

4-1-1991

The Franchising Dilemma: Franchisor Liability for Actions of a Local Franchisee

Randall K. Hanson

Follow this and additional works at: <https://archives.law.nccu.edu/ncclr>

Recommended Citation

Hanson, Randall K. (1991) "The Franchising Dilemma: Franchisor Liability for Actions of a Local Franchisee," *North Carolina Central Law Review*: Vol. 19 : No. 2 , Article 5.

Available at: <https://archives.law.nccu.edu/ncclr/vol19/iss2/5>

This Article is brought to you for free and open access by History and Scholarship Digital Archives. It has been accepted for inclusion in North Carolina Central Law Review by an authorized editor of History and Scholarship Digital Archives. For more information, please contact jbeeker@nccu.edu.

THE FRANCHISING DILEMMA: FRANCHISOR LIABILITY FOR ACTIONS OF A LOCAL FRANCHISEE

RANDALL K. HANSON†

I. INTRODUCTION

Domino's Pizza has a franchise policy of thirty minute delivery. While trying to complete a timely delivery, a local pizza delivery driver runs a red light, striking and injuring a pedestrian. Should the national franchisor have any liability for the injuries of the victim? It is estimated that there are approximately 100 lawsuits pending against Domino's including lawsuits involving twenty fatalities.¹

A husband and a wife checking into a locally owned Holiday Inn in North Carolina are assaulted and robbed. The couple assumed the motel was owned by Holiday Inn when, in fact, it was a locally owned franchise. Should Holiday Inn, as franchisor, have any liability for the injuries since they failed to indicate to the guests that the motel was locally owned and operated?² Lawsuits against nationally known franchisors such as Domino's and Holiday Inn are becoming more and more common.

Franchising is a business format which will dominate the business world for years to come. For a fee, national franchisors provide to local franchisees expertise involving a product or a service, national advertising, and name recognition.³ Franchisees typically pay a franchise fee to purchase the franchise rights and also agree to purchase all necessary products from the franchisor or an approved supplier pursuant to an ex-

† B.S./B.A. 1976, J.D. 1979, University of North Dakota; LL.M. 1987, Southern Methodist University; Associate Professor of Business Law, University of North Carolina at Wilmington.

1. Sargent, *Domino's Quick Delivery: Public Safety v. Profits*, 25 TRIAL 16 (Nov. 1989). The author states:

Domino's Pizza guarantees a delivery within 30 minutes of the order. If not, Domino's will give the customer a free pizza or refund \$3, depending on where the customer lives.

Many trial lawyers contend that delivering pizzas hot costs too much in life and limb. At least 100 suits are pending against the company. Claimants allege that Domino's drivers, many of them young and inexperienced, have injured them or killed their family members in their rush to be good employees and back up the guarantee.

Id.

2. See *Crinkley v. Holiday Inns, Inc.*, 844 F.2d 156 (4th Cir. 1988).

3. See Pitegoff, *Franchise Relationship Laws: A Minefield for Franchisors*, 45 BUS. L. 289 (1989); Annotation, *Vicarious Liability of Private Franchisor*, 81 A.L.R.3d 764 (1977); Cote, *Franchisor's Liability for Acts of Franchisee*, 39 Am. Jur. 699 (1984).

clusive dealing contract.⁴ Fast food franchises are certainly the most common types of franchises, but other common examples include hotels, car dealerships, weight loss clinics, travel agencies, soft-drink distributors, and real estate agencies. Since franchisor-franchisee business organizations have exploded in numbers, it is not surprising that there have been increasing numbers of lawsuits being filed against franchisors by injured third parties.

Often a customer of a local franchisee who is injured at a local franchise establishment will be satisfied to pursue a claim against the local franchisee rather than seeking to recover from the national franchisor. If the victim is harmed by an insolvent or underinsured franchisee, the victim may well look to the franchisor for recovery. When should the franchisor be held responsible for the actions of a local franchisee? The franchisor is faced with a dilemma. The franchisor is forced to exert some control over the franchisee to guarantee that the local franchisee provides a consistent high quality service or product and to protect the franchisor's trademark.⁵ However, if the franchisor is deemed to have exerted too much control, then the franchisor risks having the franchisor-franchisee relationship treated as an agency relationship resulting in franchisor liability for the actions of the franchisee. A number of interesting cases have been decided in recent years involving franchisor liability for local franchisee actions. Some of the franchisors which have been sued include such common names as Ramada Inn,⁶ Holiday Inn,⁷ Nutri/System,⁸ Dairy Queen,⁹ Kentucky Fried Chicken,¹⁰

4. See, e.g., *Broock v. Nutri/System, Inc.*, 654 F. Supp. 7 (S.D. Ohio 1986); *Singleton v. International Dairy Queen, Inc.*, 332 A.2d 160 (Del. Super. Ct. 1975).

Franchise fees and projected total investments for some common franchises discussed below are as follows:

Franchise	Franchise Fee	Total Investment
Dairy Queen	\$25,000	\$400,000-\$450,000
Domino's Pizza	\$1,000-3,000	\$75,000-\$150,000
Hardee's	\$15,000	\$400,000-\$1,400,000
Hilton Hotels	\$25,000	\$10,000,000+
McDonald's	\$22,500	\$165,000-\$185,000
Nutri/System	\$13,000-\$60,000	\$60,000-\$200,000
7-Eleven	\$40,000	\$84,000

R. BOND, *THE SOURCE BOOK OF FRANCHISE OPPORTUNITIES* (1989).

5. See Annotation, *Vicarious Liability of Private Franchisor*, 81 A.L.R.3d 764 (1977); Monica, *Franchisor Liability to Third Parties*, 49 Mo. L. REV. 309 (1984).

6. See, e.g., *Hyman v. Ramada Inn, Inc.*, 86 N.C. App., 274, 357 S.E.2d 394 (1987).

7. See *Crinkley v. Holiday Inns, Inc.*, 844 F.2d 156 (4th Cir. 1988); see also *Drummond v. Hilton Hotel Corp.*, 501 F. Supp. 29 (E.D. Pa. 1980) (motion for summary judgment denied).

8. See also, *Broock*, 654 F. Supp. at 7.

9. See, e.g., *Singleton v. International Dairy Queen, Inc.*, 332 A.2d 160 (Del. Super. Ct. 1975); *Stanford v. Dairy Queen Products of Texas*, 623 S.W.2d 797 (Tex. Ct. App. 1981).

10. See, e.g., *Wise v. Kentucky Fried Chicken Corp.*, 555 F. Supp. 991 (D.N.H. 1983).

BMW,¹¹ and Canada Dry.¹² Successful lawsuits against franchisors have usually been based on agency respondeat superior principles if control is present or on an apparent agency theory if no control is present.

II. REASONS ASSERTED FOR EXPANDING FRANCHISOR LIABILITY

There are a number of public policy arguments supporting an expansion of franchisor liability. First, many franchises are extremely profitable and the franchisors are better able to cover losses than are innocent victims. This is commonly referred to as the "deep pocket theory," and is commonly asserted as a justification for the concept of respondeat superior which imposes liability upon employers for the unauthorized actions of employees which occur within the scope of employment.¹³ If a local franchise harms a customer but has insufficient assets to compensate the innocent victim, then perhaps the franchisor who benefits from the franchise relationship should bear responsibility rather than leave the victim without recourse. Second, a franchisor typically receives profits from the actions of a franchisee over the life of the franchise through the use of exclusive dealings contracts. If the franchisor continues to profit from the consumption of franchisor supplied products, then the franchisor can reasonably be expected to shoulder at least a portion of the liability burden. Third, the franchisor could cover potential liability by purchasing liability insurance with the proceeds of the profits obtained by the benefits of the exclusive dealing contracts with the local franchisees.

Fourth, greater liability could prompt franchisors to more carefully monitor the actions of the local franchisee. Most franchisors are already actively involved in a number of aspects of the local franchisees' activities including site selection, training programs, determining sales prices and products which will be sold.¹⁴ A manual is typically provided covering the policy expectations of the franchisor. If liability were expanded, no doubt franchisors would increase on site inspections for dangerous practices or situations. This could result in a reduction of injuries suffered by innocent consumers dealing with franchisees. A legal system which sometimes imposes liability and which sometimes protects the franchisor sends a confusing message to franchisors. Frustrated franchisors then attempt to walk a tightrope whereby they can exercise some control, but not too much control, to avoid liability. A clear requirement of greater liability would encourage increased franchisor involvement in business operations and would potentially result in safer business operations.

11. *See, e.g., Cullen v. BMW of North America, Inc.*, 531 F. Supp. 555 (E.D.N.Y. 1982).

12. *See, e.g., Buchanan v. Canada Dry*, 138 Ga. App. 588, 226 S.E.2d 613 (1976).

13. W. Prosser and W. Keeton, *TORTS* § 69 (5th ed. 1984).

14. Pitegoff, *supra* note 3, at 293.

Finally, the public frequently views local franchises as franchisor entities and this image is often encouraged by signs, containers, and uniforms which indicate only the franchisor's name rather than calling attention to the local franchisee. Franchisors spend large amounts of money in advertising to build up name recognition and to protect and promote their trademark.¹⁵ Many consumers simply do not realize that franchises are locally owned. If the franchisor desires to create a national image through national advertising, then perhaps the franchisor should have extensive liability for creating this impression.

III. REASONS ASSERTED FOR LIMITING FRANCHISOR LIABILITY

There are also a number of reasons which can be asserted for protecting franchisors from liability. Frequently, if a customer is injured by the actions of a franchisee, the franchisee is the party at fault, not the franchisor. Public policy has a legitimate goal of placing the responsibility for harming another on the party who has caused the harm. In many cases the injured customer simply has not been harmed by the actions of the franchisor, because the customer has not dealt with the franchisor. In these cases arguably the victim should only be able to recover from the local franchisee whose actions harmed the victim.

Franchisors should be protected because they stimulate the business economy of our country.¹⁶ A successful franchise operation can create a tremendous number of jobs across the country. In addition to employing workers, these businesses also pay property taxes and income taxes. Arguably, this beneficial activity should be protected, encouraged, and fostered rather than burdened with liability pitfalls which could bring the franchise system to its knees. The number of potential lawsuits against a national franchisor could be astronomical given the large number of customers who come into contact with local franchisees.

Franchises should be encouraged because they frequently bring about low cost, high quality products and services which are deemed desirable by consumers. This is particularly true of the more rural areas in the United States where many types of businesses would not be started without the expertise and encouragement available through the franchising system.

The imposition of liability upon a franchisor often only provides an extra "deep pocket" for a victim to pursue. Local franchisees often carry

15. Monica, *supra* note 5, at 310.

16. See, e.g., Phillips, *Liability of Franchisors for the Torts of Their Montana Franchisee*, 49 MONT. L. REV. 123, 124 (1988). "The franchising boom continues to occur despite the imposition of a franchise fee for the rights inherent in using the franchise, which can run to \$50,000 or higher plus the requirement for payment of monthly royalties usually 5-7 percent of the gross, and for monthly advertising fees." Bocas, *Leaving the Corporate Nest—The Franchise Route*, 75 NATIONS BUS. 14, 20 (1987).

liability insurance coverage and, arguably, franchisor liability is improper because the local franchisee is adequately equipped to compensate victims without the imposition of liability on franchisors.

IV. FRANCHISOR LIABILITY

One of the primary assets of a franchise is the trademark which identifies the franchise. Franchisees are willing to spend large amounts of money to acquire franchise rights if the franchisor's name is widely recognized and highly regarded by the consuming public. Name recognition is obviously very important in the competitive business world. Under the Lanham Act,¹⁷ a trademark owner may license out the right to use its mark provided the mark is not used in a manner to deceive the public.¹⁸ An owner may lose its mark by abandonment if it is not used or if the manner in which it is used causes the mark to lose its significance as an indication of its origin.¹⁹ Therefore, the trademark owner must regulate the activities of the franchisee to preserve its mark and protect the public from deceptive uses of the mark. The franchisor has an additional motivation to closely control local franchisees in that the franchisor typically seeks to assure that the local franchisee will produce a uniform, high quality, product or service.

Three legal theories are commonly relied on to hold franchisors liable for the actions of franchisees: that the franchisor has exerted such extensive control over the franchisee that an agency relationship is deemed created; that there exists an apparent or ostensible agency; and negligence.

A. *Actual Agency Relationship Based on Control*

The cases to date which have held a franchisor liable for the actions of a franchisee have usually involved situations where the franchisor has exercised close control over the actions of the franchisee. Important factors leading to liability have included franchisor determination of wages and working conditions, franchisor supervision of worker activities or routines, franchisor involvement in disciplinary actions taken against franchisee employees, franchisor limitations on products and services to be offered to the public, and the detailed preparation of an operations manual.²⁰ The greater the control exerted over the franchisee, the greater the possibility the courts will find the existence of an agency relationship.

17. 15 U.S.C. § 1051 (1988).

18. *Id.* at 1055 (1988).

19. *Id.* at 1127 (1988).

20. See, e.g., *Singleton v. International Dairy Queen, Inc.*, 332 A.2d 160, 161-63 (Del. Super. Ct. 1975); Annotation, *Vicarious Liability of Private Franchisor*, 81 A.L.R.3d 764 (1977).

One of the first cases where a franchisor failed to avoid liability for injuries suffered by a customer at a local franchise operation was *Singleton v. International Dairy Queen, Inc.*²¹ In that 1975 case, a nine year old customer of a Delaware Dairy Queen franchise was injured as she left the store. The girl pushed on a metal crossbar on the door to push the door open, and the bottom portion of the glass in the door broke. The girl fell on the broken glass and received severe lacerations.²² The local franchisee and the franchisor were both sued. The franchisor sought summary judgment on the theory that the franchisee was an independent contractor and as such the franchisor was not responsible for the actions of the franchisee. Summary judgment was denied as the court felt that there was a factual question as to whether the franchise relationship constituted a master-servant relationship or an independent contractor relationship.²³ The court noted that there were a number of control factors present. A critical factor in the case appeared to be the fact that Dairy Queen (the franchisor) supplied detailed remodeling plans to be followed by the franchisee.²⁴ Dairy Queen also controlled many details of the franchise operation including the regulation of the formula for the ice cream "mix"; approval of uniforms of employees; establishment of the items to be sold and portions; requirement that all equipment and supplies be purchased from authorized suppliers; regulation of use of the trademark and the reservation of an inspection right. Dairy Queen also reserved the right to cancel the franchise if the local franchisee did not live up to the franchise agreement.²⁵ Although this case merely denied summary judgment, it caused much concern for franchisors.

In *Drummond v. Hilton Hotel Corp.*,²⁶ the plaintiff filed a fall down suit against a hotel franchisor. Hilton exerted a number of controls over

21. *Singleton*, 332 A.2d 160.

22. *Id.* at 161.

23. Dairy Queen argued in its motion for summary judgment that the franchisee was an independent contractor over whom Dairy Queen exercised "no continual or actual control of the day to day operations." The court rejected this position stating:

In the instant case, the control exercised by Dairy Queen appears to be excessive. When an entity can control the size, shape and appearance of its franchisor's establishment, impose the nationally known sign "Dairy Queen" as the only sign for the premises, require all containers to show the name of the parent company, dictate portion control, the size and shape of containers, the uniforms of the employees, subject the franchisor to the obligation to obey subsequent rules and regulations, reserve the right to inspect the premises (the absence of affirmative remedial controls, except termination in the event the inspection results are unsatisfactory, proves nothing since what is the right to inspect without the right to remedy), name the suppliers and even dictate what else may be sold on the premises, there appears little else to establish agency. The very lifeblood of the agent is in the hands of the franchisor. What greater control can there be than portion control or the nebulously defined sanction of termination by the unilateral action of the franchisor.

Id. at 162-63.

24. *Id.* at 161.

25. *Id.* at 162.

26. 501 F. Supp. 29 (E.D. Pa. 1980).

the franchisee including rights of inspection as well as a requirement that the franchisor's name be used in all advertising and promotional materials. Hilton asserted that "at no time did it maintain, own, control, or operate the hotel".²⁷ Hilton further asserted that the owners of the hotel had executed a license/franchise agreement with Hilton wherein Hilton specifically disavowed any agency relationship.²⁸ This contract term was ignored by the court, and the court held that a factual question existed as to whether the control present constituted an agency relationship. The mere denial of a agency relationship in a licensing contract did not relieve Hilton of all potential liability.²⁹

A detailed operating manual may give rise to franchisor liability. Agency control was found present in the case of *Taylor v. Checkrite, Ltd.*³⁰ In this case a local franchised check collection business allegedly wrongfully listed an individual in a bad check bulletin. The individual wrongfully listed sued the franchisor. The franchise contract between the franchisor and franchisee required the franchisee to follow a procedures manual which gave the franchisee virtually no discretion in performing the check collection business operation.³¹ Since the franchisor became actively involved in the day-to-day operating procedures of the franchisee, the court held that the franchisee was an agent of the franchisor and that summary judgment in favor of the franchisor was not appropriate.³²

While there are a number of cases holding a franchisor liable for the actions of a franchisee because of the exertion of control, there are a large number of cases wherein a franchisor has been held not responsible for the actions of a franchisee. One of the first cases decided in the area of franchisor liability was protective of the franchisor. In *McLaughlin v.*

27. *Id.* at 30.

28. *Id.* at 31.

29. *Id.* The court stated:

The agreement does have a clause limiting Hilton's liability . . . the mere fact that there is an express denial of the existence of an agency relationship is not in itself determinative of the matter. Since such a denial of agency is not sufficient to relieve Hilton of all possible liability as a matter of law, the issue of Hilton's right to control any operations of the hotel is an issue for jury determination. *Id.* at 31.

30. 627 F. Supp. 415 (S.D. Ohio 1986).

31. *Id.* at 417. The court stated:

Examining these contract provisions . . . the Court must conclude that Defendant has such right of control over the franchisee as to make that franchisee its agent in regard to the activities complained of in this lawsuit. The Procedure Manual provides very detailed, step-by-step directions to the franchisee in carrying out its business operations, including setting up new accounts for merchants, member billing, file set-up, receiving mail, check processing, bookkeeping procedures, and preparing the computer listing sheet for the Checkrite Bulletin. The franchisee is given virtually no discretion in performing these operations. Most importantly for purposes of this lawsuit, the franchisee under the manual has no discretion in the practices underlying the allegations of Plaintiff's Complaint.

Id.

32. *Id.* at 418.

Chicken Delight, Inc.,³³ a local franchisee employed a driver who injured the plaintiff while delivering chicken for the franchisee.³⁴ The plaintiff sued the franchisor, alleging that the franchise agreement was designed to control the quality and taste of all the products sold by the franchisee. The franchisee had to purchase equipment, supplies, and foods from the franchisor and agree to follow cooking specifications. Location, construction, and remodeling all had to comply with franchisor specifications.³⁵ The plaintiff also asserted that the franchisor had inspection rights and that the franchise agreement required the franchisee to promptly deliver freshly prepared food. The franchisee was required to maintain a free and adequate delivery system.³⁶ The court granted summary judgment in favor of the franchisor, holding that the delivery person was an agent/servant of the franchisee, not the franchisor.³⁷ The court noted "although the financial interest of Chicken Delight, Inc. is advanced and the reputation and goodwill of Chicken Delight, Inc. are enhanced by the delivery of hot Chicken Delight food products, such is not sufficient to establish a basis for the imposition of liability on Chicken Delight, Inc."³⁸

It is interesting to compare the Chicken Delight case with potential lawsuits against Domino's Pizza. The facts of the Chicken Delight case are closely akin to claims arising from negligent pizza delivery drivers. The key factor which sets the Domino's situation apart from the Chicken Delight situation is the Domino's franchisor policy of a thirty minute delivery guarantee.³⁹ This policy could very well be a control factor which could give rise to franchisor liability. Domino's Pizza consists of approximately 5,100 outlets.⁴⁰ Approximately one-third of the outlets are company owned. It is estimated that Domino's Pizza relies on 70,000 to 80,000 drivers.⁴¹ Allegedly Domino's employs many young drivers. The combination of potentially immature drivers with time deadlines arguably gives rise to legitimate claims. Domino's asserts that the drivers are all independent contractors, and, as such, the franchisor is not responsible for acts of neglect or misconduct.⁴² Domino's further alleges

33. 164 Conn. 317, 321 A.2d 456 (1973).

34. *Id.* at 321, 321 A.2d at 458 (the car used to deliver the chicken was owned by the franchisee).

35. *Id.*

36. *Id.* (the franchisee was required by the franchise agreement to purchase or lease an adequate number of delivery vehicles to maintain an adequate delivery service).

37. *Id.* 321 A.2d at 459 (the court further noted that the franchisee was not an agent of the franchisor).

38. *Id.*

39. Sargent, *supra* note 1.

40. *Id.*

41. *Id.* This figure is an estimate.

42. Agency is "the fiduciary relation which results from the manifestation of consent by one person that the other shall act on his behalf and subject to his control, and consent by the other to so

that the 30 minute delivery guarantees are limited to an area of one to two miles and that their prompt deliveries are a result of fast action in the kitchen rather than fast driving on city streets.⁴³ Further, drivers are not docked for late deliveries (tips may well be lower if the pizza is not hot when it is delivered).⁴⁴ The outcome of the Domino's litigation will be at a minimum very interesting and may very well influence the future of franchisor liability in the United States.

B. *Liability Based on an Apparent Agency*

In a number of franchisor/franchisee relationships the control exerted by the franchisor over the franchisee will not be deemed sufficient to support a finding of an agency relationship. Plaintiffs will then seek to establish the existence of an apparent agency relationship to impose liability upon a franchisor. The public is frequently led to believe that they are dealing with a franchisor when they enter a franchise whose signs, logos, and packaging all refer to a national franchisor without any identification of a local owner/operator. There are an increasing number of cases which impose liability on the franchisor in this type of situation. The Restatement (Second) of Agency Sec. 267 (1975) provides as follows:

One who represents that another is his servant or agent and thereby causes a third person justifiably to rely upon the care or skill of such apparent agent is subject to liability to the third person for harm caused by the lack of care or skill of the one appearing to be a servant or other agent as if he were such.⁴⁵

In the *Drummond v. Hilton Hotel Corp.*⁴⁶ case mentioned above, the plaintiff asserted that an apparent agency existed. The plaintiff alleged that "Hilton held itself out to the public in such a manner as to lead the

act." Restatement (Second) of Agency § 1 (1958). By contrast an independent contractor is "one who contracts to do something for another, but is not controlled by the other and for whose acts the other is not responsible.

Southern Pac. Transp. Co. v. Continental Shippers Ass'n., 485 F. Supp. 1313, 1316 (N.D. Mo. 1980).

43. Sargent, *supra* note 1, at 16-17. Attorneys representing plaintiffs suing Domino's are critical of Domino's delivery system.

Many trial lawyers contend that delivering pizzas hot costs too much in life and limb. . . . Claimants allege that Domino's drivers, many of them young and inexperienced, have injured them or killed their family members in their rush to be good employees and back up the guarantee of fast service. . . . Frank and Mary Jean Kranack, were broadsided on Oct. 5, 1985 by a Domino's driver who had just pulled out of the store lot en route to a delivery. The store manager rushed to the scene, Frank said in a July 18 CBS news segment: "He came down, and he grabbed the pizza out of the Domino driver's car and said, 'Let's get this pizza on the road.' And I just couldn't believe, with all the damage there, that he's worried about an \$8 pizza". . . . "Domino's entire system is based on speed. No other company I know of relies on such a dangerous combination—young drivers and speed."

Id.

44. *Id.* at 16. A late pizza is generally accounted for as a \$3 off coupon.

45. Restatement (Second) of Agency § 267 (1975).

46. 501 F. Supp. 29 (E.D. Pa. 1980).

general public, including hotel guests, to believe they were dealing directly with either Hilton or a servant or employee of Hilton, a hotel corporation of international reputation."⁴⁷ It is interesting to note that the license/franchise agreement between Hilton and the local owners provided that the local owners were to disclose to all suppliers and creditors that they were an independent entity and that Hilton had no liability for debts. On the other hand, only the name of Hilton was to be displayed in the guest rooms and public areas of the hotel.⁴⁸ The court concluded that these facts gave rise to a factual issue for a jury to decide whether an apparent agency existed.⁴⁹

The finding of an apparent agency was recently upheld in an important and interesting case involving a Holiday Inn franchise. In *Crinkley v. Holiday Inns, Inc.*,⁵⁰ a husband and wife were assaulted and robbed as they were entering their motel room. The attackers were subsequently dubbed the "motel bandits" by the media.⁵¹ Prior to the attack of the plaintiffs, the "motel bandits" had attacked a number of motel patrons in the Charlotte, North Carolina area. The husband suffered multiple bruises and a severely broken jaw; the wife suffered emotional problems as well as a heart attack fourteen months after the incident. The plaintiffs successfully sued the franchisor on the theory of an apparent agency.⁵² Holiday Inns contended that the franchise agreement disclaimed any agency relationship. The court held that the denial of liability was not determinative of the liability issue.⁵³ The court noted that Holiday Inn imposed a number of controls over the franchisee including the use of the trade name and trademark. The court noted that "the company engages in national advertising without distinguishing between company owned and franchised properties."⁵⁴ A motel directory also failed to distinguish company owned properties from franchised properties. The only indication that the motel was locally owned was a sign

47. *Id.* at 30. See Chermiside, *Vicarious Liability of Private Franchisor*, 81 A.L.R. 3d 764 (1977).

[A]n agency relationship may arise from acts and appearances which lead others to believe that such a relationship ha[s] been created[;] . . . this concept of apparent authority is based upon manifestations by the alleged principal to third persons, and reasonable belief by those persons that the alleged agent is authorized to bind the principal and . . . that the manifestations of the principal [have been] made directly to the third person or [have been] made to the community by signs or advertising.

Id. at 779-80.

48. 501 F. Supp. at 32.

49. *Id.*

50. 844 F.2d 156, 159 (4th Cir. 1988) (the franchisor and franchisee were both sued in this case).

51. *Id.* at 158.

52. *Id.* at 166. This case includes an interesting proximate cause problem as the wife sought recovery for a heart attack which was suffered fourteen months after the motel attack. *Id.* at 159-63.

53. *Id.* at 167. See also *Drummond v. Hilton Hotel Corp.*, 501 F. Supp. 29 (E.D. Pa. 1980).

54. 844 F.2d at 166.

located in the restaurant of the motel.⁵⁵ In upholding the judgment against Holiday Inns, the court noted that a jury could reasonably conclude that Holiday Inn-Concord was operated in a way as to create the appearance that it was owned by Holiday Inns, Inc. and that was one of the purposes of the franchise agreement.

In order to hold Holiday Inns liable in the *Crinkley* case, the court had to distinguish that case from a similar case decided in favor of a motel franchisor only one year earlier. In *Hayman v. Ramada Inn*,⁵⁶ a plaintiff who was a flight attendant was assaulted while a guest at a North Carolina Ramada Inn. The court in that case held that there was insufficient control present to find a direct agency relationship and further held that there was no apparent agency relationship.⁵⁷ The court held that Ramada Inn did not attempt to conceal or misrepresent its relationship with the franchisee. On the contrary, Ramada Inn required the owners to identify themselves as the owner and operator of the facility. The majority opinion noted that a sign to this effect was to be "clearly visible" and displayed "prominently at the front desk."⁵⁸ Another crucial factor leading to the judgment in favor of the franchisor was the fact that the plaintiff failed to show that she relied on any representation of the franchisor.⁵⁹ The plaintiff did not seek to stay at a Ramada Inn because of their national advertising or reputation. She stayed at the Ramada Inn because she was required to stay there by her employer as she was an airline flight attendant trainee. No reliance on the franchisor was deemed present.⁶⁰

The court in *Crinkley* distinguished the case from *Hayman* on the basis that Hayman had no choice but to stay at the Ramada Inn, while in *Crinkley*, the plaintiffs voluntarily sought out a Holiday Inn because of its national reputation. In fact, the Crinkleys had driven twenty miles north of Charlotte, North Carolina just to stay at a Holiday Inn because

55. *Id.* at 166-67. The only indication that the Holiday Inn-Concord was not owned by Holiday Inns was a sign in the restaurant that stated that the motel was operated by TRAVCO under a franchise agreement. *Id.*

56. 86 N.C. App. 274, 357 S.E.2d 394 (1987).

57. *Id.* at 278-79, 357 S.E.2d at 397-98.

58. *Id.* at 281, 357 S.E.2d at 399. The dissenting judge questioned whether notice of local ownership was ever given to customers of the Ramada Inn. The dissenting judge stated: "There is no evidence that the requirement of the agreement that Turnpike identify itself as owner/operator was ever followed." *Id.*

59. *Id.* at 279, 357 S.E.2d at 398.

60. *Id.* The Court stated:

Plaintiff has failed to demonstrate that she relied or acted upon any representation of the defendant. The uncontradicted evidence shows that she was a guest at the facility pursuant to arrangements made by her employer. There is no allegation in the Complaint or other evidence in the record that she would have chosen to stay elsewhere or done anything differently had she known that the facility was not owned and operated by the defendant.

Id.

the Holiday Inn of their choice was filled to capacity.⁶¹ Reliance was deemed present and the apparent agency was established.

In *Broock v. Nutri/System*,⁶² a woman died while participating in a diet program administered by a local franchisee. The woman's estate sued the diet system franchisor for her wrongful death. The estate asserted an actual agency theory and an apparent agency theory.⁶³ The court held that there was no actual agency relationship even though the franchisor, Nutri/System, exerted the following controls over the local franchise: the right to approve the business site, the establishing the employee pay scale, preparing of the advertising for employment, and requiring that the franchisee could sell only Nutri/System products.⁶⁴ The court did find that issues of fact remained as to whether an apparent agency existed or not and whether the plaintiff relied on representations of the franchisor.⁶⁵ It was noted that all advertising was done under the name Nutri/System, that the sign outside the franchise bore only the name Nutri/System, and that the local telephone directory listed only the name Nutri/System.⁶⁶ These facts were deemed to create a genuine issue of fact as to whether the franchisor represented the local franchisee as its agent.

C. Liability Based on Claims of Negligence

General negligence principles may lead to franchisor liability. As with all negligence claims, the four elements of a negligence action must be established in order to obtain a recovery: the existence of a duty,⁶⁷ breach of the duty of care,⁶⁸ proximate cause,⁶⁹ and proof of damages.⁷⁰

An example of an unsuccessful use of this theory appears in *Coty v. U.S. Slicing Machine Co.*⁷¹ In *Coty*, a fifteen year old employee of a Yankee Doodle Dandy restaurant, a fast food franchisee, was injured while operating a meat slicing machine.⁷² Under the Fair Labor Stan-

61. 844 F.2d 156, 158.

62. 654 F. Supp. 7 (S.D. Ohio 1986). Nutri/System is a weight loss program where the participants purchase their meals from Nutri/System.

63. *Id.* at 8.

64. *Id.* at 9.

65. *Id.*

66. *Id.*

67. RESTATEMENT (SECOND) OF TORTS, § 320 (1979); W. Keeton, D. Dobbs, R. Keeton, D. Owens, THE LAW OF TORTS, § 123 at 164 (5th ed. 1984).

68. See *Dimond v. Kling*, 221 N.W.2d 86 (N.D. 1974); Restatement (Second) of Torts, § 328A (1979); W. Prosser & W. Keeton, *supra* note 67, at 164.

69. See, RESTATEMENT (SECOND) OF TORTS, § 328A (1979); W. Keeton et al, *supra* note 67, at 165.

70. W. Keeton et al, *supra* note 67 at 165.

71. 58 Ill. App. 3d 237, 373 N.E.2d 1371 (1978).

72. *Id.* at 239, 373 N.E.2d at 1373.

dards Act⁷³ the machine involved could only be lawfully operated by persons over 18 years of age.⁷⁴ The injured plaintiff sued the franchisor on a negligent supervision theory. The court held in favor of the franchisor noting that the franchisor did not have the power under the franchise agreement to control the day-to-day operations of the franchisee.⁷⁵ Pursuant to the franchise agreement the franchisee was to comply with federal regulations which would clearly include the Fair Labor Standards Act.⁷⁶ The court of appeals was reluctant to hold the franchisor liable because, pursuant to the franchise agreement, if the franchisee was in violation of the agreement the franchisor could only demand a cure of the breach within ten days. If the breach was not timely cured, the franchisor could terminate the franchise. The court of appeals felt that the general right to rescind the franchise contract was insufficient to subject the franchisor to liability.⁷⁷

In *Wise v. Kentucky Fried Chicken Corp.*,⁷⁸ a plaintiff successfully avoided summary judgment on a negligence claim against a franchisor. In that case, an employee of a New Hampshire Kentucky Fried Chicken franchise was burned by hot cooking oil from an allegedly defective pressure fryer.⁷⁹ The plaintiff sued the franchisor under a negligence theory, alleging that the franchisor required the purchase of the fryer, that the manufacturer of the fryer had informed the franchisor of defects in the fryer, and that the franchisor had failed to warn the employees of the defects. The court held that summary judgment was inappropriate and that the negligence theory should have been decided at trial.⁸⁰

A particularly interesting negligence case decided in 1984 involved a 7-Eleven franchise convenience store. In *Cohen v. Southland Corp.*,⁸¹ a customer of a 7-Eleven store was shot during an armed robbery of the store.⁸² The plaintiff was attempting to stop the robbery when he was

73. 29 U.S.C. §§ 201-19 (1988).

74. *Coty*, 58 Ill. App. at 240, 373 N.E.2d at 1374.

75. *Id.*

76. *Id.*

77. *Id.* at 242, 373 N.E. 2d at 1376. The court stated:

The franchisor, could, therefore, have requested or demanded that the franchisee stop employing children in the proscribed manner and if the franchisee failed to comply could have terminated the entire franchise agreement. This general right to rescind the contract or "call off the work" is insufficient, however, under the reasoning of the cited cases to subject the franchisor to liability under either agency or employer-independent contractor theories.

Id.

78. 555 F. Supp. 991 (D.N.H. 1983).

79. *Id.* at 992.

80. *Id.*

81. 157 Cal. App. 3d 130, 203 Cal. Rptr. 572 (1984) (7-Eleven is an all-night franchise convenience store).

82. *Id.* at 134, 203 Cal. Rptr. at 573. When the robbery occurred, the 7-Eleven employee on duty fled to a back room of the store and did not come out of the back room until the police arrived. *Id.*

shot. The plaintiff sued the franchisor on a negligence theory alleging that the franchisor failed to protect store patrons from would-be robbers.⁸³ The trial judge granted summary judgment in favor of the franchisor. The California Court of Appeals reversed the summary judgment award. The court ruled that a fact question existed as to whether the franchisor had met the duty of making the store reasonably safe against criminal activity. Southland, the franchisor, argued that a duty to make safe was "tantamount to a requirement they hire full-time armed security guards in the hope of deterring nighttime crime"⁸⁴ and that such a requirement would result in 7-Eleven franchises' economic ruin because of already existing thin profit margins.⁸⁵ The court was not moved by this argument noting that a jury could conclude that much cheaper security measures (such as adequate lighting, notices of little cash on hand, and robbery training for employees) could amount to reasonable precautions.⁸⁶ Factual issues remained as to what precautionary steps had been taken by the franchisor, thus summary judgment in favor of the franchisor was inappropriate.⁸⁷

The future use of the negligence theory against franchisors is hard to predict. The beauty of the common law tort theory of negligence is that it can be adapted to almost any situation. From a franchisor's perspective it would appear that negligence liability potential would increase as franchisor control over franchisee operations increases.⁸⁸ The more control exerted over a franchisee, the more likely a duty of care will arise.⁸⁹ Whether a franchisor has met the required standard of care will obviously develop on a case by case basis. In some situations a franchisor may have to terminate a franchise in order to meet its responsibility of acting with reasonable care toward the public who deal with the franchisee.⁹⁰ Franchisors who fail to terminate franchisees who become insolvent or who engage in fraudulent activities may very well face valid

83. *Id.* at 134, 203 Cal. Rptr. at 573. There was much discussion about the fact that an all-night convenience store is a popular target for robberies and what strategies were taken by 7-Eleven to avoid robberies. *Id.* at 139, 203 Cal. Rptr. at 577.

84. *Id.* at 142, 203 Cal. Rptr. at 579.

85. *Id.*

86. *Id.* As Plaintiff suggests, "keeping a store open in the late evening and early morning hours invites criminal activity. It is only fair and equitable that the reasonable costs of protecting store patrons from criminal activity be borne by the owners, the operators and indirectly the patrons of convenience store and not by the community at large." *Id.*

87. *Id.* at 144, 203 Cal. Rptr. at 580. "The adequacy of defendant's measures to protect store patrons from assault or other threatening behavior of would-be robbers is therefore also a factual issue to be resolved by a jury." *Id.*

88. See Golann, *In Search of Deeper Pockets: Theories of Extended Liability*, 71 MASS. L. REV. 114 (1986).

89. *Id.* at 126-27.

90. See *Cullen v. BMW of North America*, 531 F. Supp. 555 (E.D.N.Y. 1982). In this case, the plaintiff advanced \$18,000 to a franchisee for the purchase of a BMW automobile. The franchisee never delivered the car, and the plaintiff sued the franchisor for negligence. The court held that the

negligence claims.⁹¹ These situations are particularly troublesome for franchisors as there are ever increasing numbers of cases against franchisors alleging wrongful termination of franchise rights.⁹²

V. FRANCHISOR AVOIDANCE OF LIABILITY

Franchisors can take steps to attempt to minimize their potential liability for the actions of franchisees. One way to minimize liability is to stay out of the day-to-day business operations of the franchisee.⁹³ Franchisee manuals should not be so detailed as to deprive franchisees of all discretion as to how the business is to be run. Company policies which could require a reckless performance in order to comply with these policies obviously should be avoided (*i.e.*, 30 minute delivery).

In several cases defense attorneys have raised the Lanham Act as a defense.⁹⁴ The basic argument is that the Lanham Act requires certain actions by franchisors to control franchisees in a way to protect and administer trademark protections. If the Lanham Act requires controls, then compliance with the requirements of the Act should not result in franchisor liability for the actions of the franchisee. Arguably the following activities are required by the Lanham Act: supervision of advertising,⁹⁵ inspection of premises,⁹⁶ control of supplies and suppliers,⁹⁷

franchisor was aware of the insolvency and unscrupulous business activities of the franchisee and negligently failed to protect customers of the franchisee. *Id.* at 558, 565-66.

91. *Id.* at 565-66. The court stated:

Here, the evidence shows that BMW/NA created a situation which afforded Bavarian the opportunity to defraud or steal from customers relying on the good reputation of BMW. Cullen walked into the showroom specifically relying on the publicly displayed BMW logo as representing a particular level of quality product. The situation here was such as to give him no notice of any deficiency in the franchise or Bavarian's relationship with BMW. BMW/NA, on the other hand, was well aware of Bavarian's impairment of BMW's reputation through various acts . . . yet it failed to take the available steps to prevent the further misuse of the BMW name and the misrepresentation that Bavarian continued to be an authorized BMW dealer. . . . The facts in evidence show that BMW/NA had knowledge of at least five recent incidents prior to Cullen's in which Bavarian had received partial payment for automobiles and had not delivered the cars. . . . BMW/NA was apprised of Bavarian's propensity for unscrupulous business transactions.

Id.

92. See Blair, *Measuring Damages for Lost Profits in Franchise Termination Cases*, 8 FRANCHISE L.J. 3 (Fall 1988); Perry & Weinberg, *The Federal Antitrust Perspective*, 32 N.Y.L. SCH. L. REV. 749 (1987); Note, *Franchise Termination: An Analysis of the Implied Covenant of Good Faith in Franchise Agreements*, 12 AM. J. TRIAL ADVOC. 325 (1988).

93. See Golann, *supra* note 88, at 115; See also Nichols v. Arthur Murray, Inc., 248 Cal. App. 2d 610, 56 Cal. Rptr. 728 (1967).

94. See Monica, *supra* note 5, at 317; see also Murphy v. Holiday Inns, Inc., 216 Va. 490, 219 S.E.2d 874 (1975).

95. See Oberlin v. Marlin Am. Corp., 596 F.2d 1322 (7th Cir. 1979); Drexel v. Union Prescription Centers, 582 F.2d 781, 787 (3d Cir. 1978); Singleton v. International Dairy Queen, 332 A.2d 160, 162 (Del. Super. Ct. 1975).

96. See Marlin, 596 F.2d 1322 (7th Cir. 1979); Drexel, 582 F.2d at 787; Wood v. Holiday Inns, 508 F.2d 167, 175 (5th Cir. 1975). "Periodic inspections should not alone create an agency relation-

limitations on the types of products or services sold,⁹⁸ inspection of books,⁹⁹ requirement of financial statements,¹⁰⁰ requirement of periodic reports,¹⁰¹ and reservation of the right to terminate the franchise agreement for noncompliance with contract terms.¹⁰² Franchisors who are exerting no more than these Lanham Act controls will have a strong argument that there is no actual agency relationship. Plaintiffs seeking to establish an actual agency situation will seek to establish controls which go beyond these minimal controls.

Franchisors have frequently tried to rely upon franchise contract provisions disclaiming any agency relationship. The contract will typically assert an independent contractor relationship between the franchisor and the franchisee. These contract clauses are almost always ignored and the court will review the factual situation rather than relying upon the parties characterization of their relationship.¹⁰³

The apparent authority cases discussed above should stress to franchisors the importance of clearly disclosing to the public which businesses are locally owned and which businesses are company owned. This would appear especially important in franchise operations which are not commonly thought of as being independently operated. A hotel franchise would appear to be a good example of a franchise which is commonly thought of as *not* being franchised. Most people probably are aware of the fact that McDonald's restaurants are local franchises, whereas Hilton Hotels are commonly thought of as being company owned. Franchisors should start requiring that local franchisees place their name on signs, letterheads, and packages, to clearly indicate that the business is locally owned and operated. This would certainly make it more difficult to establish an apparent agency theory as it would be difficult to establish the necessary reliance on the part of the consumer.¹⁰⁴ It would seem that the indication of the name of the franchisee would be

ship. The appearance of the premises from which the trademarked product or service is delivered to the public is important to maintaining the quality of the trademark." Monica, *supra* note 5, at 321.

97. See, e.g., *Singleton*, 332 A.2d at 162; *Slates v. International House of Pancakes*, 90 Ill. App. 3d 716, 767, 413 N.E.2d 457, 465 (1980).

98. See, e.g., *Billups v. Magness Constr. Co.*, 391 A.2d 196, 198 (Del. 1978); *Stanford v. Dairy Queen Prods.*, 623 S.W.2d 797 (Tex. Civ. App. 1981).

99. Inspection of books is almost universally used in franchisor/franchisee contracts, especially if the franchise fee includes a percentage of gross sales. See *Drexel*, 582 F.2d at 787.

100. See, e.g., *Drexel*, 582 F.2d 781; *Murphy*, 216 Va. at 494, 219 S.E.2d at 877.

101. *Murphy v. Holiday Inns, Inc.*, 216 Va. 490, 494, 219 S.E.2d 874, 877 (1975).

102. See *Wood v. Holiday Inns*, 508 F.2d 167, 175 (5th Cir. 1975); *Singleton v. International Dairy Queen*, 332 A.2d 160 (Del. Super. Ct. 1975); *Coty v. United States Slicing Mach. Co.*, 58 Ill. App. 3d 237, 373 N.E.2d 1371, 1374 (1978).

103. See *Drummond v. Hilton Hotel Corp.*, 501 F. Supp. 29 (E.D. Pa. 1980).

104. See, e.g., *Crinkley v. Holiday Inns, Inc.*, 844 F.2d 156 (4th Cir. 1988); *Hayman v. Ramada Inn*, 86 N.C. App. 274, 357 S.E.2d 394 (1987).

easy to require and would have little negative impact upon the consuming public.

It is impossible to list steps which can be taken to avoid negligence lawsuits against franchisors. The obvious solution is to act reasonably under the circumstances at all times. This simplistic approach is no doubt the best defense to negligence lawsuits.

VI. CONCLUSION

At the present time, franchisor liability law is still evolving. It is difficult to accurately predict the future extent of franchisor liability. It appears inevitable that there will be an increasing number of lawsuits against franchisors—whether for good or for bad—and franchisors need to be aware of the risks so they can plan accordingly.

The issue of how much control a franchisor should exert over the actions of a franchisee is particularly perplexing. Our legal system needs to give specific directions to franchisors as to what is expected of a franchisor. A legal system which sometimes imposes liability and sometimes protects the franchisor sends a confusing message to franchisors. Frustrated franchisors then attempt to walk a tightrope whereby they exercise some control, but not too much control so as to avoid liability. A clear requirement of greater liability would encourage increased franchisor involvement in business operations and would arguably result in safer business operations.

If franchisors react positively to increasing responsibilities and exert positive controls over franchise operations, perhaps injuries and mishaps will decrease and the social goal of safe and efficient business activities will result.