." Furthermore, it defines its "franchisees" as "independent contractors."[3] In total, there are approximately 14,800 Subway sandwich shops throughout the United States; DAI owns and operates two of these. One store is located in Milford, Connecticut, where DAI is headquartered; DAI considers it a "test store" and constructed it for the purpose of testing new products, decor, signage and concepts. The second store is located in Lakehurst, New Jersey. Pursuant to a contract with the United States Navy, DAI was obligated to keep this store open after a franchisee abandoned the location.

The franchise agreement referenced above gave William Ihrig the right to operate a Subway sandwich shop in Whitesburg, Kentucky. Ihrig organized Watash, UBC, and assigned Watash his rights under this agreement. As Ihrig's assignee, Watash's obligations under that agreement included, but were not limited to: 1) constructing, equipping, and operating the sandwich shop at a

[2] Part "A" of the "RECITALS" section.

[3] Part "10(a)" of the "AGREEMENT" section provides: "The Franchisee is, and shall be identified at all times during the term of this Agreement, as a natural person, an independent contractor and not an agent or employee of the Company [DAI]."

location approved of by DAI and in accordance with DAI's operating manual;[4] 2) being open for business within 365 days of the execution of the agreement;[5] 3) "refrain[ing] from conducting any business or selling any products other than those approved by [DAI] at the approved location";[6] 4) maintaining all policies of insurance and naming DAI as an additional insured under those policies; and 5) in the event Watash desired to sell its sandwich shop, offering to sell the sandwich shop to DAI first, *e.g.*, giving DAI a right of first refusal.[7]

Additionally, DAI retained the right to inspect the sandwich shop on a monthly basis to ensure that Watash met the standards set forth in the agreement. Watash agreed to pay 8% of its gross income generated by the operation of the Subway sandwich shop to DAI. Also, if Watash materially breached the agreement with DAI, the agreement entitled DAI to evict Watash from the

[4] Part "5(a)" of the "AGREEMENT" section provides that "[Watash] will then construct and equip [its] sandwich shop in accordance with [DAI] specifications contained in the Operating Manual." Part "5(b)" of the "AGREEMENT" section provides that "[Watash] shall operate [its] store in accordance with [DAI]'s Operating Manual which may be updated from time to time as a result of experience, changes in the law or changes in the marketplace. [Watash] agrees to conform to such changes, and to make all reasonable expenditures necessitated within the time periods reasonably established by [DAI]."

[5] Part "5(a)" of the "AGREEMENT" section.

[6] Part "5(b)" of the "AGREEMENT" section.

[7] Part "9(a)(1)" of the "AGREEMENT" section provides that "The Franchisee may sell his franchise and sandwich shop to a natural person (not a corporation), provided [t]he Franchisee first offers, in writing, to sell his franchised sandwich shop to the Company on the same terms and conditions as offered by a bona fide third party offeror and the Company fails to accept such offer for a period of thirty (30) days.

premises of the Subway sandwich shop[8] and also provided that the right to operate a Subway sandwich shop on those premises would, in that event, revert to DAI.[9]

On July 2, 2009, the ALJ considered the relationship between DAI and Watash and held that KRS 342.610(2)(b) could not impute liability upon DAI. In relevant part, the ALJ reasoned:

> Generally speaking, a franchise will give the right to a private person or corporation to market another's product or to use another's name brand. In this instance, the franchise agreement gave Watash the right to operate a Subway shop in Whitesburg Kentucky for a price. If the relationship had been that of subcontractor and contractor, one would think Doctors would be paying Watash to operate the shop. Instead, it was Watash, who was paying Doctors for the right to operate the shop. While the argument of the UEF does point to some rights retained by the franchisor, such as the right to be named as an additional insured and be given notice of cancellation policies, this is clearly a much different arrangement than that which is contemplated in K.R.S. 342.610. If the Legislature had intended for K.R.S. 342.610 to encompass the relationship between a franchisor and a franchisee, it would have been very easy to include such language in the statute. Therefore, the Administrative Law Judge finds the defendant, Doctors Associates Inc., to have no responsibility or liability under K.R.S. 342.610 in this particular claim.

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[8] Part "5(a)" of the "AGREEMENT" section provides that "the Company [DAI] or one of its designees will lease the premises and sublet them to the Franchisee at cost." Part "6" of the "AGREEMENT" section provides: "If this Agreement is materially breached by the Franchisee, the Company or its designee may cancel the Sublease with the Franchisee upon such notice as is required in the Sublease."

[9] Under part "3(c)" of the "AGREEMENT" section, a franchisee is given "a limited license to use of the Company's rights in and to its service marks and trademarks in connection with the operation of one sandwich shop to be located at a site approved by the Company and the Franchisee." Part "10(b)" of that same section then provides that "if the Franchisee, for any reason, abandons, surrenders, or suffers revocation of all or any part of his rights and privileges under this Agreement, all such rights shall revert to the Company [DAI]."

In short, the ALJ reasoned that 1) all relationships involving commercial franchisors and franchisees fall outside the scope of Kentucky's Workers' Compensation Act; and 2) Watash was paying DAI to operate the Subway sandwich shop and, therefore, could not be considered DAI's subcontractor.

The Fund appealed to the Board of Workers' Claims, which affirmed the ALJ's decision and the bases of that decision. The Board elaborated upon the ALJ's opinion by stating:

> DAI clearly is in the business of developing franchises for the purpose of securing royalties rather than actually operating sandwich shops. It is more of a service provider to restaurants and cannot be viewed as being primarily or even significantly in the business of making and selling sandwiches.

The Board also added that the relationship between DAI and Watash fell outside the scope of the Act because DAI did not control the day-to-day activities of Watash, and because Watash could "certainly have sandwich shops without the Subway name."

The fund now appeals the respective orders of the ALJ and the Board.

STANDARD OF LAW

In general, the duty of this Court is to correct the Board only where it has overlooked or misconstrued controlling statutes or precedent, or committed an error in assessing the evidence so flagrant as to cause gross injustice. *Western Baptist Hospital v. Kelly*, 827 S.W.2d 685, 687-688 (Ky.1992); *Whittaker v.*

Rowland, 998 S.W.2d 479, 482 (Ky.1999). It has long been settled in this Commonwealth that "judicial review of administrative action is concerned with the question of arbitrariness. . . . Unless action taken by an administrative agency is supported by substantial evidence it is arbitrary." *American Beauty Homes Corp. v. Louisville and Jefferson County Planning and Zoning Commission*, 379 S.W.2d 450, 456 (Ky. 1964). Substantial evidence is defined as "that which, when taken alone or in light of all the evidence, has sufficient probative value to induce conviction in the mind of a reasonable person." *Bowling v. Natural Resources and Environmental Protection Cabinet*, 891 S.W.2d 406, 409 (Ky. App. 1994); *see also Kentucky State Racing Commission v. Fuller*, 481 S.W.2d 298 (Ky. 1972).

Once a reviewing court has determined that the agency's decision is supported by substantial evidence, the court must then determine whether the correct rule of law was applied to those facts by the agency in making its determination. If so, the final order of the agency must be upheld. *Bowling*, 891 S.W.2d at 410.

ANALYSIS

The question presented in this case is whether the ALJ correctly determined that DAI is not responsible, as a matter of law, for providing workers' compensation benefits to an employee of Watash, pursuant to KRS 342.610(2)(b).

To begin, KRS 342.610 makes "[e]very employer subject to this chapter . . . liable for compensation for injury . . . without regard to fault as a cause of the injury." KRS 342.610(1). The statute also makes "[a] contractor who

subcontracts all or any part of a contract . . . liable for the payment of compensation to the employees of the subcontractor unless the subcontractor primarily liable for the payment of such compensation has secured the payment of compensation as provided for in this chapter." KRS 342.610(2). "A person who contracts with another . . . [t]o have work performed of a kind which is a regular or recurrent part of the work of the trade, business, occupation, or profession of such person shall for the purposes of this section be deemed a contractor, and such other person a subcontractor." *Id*. The purpose of this statute is "to discourage a contractor from subcontracting work that is a regular or recurrent part of its business to an irresponsible subcontractor in an attempt to avoid the expense of workers' compensation benefits." *Gen. Elec. Co. v. Cain*, 236 S.W.3d 579, 585 (Ky. 2007).

As noted above, the ALJ concluded that KRS 342.610 could not impose liability for workers' compensation benefits upon DAI for Watash's injured employee because, as it reasoned: 1) DAI is a "commercial franchisor" and because no language contained in KRS 342.610 specifically refers to the relationship between a commercial franchisor and its franchisees, the General Assembly could not have intended KRS 342.610 to apply to any commercial franchise relationship; and 2) a contractor-subcontractor relationship only exists under the statute where the contractor pays the subcontractor to perform work, and because Watash was paying DAI, Watash could not be DAI's subcontractor.[10]

[10] In its separate opinion, the Board agreed with the ALJ's conclusions and also found that Watash could not be DAI's subcontractor under KRS 342.610(2)(b) because "the record

However, under a proper analysis of KRS 342.610, neither reason is relevant to a determination of whether a person is a contractor.

Regarding the ALJ's first reason for finding in favor of DAI, it is true that KRS 342.610 does not include language encompassing the relationship between a commercial franchisor and its franchisee. However, it is equally true

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contained evidence that DAI did not control the day to day activities of its franchisees," and because Watash, as the owner of a Subway sandwich shop, could "certainly have sandwich shops without the Subway name."

Regarding its first reason, the right to control details of the work performed is the key consideration in determining whether one is an employee or independent contractor. *Ratliff v. Redmon*, 396 S.W.2d 320, 327 (Ky. 1965). Here, however, the issue is not whether Watash or Brown were DAI's employees; rather, the issue is only whether the relationship between Watash and DAI fits the specific criteria of KRS 342.610(2)(b). That statute contains no requirement of "control" and, in considering "control" as a factor in an analysis under that statute, the Board added language to the statute and erred as a matter of law. *See Commonwealth v. Harrelson*, 14 S.W.3d 541, 546 (Ky. 2000) ("Where a statute is intelligible on its face, the courts are not at liberty to supply words or insert something or make additions which amount, as sometimes stated, to providing for a *casus omissus*, or cure an omission.")

It was also both legally and factually incorrect for the Board to conclude that Watash could not be considered a subcontractor under KRS 342.610(2)(b) because Watash could "certainly have sandwich shops without the Subway name."

This statement is legally incorrect because nothing in KRS 342.610(2)(b) requires a subcontractor under that statute to have an exclusive contract with the contractor. The only relevant inquiry under that statute is whether a person is contracting with another "[t]o have work performed of a kind which is a regular or recurrent part of the work of the trade, business, occupation, or profession of such person."

Furthermore, this statement is factually incorrect because the terms of the agreement between DAI and Watash forbade Watash from having any other sandwich shops without the Subway name. Under section "5" of the "AGREEMENT" heading, parts "b" and "d," the franchise agreement between DAI and Watash provides:

> b. The Franchisee shall refrain from conducting any business or selling any products other than those approved by the Company [DAI] at the approved location.
>
> . . . .
>
> d. [The Franchisee shall] refrain from engaging in any other business, directly or indirectly, during the term of this Agreement, identical with or similar to the business reasonably contemplated by this Agreement at any place except as a duly licensed franchisee of Doctor's Associates, Inc.

that no Kentucky statute, including KRS 342 *et seq*., actually defines what a commercial franchise is. For that matter, the ALJ and Board failed to cite any authority defining this phrase in their respective opinions, and neither the Fund nor DAI makes any attempt to define it in their briefs. In that light, we must first define what a commercial franchise is under Kentucky law, and then consider whether the relationship between DAI and Watash, if it qualifies as a "commercial franchise" relationship, requires us to exempt it from the meaning of the term "subcontractor" as defined in KRS 342.610(2)(b).

Initially, we note that the closest and most comparable definition of the term "commercial franchise," and closest explanation of what its legal effect in Kentucky is, is found in KRS 367.801 through KRS 367.819, *i.e.*, "The Business Opportunity Act." KRS 367.801(5) defines the term "business opportunity" as follows:

> "Business opportunity" means the sale or lease, or offer to sell or lease, of any products, equipment, supplies, or services for the purpose of enabling the consumer investor to start a business when:
>
> (a) The offeror obtains an initial required consideration of not less than five hundred dollars ($500) from the purchase or lease of the business opportunity or inventory associated therewith; and
>
> (b) The offeror has represented, directly or indirectly, that the consumer/investor will earn, can earn, or is likely to earn a gross or net profit in excess of the initial required investment paid by the consumer/investor for the business opportunity; or

> (c) 1. The offeror has represented that he has knowledge of the relevant market and that the market demand will enable the consumer/investor to earn a profit from the business opportunity; or
>
> 2. The offeror has represented that locations will be provided or assistance will be given directly or indirectly to the consumer/investor in finding locations for the use or operation of the business opportunity including, but not limited to, supplying the consumer/investor with names of locator companies, contracting with the consumer/investor to provide assistance with or supply names of or collect a fee on behalf of or for a locator company; or
>
> 3. The offeror has represented that there is a guaranteed market or that the offeror will buy back or is likely to buy back any product made, manufactured, produced, fabricated, grown, or bred by the consumer/investor using, in whole or in part, the products, supplies, equipment, or services which were initially sold or offered for sale to the consumer/investor by the offeror.

Additionally, KRS 367.807(1)(a) exempts an offeror of a "business opportunity" from the provisions of KRS 367.801 to 367.819 if the offeror meets the definition of a "franchise" as set forth in 16 Code of Federal Regulations (C.F.R.) section 436 *et seq*.[11] Thus, the General Assembly has associated the term

[11] 16 CFR section 436.1(h) defines "franchise" for purposes of federal regulations concerning the sale of franchises:

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

"business opportunity" with the federal definition of a "franchise," and has recognized that the two terms may overlap. Furthermore, the General Assembly has recognized that, at least for purposes of regulating the sale of a business opportunity (which may in turn qualify as a "franchise" under the federal definition), the relationship between the offeror and consumer/investor of a business opportunity is a specific type of contractual relationship in which the consumer/investor is required to give the offeror consideration in return for products, equipment, supplies, or services, or a lease of products, equipment, supplies, or services, for the purpose of enabling the consumer/investor to start a business. KRS 367.801(5).

KRS chapter 367 does not, however, provide any guidance concerning the nature of the ongoing relationship between the offeror and consumer/investor of a business opportunity that results *after* the sale of the business opportunity. Nor are there any other relevant Kentucky statutes that specifically define the nature of the ongoing relationship between that offeror and consumer/investor or otherwise inform the question whether this relationship and a relationship subject to the purview of KRS 342.610(2)(b) are necessarily mutually exclusive. For that

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> (2) The franchisor will exert or has authority to exert a significant degree of control over the franchisee's method of operation, or provide significant assistance in the franchisee's method of operation; and
>
> (3) As a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate.

reason, KRS chapter 367 does not inform the question of whether the relationship between DAI and Watash could also constitute a contractor-subcontractor relationship pursuant to KRS 342.610(2)(b).

Furthermore, there is no caselaw from Kentucky to the effect that a franchisor is always or even presumptively exempt from providing workers' compensation benefits for the employees of its franchisees, in the event that its franchisees fail to do so. And, in jurisdictions outside of Kentucky, courts have resolved whether franchisors are liable for workers' compensation benefits, albeit under varying theories, based upon the specific facts of those cases, rather than by resorting to general rules of exemption.[12]

This Court recognizes the similarities and overlap between the General Assembly's definition of "business opportunities" and the Federal definition of "franchises." We also appreciate that franchises are unique business arrangements that can differ in many important aspects from a traditional

[12] *See Maryland Cas. Co. v. Department of Industry, Labor and Human Relations*, 77 Wis.2d 472, 253 N.W.2d 228 (Wis. 1977) (franchisor held liable to pay workers' compensation benefits to employee of franchisee pursuant to WIS. STAT. § 102.06 (1975). That statute holds an employer "liable for compensation to an employee of a contractor or subcontractor under him" that has failed to provide workers' compensation benefits to its own employees. The Supreme Court of Wisconsin held that because the franchisee provided "services which are integrally related to the finished product or service provided by" the franchisor, the franchisor was liable to pay benefits to the franchisee's employee pursuant to that statute. *Id*. at 479.); *see also Domino's Pizza, Inc. v. Casey*, 611 So.2d 377 (Ala. Ct. App. 1992) (holding franchisor, along with franchisee, liable to pay workers' compensation benefits to employee of franchisee after finding, based upon the circumstances, that franchisor and franchisee were joint employers.); *see also McMillan ex rel. Estate of McMillan v. College Pro Painters (U.S.) LTD*, 350 F.Supp.2d 132 (D. Me. 2004) (holding that the issue of whether an employer-employee relationship existed between a franchisor of a house painting business and a worker with respect to a painting project during which the worker was killed involved a fact question that could not be resolved on motion to dismiss a wrongful death action against the franchisor on the ground that it was barred by Maine's Workers' Compensation Act.)

employment relationship. *See* Dean T. Fournaris, *The Inadvertent Employer: Legal and Business Risks of Employment Determinations to Franchise Systems*, 27 SPG Franchise L.J. 224, 230 (2008) ("Franchising is a unique type of business arrangement. As such, a natural tension exists between the types of franchisor controls that are inherent in franchising and the types of control over day-to-day tasks that courts and regulators traditionally evaluate to determine whether an employment relationship exists.").

That said, we are not persuaded that "business opportunity" relationships, or "franchise" relationships, are *per se* exempt from the purview of KRS 342.610(2)(b), and we find error in that part of the ALJ's order holding that "franchisors" are exempt from liability under the Act. The question of whether a particular business opportunity or franchise relationship satisfies KRS 342.610(2)(b) must be answered on a case-by-case basis, by examining the specific relationship between the alleged contractor and subcontractor and determining whether, pursuant to that statute, the alleged subcontractor has performed work "of a kind which is a regular or recurrent part of the work of the trade, business, occupation, or profession of [the contractor]."

The ALJ's second basis for finding in favor of DAI was its assumption that the only means by which a contractor may remunerate a subcontractor for work is by directly paying the subcontractor for that work. The ALJ reasoned that, because Watash was paying royalties and licensing fees to DAI, Watash was not remunerated by DAI and, therefore, was not performing work for

DAI. In sum, the ALJ held that the flow of money between DAI and Watash conclusively demonstrated that DAI and Watash were merely parties to a simple purchase agreement. We disagree.

To begin, the Act does not define the term "remuneration." Nor, for that matter, does the Act specify how a person must remunerate another for work performed, whether that remuneration may be given indirectly or by another entity, or whether that remuneration may consist of a right and obligation, given to one party, to perform a service that is, in and of itself, beneficial to both parties.

However, the definition of "work," under the Act, contains the word "remuneration."[13] And, in a situation that appears to be analogous to the one at bar, this Court determined that a contractor-subcontractor relationship did exist, *i.e.*, that a subcontractor was performing work for a contractor, under the purview of KRS 342.610. In *R.O. Giles Enterprises, Inc. v. Mills*, 275 S.W.3d 211 (Ky. App. 2008), a logging company paid a landowner for the right to remove timber from the landowner's property and subsequently paid that landowner "35 percent on all saw logs and peelers and $5.00 per ton on soft chip and $3.00 per ton on all hardwood chip." *Id*. at 212. An employee of the logging company was killed while removing this timber; upon discovering that the logging company carried no workers' compensation insurance, his estate sought benefits from the landowner instead, pursuant to KRS 342.610(2)(a). The landowner argued that the timber was removed pursuant to a simple agreement for the sale of timber, and not for work or

[13] KRS 342.0011(34) provides that "work" means "providing services to another in return for remuneration on a regular and sustained basis in a competitive economy."

services performed on behalf of the landowner. In support, the landowner cited to the fact that it was being paid by the logging company, and not vice-versa. *Id*. at 214.

Nevertheless, this Court disregarded the label these parties gave to their arrangement (*i.e.*, a "purchase agreement"), the method of how payment was made for the removal of the timber, and the issue of who was paying whom. Instead, we resorted to the plain language of KRS 342.610(2)(a), which holds liable for benefits a person who contracts with another "[t]o have work performed." On that basis, we held that the logging company was performing work for the corporate landowner because the landowner's ultimate reason for removing timber from its land was to advance the removal of the coal underneath that timber; the corporate landowner had made a commercial decision to lease its land for the removal of coal through the mountaintop removal method, and it was necessary to first remove the timber from the land in order to facilitate that operation. In that light, this Court held that the logging company fit the definition of a "subcontractor," as defined under KRS 342.610(2)(a), and that the corporate landowner was liable to pay benefits to the logging company's employee as a consequence.

Here, the arrangement between Watash and DAI, and the facts of this case, share a number of similarities with *R.O. Giles*. Watash paid DAI for the right to operate a Subway sandwich shop and sell subway sandwiches, and paid DAI 8% of its gross revenues from the endeavor. An employee of Watash was injured

while operating the Subway sandwich shop. Upon discovering that Watash carried no workers' compensation insurance, and after paying benefits and a settlement to that employee, the Fund sought indemnity from the franchisor, DAI, pursuant to KRS 342.610(2)(b). DAI argues that, when Watash operated a Subway sandwich shop, Watash was not working for or performing services on behalf of DAI, and was merely doing so pursuant to a simple sale of a license. In support, DAI cites to the fact that it was being paid by Watash, and not vice-versa.

However, *R.O. Giles* demonstrates that a party cannot exempt itself from the status of a contractor, per KRS 342.610(2), merely by labeling its arrangement with a subcontractor a "purchase agreement" and citing to the fact that the alleged subcontractor appears to have paid the alleged contractor. *R.O. Giles* also reemphasizes that the label that one party attaches to an arrangement, *i.e.*, a purchase agreement, is entitled to no deference from the Court and is not dispositive to whether that arrangement qualifies that party as a contractor under the statute. Rather, legal fictions must be disregarded and the situation must be viewed "realistically" in light of the business being conducted and the services rendered. *See Commonwealth v. Potts*, 295 Ky. 724, 175 S.W.2d 515, 516 (1943); *see also Brewer v. Millich*, 276 S.W.2d 12, 16 (Ky. 1955) ("Courts look behind the legal terminology to discover and expose the real relationship between the parties as regards the question of the failure to obtain compensation coverage.")

For that reason, the fact that Watash paid fees and royalties to DAI for the right to operate a Subway sandwich shop is not dispositive of, nor should it

conclusively resolve, whether Watash was performing work as DAI's subcontractor under the purview of KRS 342.610(2)(b). Rather, the resolution of this question requires the finder of fact to put aside that Watash purchased a "franchise" from DAI, and to instead look to the nature of the lasting relationship that was created between DAI and Watash *thereafter*. If DAI essentially contracted with Watash to perform a function that is a regular and recurrent part of DAI's business, then the arrangement between Watash and DAI, being identical to the arrangement described in *R.O. Giles*, constitutes remuneration within the meaning of the Act. Thus, if selling Subway sandwiches to the public is a regular and recurrent part of DAI's business, then Watash was unquestionably performing work that DAI otherwise would have had to perform for itself and with its own employees, and Watash would fit the definition of a "subcontractor," as defined under KRS 342.610(2)(b).

In *Cain*, 236 S.W.3d at 588, the Supreme Court of Kentucky determined the proper analysis KRS 342.610(2)(b) requires to answer what is a "regular and recurrent part of the work of the trade, business, occupation, or profession" of a contractor:

> Work of a kind that is a "regular or recurrent part of the work of the trade, business, occupation, or profession" of an owner does not mean work that is beneficial or incidental to the owner's business or that is necessary to enable the owner to continue in the business, improve or expand its business, or remain or become more competitive in the market. It is work that is customary, usual, or normal to the particular business (including work assumed by contract or required by law) or work

> that the business repeats with some degree of regularity, and it is of a kind that the business or similar businesses would normally perform or be expected to perform with employees.

Cain also cautions that "[t]he test is relative, not absolute," and advised that factors relevant to making the determination include the contracting business's "nature, size, and scope as well as whether it is equipped with the skilled manpower and tools to handle the task the independent contractor is hired to perform." *Id*. (internal citations omitted.) Additionally, even if an alleged contractor may never perform the job the subcontractor is hired to do with its own employees, it is still a contractor under KRS 342.610(2)(b) if the job is one that is usually a regular or recurrent part of its trade or occupation. *See Fireman's Fund Ins. Co. v. Sherman & Fletcher*, 705 S.W.2d 459, 462 (Ky. 1986).

If the ALJ believes that the relationship between DAI and Watash does not fall under the purview of KRS 342.610(2)(b), he is required, at a minimum, to clearly set forth facts in support of this ultimate conclusion. *Shields v. Pittsburgh and Midway Coal Min. Co.*, 634 S.W.2d 440, 444 (Ky. App. 1982). As it stands, however, the ALJ's July 2, 2009 order holding DAI exempt from the purview of KRS 342.610(2)(b) fails to make any of the findings of fact that would support such a conclusion, as mandated in *Cain*. Instead, the ALJ's order relied exclusively upon its reasoning that all franchise relationships are exempt from the Workers' Compensation Act, and that the payment arrangement described between DAI and Watash conclusively exempted the arrangement between DAI and

Watash from the Act as nothing more than a simple purchase agreement. But, we have found the ALJ's reasoning to be in error.

The ALJ is the finder of fact in workers' compensation matters. *Ira A. Watson Dept. Store v. Hamilton*, 34 S.W.3d 48, 52 (Ky. 2000). As such, we reverse the respective decisions of the Board and ALJ and remand this matter to allow the ALJ to: 1) take additional proof regarding the nature of DAI's business and whether the work that Watash performed was a regular or recurrent part of its business under KRS 342.610(2)(b); and 2) make additional findings of fact, based upon substantial evidence of record, supporting the legal conclusion that KRS 342.610(2)(b) either does or does not apply in this instance, and to make any other findings not inconsistent with this opinion.

WHITE, SENIOR JUDGE, CONCURS.

THOMPSON, JUDGE, CONCURS AND FILES SEPARATE OPINION.

THOMPSON, JUDGE, CONCURRING: I concur with the well-written opinion by the majority because its limited directions are to remand for further findings of fact in support of the ALJ's opinion. In determining his findings of fact, the ALJ may want to conduct an analysis pursuant to the law in *Papa John's Intern., Inc. v. McCoy*, 244 S.W.3d 44 (Ky. 2008). The key to that analysis is the control over the franchisee which would lead to a finding of vicarious liability for the acts of the franchisee.

Further, the ALJ may wish to conduct an analysis as to whether the franchisor failed to enforce the requirements of the franchise agreement which imposed upon the franchisee the duty to maintain adequate insurance and to list the franchisor as an additional insured.

By designation of the franchisor as an additional insured under the insurance policy, the franchisor was guaranteed to receive copies of all notices of cancellation, non-renewal, coverage reduction or elimination before the effective date of the cancellation, non-renewal or coverage change. A question would revolve around whether the franchisor properly conducted an audit of the insurance of the franchisee after the imposition of this duty.

The Restatement of Agency § 219 discusses when the franchisee purports to act or speak on behalf of the franchisor and whether there is reliance upon the apparent authority of the franchisor.

I conclude with the fact that I agree with the ALJ that, generally, franchisors will not be liable for the failure of a franchisee to carry proper insurance. However, I agree with the majority that there must be a case-by-case analysis based upon specific facts and, therefore, further findings are necessary.

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