FRANCHISOR LIABILITY FOR FRANCHISEE ACTIONS

Author

Sara Turner

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Coauthored by Stuart M. Kreindler, 301.585.1266, stuart_kreindler@choicehotels.com

Stuart Kreindler is Senior Counsel, Litigation and Risk Management for Choice Hotels International, Inc. Choice is a publicly traded corporation on the NYSE that franchises hotels around the world under the brand names Comfort Inn®, Comfort Suites®, Quality®, Clarion®, Sleep Inn®, Econo Lodge®, Rodeway Inn®, MainStay Suites®, Suburban Extended Stay Hotel®, Cambria Suites® and Ascend Collection®.

Introduction

In general, actors are not legally responsible for the torts of others. However, in certain situations, an argument can be made that one party exerted sufficient control over another party to incur liability for the second party's actions. In the context of franchisor/franchisee relationships, plaintiffs often attempt to rely on the theory of agency and, in federal employment cases, the single employer theory to attempt to impute vicarious liability to the franchisor.

Courts have typically taken two paths in cases where franchisors have been found liable under an agency theory. First, courts have held that, in certain circumstances, a franchisor can create an actual agency relationship with its franchisee by exerting day-to-day control over the franchisee. The level of operational integration necessary to constitute control of day-to-day operations varies by jurisdiction. However, courts have generally refused to assign liability where the franchisor exerts control solely to protect trademarks or to protect the quality and uniformity of its product.

Second, some courts have held that franchisors can create an apparent agency relationship with a franchisee. Under this theory, if a plaintiff reasonably and justifiably believes the franchisor controls the operation of the business and relies on that belief to his detriment, the franchisor can be held liable for actions of the franchisee. To prevail, a plaintiff must establish that he selected the franchisee's business because of the reputation or expectation of quality of the franchisor.

In addition to agency theory, federal courts in Title VII discrimination and harassment cases have found franchisors vicariously liable through the single employer theory. When a franchisor closely controls the employment decisions of the franchisee, some courts have considered the franchisor and the franchisee to be co-employers. As a co-employer, the franchisor may become liable for the acts of the franchisee's employees.

Agency Theory

The most common method plaintiffs use to attempt to impute vicarious liability on franchisors is agency theory. Agency theory has two branches. The first is actual agency. Under actual agency theory, the principal (the franchisor) is alleged to have exerted enough control over the agent (the franchisee) that the law presumes the agent is acting on behalf of the principal. Traditionally, a franchisor in an actual agency relationship would be liable for all the actions of the franchisee by virtue of the agency relationship alone.
The central question in determining actual agency is the level of control the franchisor exerts over the franchisee. Courts in most jurisdictions employ the "day-to-day operations" test when examining the franchisor's level of control. Under this test, plaintiffs will need to prove that the franchisor's control is extensive enough to regulate the day-to-day operations of the franchisee in order to show that an actual agency relationship exists.

The second branch of agency theory is apparent agency. Instead of examining actual control, apparent agency inquiries seek to determine whether a plaintiff reasonably believes the franchisor controlled the franchisee. If the plaintiff relied on such a reasonable belief to his or her detriment, a plaintiff may allege that apparent agency exists.

**Actual Agency**

For a franchisor to be liable for the torts of its franchisee under actual agency theory, a plaintiff must prove that the franchisor controlled the franchisee's day-to-day operations. The unique nature of the franchise relationship has led courts to construe day-to-day control over a franchisee narrowly. Efforts by a franchisor to protect a trademark do not create an agency relationship, nor do policies and procedures designed to maintain the quality and uniformity of products or experiences. When courts have found agency by actual authority, franchisors have mandated, in detail, the specifics of their franchisees' business operations. Moreover, some courts have narrowed the actual authority test by limiting franchisor liability only to situations where the franchisor had control over the instrumentality of the tort.

In general, efforts to maintain trademarks and ensure product uniformity do not create an agency relationship. The Lanham Act requires that franchisors control their trademarks, and courts have provided leeway to do so without incurring liability. These requirements generally do not exhibit control of the operations of the franchisee sufficient to create agency liability and courts typically dismiss hotel franchisors on summary judgment when this level of control is exhibited. For example, in *Theos & Sons, Inc. v. Mack Trucks, Inc.*, Mack Trucks' insistence that its dealers use only parts supplied by it or a company it recommended did not demonstrate control, but rather reflected "the ordinary desire of manufacturers to set sufficient minimum performance and quality standards to protect the good name of [its] trademark that [it is] allowing another to display." In addition, requiring franchisees to display the franchisor's logo does not create an agency relationship. Franchisors may also specify building design and demand that the franchisee utilize only branded employee uniforms and packaging supplies.

A franchisor can also issue and enforce guidelines to control the quality and uniformity of its products without incurring agency liability—so long as the franchisee maintains sufficient authority to implement those standards. For instance, issuing an operation manual does not, in and of itself, create an agency relationship if the purpose of the manual is to ensure quality standards. Operation manuals with detailed requirements should take care not to specify exactly how a franchisee implements those requirements. In addition, franchisors may reserve the right to inspect the franchisee's operations for compliance with brand standards and may retain the authority to revoke the franchise for failure to comply. A franchisor's reservation of the right to inspect, monitor or evaluate the franchisee's compliance with its standards and to terminate the franchise for noncompliance has not been held to be the equivalent of retaining day-to-day supervisory control of the franchisee's business operations as a matter of law.

Some courts have found, however, that in certain instances a franchisor's actions can extend beyond protecting its product to influencing the day-to-day operations of the franchisee's business. This line can be uncertain, and facts that fail to create an agency relationship in one jurisdiction may provide a jury question in another. The result tends to turn on the detail of the mandatory requirements the franchisor places on the franchisee. As one court explained, the narrow line between non-agency and agency is "the distinction between recommendations and requirements."

Discussing two cases in which franchisors incurred liability will provide clarity. In a case involving Hilton Hotels, the court determined that the franchisor controlled the daily operation of its franchisees by specifying minute details in an operation manual:
[The manual regulates] identification, advertising, front office procedures, cleaning and inspection service for guest rooms and public areas, minimum guest room standards, food purchasing and preparation standards, requirements for minimum supplies of "brand name" goods, staff procedures and standards for soliciting and booking group meetings, functions and room reservations, accounting, insurance, engineering and maintenance, and numerous other details of operation.

These details led the court to hold that Hilton determined the exact manner in which the franchisee could conduct business. Likewise, a court held that Domino's Pizza created an agency relationship with its franchisee by publishing an operation manual that was "a veritable bible for overseeing a Domino's operation" and "literally [left] nothing to chance." When examining actual agency in the context of franchises, some courts have narrowed the scope of liability with the instrumentality test. Under this test, a franchisor is only liable for the torts of its franchisee if it exerted control over the area of operations that caused the tort.

Some recent cases illustrate the instrumentality test. In Hong Wu v. Dunkin' Donuts, decided by a federal court under New York law, Dunkin' Donuts was not held liable for a late-night robbery and battery at a franchisee's store. The franchisor did not mandate how the store should be secured, so it had no control over the instrumentality that caused the tort. In Wisconsin, a work release prisoner killed himself and two other people after walking off his job at an Arby's franchise, but the franchisor was not liable for the deaths because its franchise agreement gave sole control of employee supervision to the franchisee. In Kentucky, a businessman sued Papa John's International for defamation after a driver employed by the local franchisee made false accusations. Papa John's was not vicariously liable because the franchisor had no control over how the driver conducted his deliveries.

Apparent Agency

Under the theory of apparent agency, plaintiffs will argue that a franchisor can create an agency relationship even if it does not control the franchisee's day-to-day operations. The test for determining apparent agency requires that the plaintiff show a justifiable belief that the franchisor operates the franchise and a justified detrimental reliance on that belief. The detrimental reliance portion of apparent agency has proven the most difficult element for a plaintiff to establish. When plaintiffs have made successful apparent agency claims, the cases generally turn on the positive reputation of the franchisor.

To establish vicarious liability through apparent agency, a plaintiff must generally demonstrate four elements. Not all courts explicitly recognize each of the four elements, but most analyses of apparent agency follow a similar path. To prove apparent agency, (1) a plaintiff must establish an actual belief that the franchisor controls the operations of the franchised store; (2) the belief must be justified; (3) the plaintiff must rely on that belief to his detriment; and (4) the plaintiff's reliance on that belief must be justified. In short, the elements of apparent agency provide vicarious liability to the franchisor only when a plaintiff justifiably changes his position because of his belief that the franchisor controlled the operation of the franchise.

Even if a plaintiff attempting to show apparent agency reasonably believes that the franchisor operates a franchise, the plaintiff may fail because he can not show that he detrimentally relied on that belief. For example, in Wood v. Shell Oil, the plaintiff claimed an apparent agency relationship between Shell Oil and a local franchise. The Alabama Supreme Court denied that claim, finding "[n]o evidence that [the plaintiff] did business with Parker Shell because of a desire to do business with a more responsible party (i.e., Shell Oil)." Similarly, in Little v. Howard Johnson, a Michigan case, a plaintiff sued Howard Johnson after slipping on ice outside a restaurant located at a franchisee's hotel. The plaintiff could not prove apparent agency because "[n]o evidence was presented which indicated that plaintiff justifiably expected that the walkway would be free of ice and snow because she believed that defendant operated the restaurant."

When a plaintiff successfully raises a question of apparent agency, the case generally involves evidence demonstrating reliance on the franchisor's reputation. In Crinkley v. Holiday Inn, a guest who was robbed
and assaulted during her hotel stay testified that she chose Holiday Inn because she thought it would be a "good place to stay" based on her previous visits to the chain. Her reliance on Holiday Inn's national reputation was enough to send the case to the jury. Likewise in Billops v. Magness Construction Co., discussed previously, a plaintiff chose to hold an event in the ballroom of a Hilton Hotel franchise. In a deposition, the plaintiff stated: "the attitude of the personnel at that point, it so alarmed me that it broke my heart because I put a lot of faith and trust into the Hilton, because it was a major hotel. . . ." In Allen v. Choice Hotels International Inc., a Mississippi Appellate Court found that a lobby plaque identifying the hotel as a franchised location was sufficient to negate any belief by the public that customers were doing business with Choice Hotels and, therefore, refused to find a principal-agent relationship pursuant to apparent agency. In addition, the United States District Court for the District of South Carolina held that "Choice's national advertisements and [the franchisee's] usage of the Comfort Inn® mark and name, when coupled with notice at the registration desk and the elevator that Choice did not run and operate the hotel and did not constitute a representation for purposes of establishing apparent agency."

Apparent agency demands that a plaintiff justifiably believe that the franchisor operates the franchise and that the plaintiff detrimentally relied on that belief. If a customer identifies a franchise only with the franchisor and patronizes that location because of the franchisor's good reputation, a court may find the existence of an apparent agency relationship.

**Single Employer Liability**

Title VII of the Civil Rights Act of 1964 provides protection for employees against discrimination and sexual harassment. Actions under Title VII may include a claim against the franchisor. In Title VII cases, many federal courts use the single employer test. This test was intended to be less stringent than agency theory to allow greater access to Title VII remedies against the franchisor. Under the single employer test, if a parent company controls the "day-to-day employment decisions" of a subsidiary, then some courts have held that the parent and the subsidiary employ workers together. As co-employers, they may share in liability for Title VII violations by employees.

As with the agency test, whether a franchisor becomes liable for federal discrimination and harassment claims depends on the level of control the franchisor exerts over the franchisee. For example, in Alberter v. McDonald's Corp., McDonald's provided employment policies in its business manuals, but these polices were optional. The franchisee made the ultimate decision about employment procedures, so McDonald's was not found liable for Title VII claims. On the other hand, in Miller v. D.F. Zee's, Inc., Denny's Inc. became liable for the sexual harassment claims of its franchisee's employees because the court found that Denny's exerted "the right to control [its] franchisees in the precise parts of the franchisee's business that allegedly resulted in plaintiffs' injuries -- training and discipline of employees."

**Direct Liability**

Some plaintiffs will attempt to assert direct liability claims against franchisors. Plaintiffs will allege that a franchisor that assumes or maintains responsibility over a particular aspect of the franchise business cannot avoid responsibility just because it is involved in a franchise relationship. Some courts have imposed liability on franchisors for injuries or violations that occur in areas where it is clear that the franchisor maintains or has assumed responsibility. Thus, if the franchisor voluntarily assumes responsibility for some aspect of the franchise operations, it may also be responsible if it is negligent in doing so. These cases do not involve vicarious liability per se because the franchisor is held liable for its own conduct, albeit stemming from a franchised business. In these situations, the franchisor is being exposed to liability on two different theories of recovery. A franchisor may be subject to liability based on vicarious liability for the actions of its franchisee but may also be separately responsible for its own negligence for voluntarily assumed responsibilities.

**Conclusion**
To avoid incurring vicarious liability, franchisors must take care not to exert too much control over their franchisees. Under actual agency theory, a franchisor may risk becoming vicariously liable for the torts of its franchisee by controlling the franchisee's daily operations. Likewise, the single employer test used by federal courts in Title VII cases may impute vicarious liability when the franchisor controls the franchisee's employment practices. In addition, even if the franchisor does not maintain control over the franchise, a franchisor may become liable through apparent agency. Under apparent agency theory, a plaintiff can attempt to establish vicarious liability by demonstrating her justifiable belief that the franchisor operated the franchise and her detrimental reliance on that belief. Finally, some plaintiffs will attempt to bring actions for direct liability for things a franchisor controlled and did so negligently.