FRANCHISOR, FRANCHISEE AND VICARIOUS LIABILITY

In what ways can a franchisor be held liable for the actions of its franchisees? We take a look at recent vicarious liability claims involving franchises in other industries that may inform car rental.

BY LESLIE J. PUJO AND WESLEY D. HURST

FRANCHISING ACCOUNTS FOR 9.1 MILLION direct jobs, $994 billion of economic output for the U.S. economy, and 3% of the Gross Domestic Product (GDP) in many sectors, such as lodging, quick-service restaurants, personal services, business services, and the car rental industry, according to the International Franchise Association.

Franchising is everywhere, but what is it from a legal perspective? And what are the unique legal issues to consider?

WHAT IS A FRANCHISE?

Franchising is a method for business expansion where a brand owner (the franchisor) distributes its goods or services via a network of independent operators (the franchisees). In a typical franchise relationship, the franchisee pays an initial franchise fee and continuing fees for the right to sell products or services under the franchisor's trademark and operating system.

To protect the brand (as required under trademark law) and promote uniformity and consistency, the franchisor's system generally includes training, marketing support, employee uniform, and interior decor requirements, customer service standards, and computer system requirements.

The franchisee acts as an independent business with autonomy for implementing the system and managing the day-to-day operations at its location. The rights, duties, and responsibilities of the two parties are typically spelled out in a franchise agreement.

Because of its unique nature, a number of legal issues may affect franchising, including one that is familiar to those in the car rental industry: vicarious liability. Vicarious liability is a theory that imposes responsibility on one person (like a franchisor) for the actions of another (like a franchisee), even if the first person was not negligent itself.

Unlike car rental operators, to date, franchisors have not been subject to laws imposing vicarious liability based solely on ownership of the brand. Instead, courts and government agencies use several different theories to evaluate whether the franchisor is vicariously liable — or in some cases jointly liable.

VICARIOUS LIABILITY CLAIMS IN EMPLOYMENT

A number of recent cases have considered whether a franchisor can be vicariously liable for actions of a franchisee's employees, or even be deemed to be a "joint employer" of the franchisee in connection with alleged labor law violations of the franchisee's business. The answer generally turns on the degree of control that the franchisor exercises over the franchisee's operations, but courts and agencies do not always use the same legal test to evaluate "control," which can lead to mixed results.

Domino's and Harassment Claim: In Patterson v. Domino's Pizza, (60 Cal.4th 474; 2014), the California Supreme Court evaluated whether Domino's Pizza was responsible for the alleged sexual harassment of a franchisee's employee by another employee of that franchisee.

The plaintiff argued that Domino's effectively controlled the day-to-day operations of the franchisee because of the comprehensive Domino's system covering aspects of the franchised business, such as site construction, store refurbishing, equipment and furnishings, menus and pricing, computer system and data access, reporting, and inspections.

The court rejected the plaintiff's arguments that these requirements exceeded quality controls necessary to protect the brand. Instead, the court found that Domino's detailed standards were designed to protect the Domino's brand, but Domino's did not control the relevant day-to-day operations of the franchisee, such as the hiring, firing, discipline, and management of employees.

Absent that control, Domino's could not be held liable for the actions of the franchisee's employees. This result followed recent trends in other cases limiting franchisor vicarious liability to situations where the franchisor controls the "instrumentality" of the harm or the specific policies and procedures at issue.

McDonald's as "Ostensible" Agent: Ochoa v. McDonald's Corp. (133 F. Supp.3d 1228; N.D. Ca. 2015) is a class-action case claiming that McDonald's was jointly liable for the alleged California Labor Code violations of its franchisee base. The court first determined that McDonald's and the franchisee were not in a "true agency" relationship because McDonald's did not have direct control over the wages, hours, or working conditions of the franchisee due to the franchise system controls and requirements.

On the other hand, the court concluded that there was enough evidence suggesting that the franchisee was an "ostensible agent" of McDonald's and denied McDonald's motion for summary judgment on that claim. The court based its finding, in part, on employee claims that wearing McDonald's uniforms, serving food in McDonald's packages, and receiving paystubs and other materials with McDonald's logos led them to believe that McDonald's was their employer. The class was recently certified for the ostensible agency issue, and the case is pending.

McDonald's and Labor Claims: In 2014, the National Labor Relations Board (NLRB) charged McDonald's as a "joint employer" in several unfair labor practice claims brought against McDonald's franchisees — without providing details on how it reached the conclusion on the joint employer issue. The case, Fast Food Workers Committee and SEIU v. McDonald's USA LLC, Case Nos. 02-CA-093893 et al., is currently pending before an administrative law court in New York.

VICARIOUS LIABILITY CLAIMS IN OTHER CONTEXTS

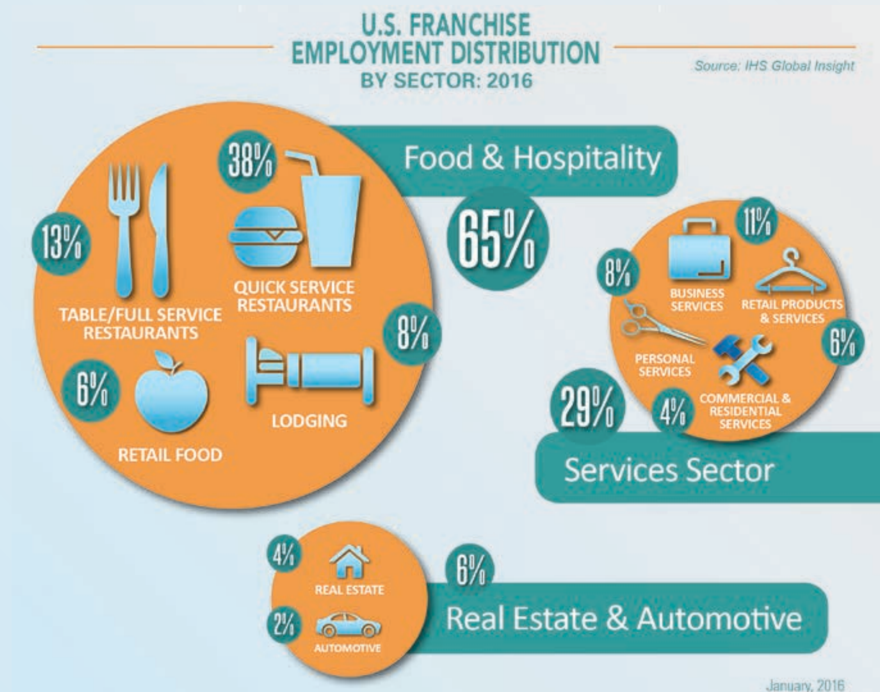
Taco Bell and Text Message Blasts: Thomas v. Taco Bell — 879 F.Supp.2d 1079 (C.D. Ca. 2012) Aff'd 582 Fed. Appx. 678 (2014) — involved a group of Taco Bell franchisees and Taco Bell Corp. (the franchisor) organizing an advertising association and embarking on a sweepstakes promotion by use of a blast text message.

A class action was filed in federal court in California against Taco Bell Corp. alleging a violation of the Telephone Consumer Protection Act (TCPA), which imposes liability for calls using an automatic dialing system that are made without prior consent. The plaintiff sought to hold the franchisor vicariously liable for the actions of the advertising association and the advertising agency that sent the text message.

The court noted that the plaintiff did not present any evidence that Taco Bell participated in the creation of the text message or played any role in the decision to send the promotion by a text blast. Even though Taco Bell was a member of the association, the court found that the association and the advertising team (and not Taco Bell) directed the "means and manner" of the promotion. The court also noted there was no evidence that Taco Bell approved or ratified the action.

Computer Sales and "Spying" Software: In Peterson v. Aaron's Inc. (108 F.Supp.3d 1352; N.D. Ga, 2015), filed in Georgia, plaintiffs alleged that information in their computers was unlawfully accessed.

Aspen Way Enterprises Inc., a franchisee of Aaron's, is in the business of leasing and selling personal computers. The plaintiffs, who purchased or leased computers from Aspen, alleged that Aspen installed PC Rental Agent software on the computers that allowed Aspen to remotely access user activity logs and other private information stored on the leased or purchased computers. Plaintiffs alleged that Aspen did not notify customers of this software.



The franchisee and the franchisor moved to dismiss the case. The court concluded that Aspen, the franchisee, could be sued on invasion of privacy theory. The court next addressed whether Aaron's, the franchisor, could be pursued based on the conduct of the franchisee. The court first noted that there was no basis to assert a conspiracy theory between the franchisor and the franchisee.

The court did, however, conclude that the case could proceed against the franchisor on an "aiding and abetting" theory under Georgia law. The court noted that the plaintiffs alleged that Aaron's knew that Aspen was invading its customers' privacy and provided assistance that aided Aspen. In particular, it was alleged that Aaron's promoted the software to Aspen, trained Aspen on the use of the software, granted Aspen permission to use the software, provided Aspen with assistance with use of anti-virus software, and that Aaron's had been informed that Aspen was using this software to track customers' keystrokes and other aspects of customers' use of the computer.

The court concluded that if the allegations of complaint could be proved, Aaron's could be found jointly liable for the invasion of privacy asserted against Aspen.

LESSONS

Although any inquiry about franchisor responsibility for the actions of franchisees and their employees is fact specific, past cases indicate that franchisors should limit controls to those that are necessary to maintain brand integrity and promote uniformity and consistency.

Some examples include:

- Franchisors should set standards for use of the trademark.
- Franchisees should have autonomy in all human resources decisions and actions, including hiring, firing, discipline, scheduling, promotion, and termination.
- Franchisees should clearly explain the franchise relationship to their employees and clarify that the franchisee is the sole employer.
- Franchisors that don't control the means and manner of relevant franchisee operations may have a defense to vicarious liability. ARN

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