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Franchisor liability: It's all about control

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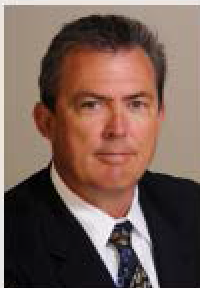

On June 4, the state Supreme Court heard oral argument in the case of *Patterson v. Domino's Pizza LLC*, S204543. The court will soon decide whether a franchisor will be liable for acts of franchisee-employees, and likely shape the future of franchising in California.

By default, franchisees are considered independent contractors. Franchisees' employees are not employees of the franchisor; they are supposed to be hired, supervised and if necessary, fired, solely by the franchisee. So why should the franchisor be held liable for the conduct of individuals they are not responsible for supervising?

The answer is all about control. A franchisor will be vicariously liable for torts committed by its franchisee's employees when it exercises "complete or substantial control" over a franchisee. *Kaplan v. Coldwell Banker Residential Affiliates Inc.*, 59 Cal. App. 4th 741, 745 (1997). In other words, if the franchisor at least substantially controls what a franchisee is doing, courts will treat the franchisee and its workers as employees instead of independent contractors.

The "substantial control" test seems simple enough - except that, under California law, the existence of a franchising relationship depends on control. By definition, a franchisee must operate in accordance with a "marketing plan or system prescribed subscribed in substantial part by the franchisor." Corporations Code Section 31005(a)(1)-(2); Business and Professions Code Section 20001(a)-(b). Moreover, because franchisees use franchisor trademarks, franchisors need to control how those trademarks are used or else they risk losing them altogether.

In reality, franchisors must do more than control their trademarks' use. Their long-term survival hinges on an ability to ensure their franchisees provide the high quality goods and services that they advertise - and do so consistently. Consumers value consistency, especially in the fast-food industry. For instance, prospective patrons do not see a restaurant as a just another franchisee; rather, they see the fast-food brand and expect that their overall experience will be just as enjoyable as it was somewhere else. For corporations with franchise locations across the country, maintaining quality and consistency requires an extraordinary amount of control.

If franchisees are required to operate independently without meaningful oversight, how can franchisors expect to maintain their brand's value with consumers?

California courts understand franchisors have an entirely legitimate prerogative to control certain franchisee operations, and acknowledge that franchisors "must be permitted to retain such control as is necessary to protect and maintain its trademark, trade name and good will" without being subjected to vicarious liability. *Cislaw v. Southland Corp.*, 4 Cal. App. 4th 1284, 1296 (1992). The need for a balance here is obvious. But how much control is too much, and what kind of control is impermissible?

Enter *Patterson*. The case centers on a young woman named Taylor Patterson who was sexually harassed by an assistant manager at a Domino's Pizza store franchised by Sui Juris LLC in Thousand Oaks.

When confronted about the harassment, Daniel Poff, owner of Sui Juris, promised to fire the assistant manager but failed to do so. Patterson quit her job shortly thereafter. Meanwhile, Domino's, also contacted by Patterson's father, sent an "area leader" to meet with Poff. The representative allegedly told Poff to fire the assistant manager and retrain his other employees.

Patterson sued Sui Juris and Domino's for, among other things, sexual harassment and constructive discharge. She alleged that the assistant manager was essentially Domino's as well. Domino's soon found itself the only solvent defendant when Sui Juris filed for bankruptcy.

With his company in bankruptcy, Poff essentially threw Domino's "under the bus." At his deposition, Poff complained of being "ticky-tacked to death" by stifling guidelines and oversight. He recounted how an "area leader" ordered another employee fired. And if he did not do exactly as instructed, he would lose his franchise.

Nevertheless, the trial court granted summary judgment for Domino's on the grounds that undisputed facts established that training and supervising employees was solely the franchisee's responsibility.

The 2nd District Court of Appeal reversed, finding reasonable inferences that Sui Juris was not acting independently. Instead of managerial responsibility under the franchise agreement, the court looked for managerial independence under the "totality of the circumstances."

The court took particular issue with Domino's ability to direct internal operations, even remotely accessing and auditing franchisee records on a regular basis. It also noted testimony indicating that Domino's representatives had demanded that certain employees be terminated. Little (if any) consideration was made for Domino's need to protect its goodwill in aspects other than "food preparation standards."

Taking its case to the state Supreme Court, Domino's now advocates for a new bright-line "instrumentality test" under which a franchisor would be liable only where it controls the specific instrumentality causing the harm. Whether the court will adopt this "modern rule" is anyone's guess. Nor is it a given whether Domino's would avoid liability under it.

No matter the outcome, *Patterson*'s importance is difficult to overstate; Domino's dealings with Sui Juris are by no means exceptional. More importantly, in today's brand-obsessed culture, comprehensive marketing and management systems are the norm. Franchisors are also expected to play a substantial role in the successful operation of a franchise. If franchisees are required to operate independently without meaningful oversight, how can franchisors expect to maintain their brand's value with consumers?

Franchisors should start paying closer attention to how their franchise relationships play out in everyday practice. And unless efforts are made to ensure that roles remain distinct for all parties involved, franchisors may well be in for a deluge of potential liability.

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