VICARIOUS LIABILITY

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October 15 – 17, 2008
The Hilton Austin
Austin, TX

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VICARIOUS LIABILITY

I. INTRODUCTION

Inherent in a franchise system is the tension between the franchisor’s obligation to protect the integrity of the brand by imposing uniform standards on independent franchisees, and the need to allow independent franchisees the flexibility to maximize the potential of their individual businesses. In asserting vicarious liability claims against a franchisor based on acts of its franchisee, a clever plaintiff’s attorney will try to exploit this tension, seeking to blur the line between enforcing a system of uniform standards and having day-to-day operational control over a franchised business.

How can a franchise system strike the right balance? Rule #1 is to understand the legal landscape, including the trend away from judging a franchisor’s control based simply on the fact that it has uniform system standards (as it must to police its brand under the Lanham Act) toward looking at the “instrumentality of the harm” to determine whether the franchisor had day-to-day control over that aspect of the franchisee’s operations that allegedly caused a particular plaintiff’s injury. Given this trend in the case law, Rule #2 is for the franchisor to pick its battles. If delivery of a particular standard is not central to the system’s brand promise, the franchisor may be better served by offering voluntary guidelines or suggestions in order to avoid even the appearance of day-to-day control. Conversely, if a standard is central to the brand promise (for example, food safety to a restaurant chain), then the balance may tip in favor of a more prescriptive approach to try to insulate the system from the occurrence of lawsuit-provoking, adverse events in the first place.

The good news is that vicarious liability claims present the franchisor and franchisee an opportunity to advance a common cause. For the most part, franchisors and franchisees have a shared interest in the franchisor’s dismissal from the suit as quickly as possible to reduce the potential financial and media exposure that attends the inclusion of a “deep pocket” corporate defendant. At trial, franchisors and franchisees generally remain aligned to defeat the plaintiff’s direct and vicarious liability claims, waiting until a later date to pursue potential indemnification or cross claims, if necessary. Consequently, a franchise system is well-advised to consider the implications of potential vicarious liability claims when designing and drafting its system standards and controls, rather than waiting for courts to resolve the tension.

This article provides an overview of the legal landscape for franchise vicarious liability claims, as well as practical tips for franchisees and franchisors dealing with such claims. In Part II, we discuss the two legal relationships that can give rise to vicarious liability—actual and apparent agency. In Part III, we discuss the tension in a franchise system between enforcing system standards and controlling the instrumentality that led to the plaintiff’s harm. How a franchisor’s conduct is characterized on that spectrum of control will likely determine whether or not the franchisor can be held vicariously liable. Part IV discusses the strength and effect of a franchisor’s disclaimer of agency and control, with some practical tips about how to bolster the effectiveness of such disclaimers. Part V describes some of the typical types of vicarious liability claims that franchisors face, including personal injury, product liability, sexual harassment, ADA, and recently, FACTA. In Part VI, we discuss some of the practical issues that arise from the franchisor and franchisee perspective in litigating a vicarious liability case. Finally, in Part VII, we discuss the important role insurance can play in managing these lawsuits.
II. VICARIOUS LIABILITY – AGENCY ANALYSIS

Principles of agency supply the analytic framework for vicarious liability. Accordingly, the vicarious liability of a franchisor depends upon the finding of an agency relationship with the franchisee. Two potential agency relationships provide the basis for imposing vicarious liability on a franchisor for the actions of a franchisee: actual agency and apparent agency. Actual agency is usually found if the franchisor exercises sufficient control over the franchisee’s day-to-day operations so as to render the franchisee an agent of the franchisor. Apparent agency is usually found if the franchisor (the putative principal) represents that the franchisee (the putative agent) is in fact the franchisor’s agent or the franchisor negligently allows the franchisee to represent that it is the agent of the franchisor, and the plaintiff justifiably relies on the representations.

A. Actual Agency

The existence of an actual agency relationship depends upon the degree of control exerted by the franchisor over franchisee’s operation. Over the last five or so years, the trend across jurisdictions has been towards adopting a more narrowly defined “control of the instrumentality of harm” test for the imposition of liability, as opposed to the more general “control of the means and manner” of operation test.

1. Right to Control “Means and Manner” of Operation

The traditional test of franchisor liability under a theory of actual agency is “whether the alleged principal has the right to control the manner and method in which the work is carried out by the alleged agent.” This “right to control” test has historically been used to determine the existence of actual agency in an independent contractor context. It is important to note that under that test, agency is established merely by the “existence of the right to control,” and not necessarily by the exercise of that right. However, an agency relationship is not created because the franchisor or alleged principal requires a certain standard of performance, or retains the “right to control the result” of the alleged agent’s work. Under the established test, only the right to

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1 This paper does not address direct negligence claims against franchisors although such claims are frequently asserted along with vicarious claims. Jurisdictions which have ruled on this issue hold that franchisors do not owe a general duty of care to their franchisees’ invitees. See Allen v. Choice Hotels Int’l, Inc., 2008 WL 1925110 (4th Cir. 2008).

2 Oliveira-Brooks v. Re/Max Int’l, Inc., 865 N.E.2d 252, 258 (Ill. App. Ct. 2007) (finding no agency relationship absent evidence that franchisor “retained the right to control the specific means and manner by which [franchisee’s] sales associates conduct their day-to-day real estate activities”); see also, Corrales v. Days Inn Worldwide, Inc., Bus. Franchise Guide (CCH) ¶ 13,187 (D. Col. 2005) (finding no actual or apparent agency relationship where “license agreement established independent rights and obligations” and there was “insufficient control [of day-to-day] operations exercised by DIW through its license agreement and its actual practices” over franchisee); D.L.S. v. Maybin, 121 P.3d 1210, 1213 (Wash. Ct. App. 2005) (holding McDonald’s not liable to employee of franchisee absent showing of “control over daily operations”).

3 See Cawthon v. Phillips Petroleum Co., 124 So.2d 517, 519 (Fla. 2d DCA 1960) (“Where the employee is merely subject to the control or direction of the employer as to the result to be procured, he is an independent contractor; if the employee is subject to the control of the employer as to the means to be used, then he is not an independent contractor”); Fry v. Industrial Comm’n, 546 P.2d 1149, 1151 (Ariz. App. 1976) (finding no agency relationship where claimant “had the right to control the manner and means of the store’s operation”).

4 Martin v. Goodies Distribution, 695 So.2d 1175, 1177 (Ala. 1997).

control the “means and manner in which the result is achieved” gives rise to an actual agency relationship. In the franchise context, courts typically view the “Means and Manner” test as a determination of whether the franchisor controls the day-to-day operations of a franchisee.

In Ortega v. General Motors Corp., the plaintiff alleged that the dealer franchise agreement between GMC and one of its franchisees established the dealer as an agent of the franchisor. The plaintiff argued that eight separate provisions created the requisite level of control by the franchisor needed to establish agency: 1) the right to approve location and design of dealership; 2) requiring the franchisee to remain open on certain days and display certain signage; 3) imposing a uniform system of accounting, and retaining the right to inspect records; 4) prescribing a minimum owned net working capital; 5) establishing standards as to sales and customer service; 6) providing warranty service; 7) providing training; and, 8) prohibiting fraud in the franchisee’s dealings with customers. The court further examined “all of the rights and duties of the parties under the agreement,” especially those implicating the “day-to-day operation” of the franchisee’s business. Based on the franchisee’s independent ownership of the dealership, control over the hiring, firing and supervision of its employees, right to negotiate prices with its customers, and responsibility for the successful operation of the dealership, the court determined as a matter of law that the franchisee controlled the “method or mode of the operation of [its] business.”

Conversely, in Nichols v. Arthur Murray, Inc., the court recognized the existence of an agency relationship based on the right to control retained by the franchisor over its franchisee as evidenced by the franchise agreement. Fourteen independent requirements established the franchisor’s control over the day-to-day operation of the franchisee’s business, including control over employment decisions, advertisements, and record keeping, and a provision authorizing “broad control over the operation of the enterprise.” Contrary to the franchisor’s contention, the court reasoned that “the controls conferred were not related anywise to the protection of the defendant’s trade name.” Of late, there appears to be little development in the application of this test.

2. Control of “Injury-Causing Activity”

The recent trend favoring the application of the “injury-causing activity” or “instrumentality” test when assessing franchisor liability for the security breaches and tortious conduct of its franchisee and the franchisee’s employees received its first through examination in Wu v.

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6 Id. at 54.
7 392 So.2d 40 (Fla. App. 1980).
8 Id. at 42.
9 Id. at 43.
10 Id.
12 Id. at 615.
13 Id. at 615-16.
In *Kerl v. Rasmussen*, the first in a line of state supreme court cases since *Wu v. Dunkin’ Donuts* to adopt this approach, the Wisconsin Supreme Court concurred that the proper test for determining liability is whether a franchisor exerted control over the “specific aspect” of the franchisee’s business “that is alleged to have caused the harm.” The court affirmed the entry of summary judgment holding that the franchisor was not liable for the franchisee’s negligence in hiring, retaining, and supervising a work-release inmate who walked off the job without permission and shot his ex-girlfriend and her fiancée. In light of the unique nature of the franchise business model, the court reasoned that “marketing, quality, and operational standards commonly found in franchise agreements [and likely sufficient under the “means and manner” test for a finding of liability] are insufficient to establish the close supervisory control or right of control necessary to demonstrate the existence of a master/servant relationship.”

Applying the analysis in *Kerl* and analogizing from the independent contractor context, the court in *Allen v. Choice Hotels Int’l* held that a “franchisor should be held vicariously liable only when it had the right to control the specific instrumentality or aspect of the business that was alleged to have caused the harm.” The plaintiff brought suit following the violent acts of a hotel intruder resulting in the death of her husband and her own personal injuries. The plaintiff believed the franchise agreement and other rules enacted by the franchisor created liability for the franchisee’s negligence. The court reasoned that imposing liability for general day-to-day control of operations intended to protect the trademark would unfairly penalize franchisors for fulfilling the strict requirements of the Lanham Act and protecting the “goodwill value of the . . . trademark associated with the business.”

Similarly, in *Vandemark v. McDonald’s Corp.*, the plaintiff employee brought suit for injuries sustained in an overnight, on-the-job attack by two intruders with a baseball bat. The plaintiff contended that the franchisor was liable for the injuries because the franchisor’s operations manual and “Play Book,” a manual field consultants used in evaluating franchisee compliance, addressed a number of safety and security issues. The court refused to impose liability, concluding that “although the defendant maintained authority to insure the uniformity and

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14 105 F. Supp. 2d 83, 87 (E.D.N.Y. 2000) (holding franchisor not liable for rape and assault of franchisee’s employee absent evidence in the franchise agreement, or otherwise, that franchisor controlled security matters). The roots of this approach go back at least to *Exxon Corp. v. Tidwell*, 867 S.W.2d 19, 23 (Tex. 1993).

15 682 N.W.2d 328, 341 (Wis. 2004).

16 Id. at 342.

17 Id. at 332.


19 *Allen*, 942 So.2d at 819-20 (Miss. Ct. App. 2006).

20 Id. at 825.

21 Id. at 826.

22 904 A.2d 627, 630 (N.H. 2006).

23 Id. at 631.
standardization of products and services offered by [the franchisee] . . . such authority did not extend to the control of security operations.” 24 Specifically, because neither the operations manual nor the Play Book imposed an explicit mandate on the franchisee to implement the franchisor’s safety and security policies, they did not evidence sufficient franchisor control over the relevant instrumentality.25

In *Papa John’s Int’l v. McCoy*,26 the Kentucky Supreme Court extended the *Kerl* analysis beyond negligent security claims, and adopted the “instrumentality” test in analyzing franchisor liability for a franchisee’s employees’ tortious acts. The plaintiff/appellee sought to hold the franchisor liable for false statements made by the franchisee’s delivery driver to police regarding a “pizza delivery gone wrong.”27 The delivery driver alleged that he was falsely imprisoned by the plaintiff.28 The court stated that unless the franchisor had “control over the pizza delivery driver’s intentional, tortious conduct . . . [the franchisor] cannot be held vicariously liable.”29 Again, the “unique franchise arrangement” and unfairness of penalizing a franchisor for protecting its mark diminished the need to impose liability on the franchisor and resulted in the adoption of the modified test.30

3. **Is It a Question of Fact?**

It is well settled that determining the existence of an agency relationship is a question of fact.31 If, however, the claim concerns actual agency, courts have an easier task entering summary judgment if applying the “instrumentally” test. If the court applies the traditional “method and means” test, the likelihood of summary judgment is diminished. Similarly, the existence of a relationship of apparent authority “is normally a question for the trier of fact.”32

**B. Apparent Agency**

Courts apply two standards for recognizing the existence of an apparent agency relationship. All jurisdictions find an apparent agency relationship when a principal-franchisor “makes objective manifestations leading a third person to believe the wrongdoer is an agent of the

24 *Id.* at 636.
25 *Id.*
26 244 S.W.3d 44, 55 (Ky. 2008).
27 *Id.* at 47-48.
28 *Id.*
29 *Id.* at 47.
30 *Id.* at 54.
31 *See Vandemark v. McDonald’s Corp.*, 904 A.2d 627, 634 (N.H. 2006); *cf. Oliveira-Brooks v. Re/Max Int’l, Inc.*, 865 N.E.2d 252, 258 (Ill. App. Ct. 2007) (“While the existence of any agency relationship is usually a question of fact, it becomes a question of law when the facts regarding the relationship are undisputed or no liability exists as a matter of law”).
principal.” Furthermore, some jurisdictions also are willing to find the existence of apparent agency where a principal-franchisor “knowingly acquiesce[s] in the agent’s exercise of authority.”

1. The Principal’s Actions

Most courts evaluate claims for apparent agency “based upon the actions of the principal, not those of the agent.” In Rosser, while failing to find apparent agency, the court reasoned that the franchisee-repair shop’s display of franchisor-AAMCO’s logo “did not mean [the franchisor] held [the franchisee] out to the public as its agent.” Additionally, the franchisor’s advertisements did not give rise to apparent authority because the franchisee’s repair invoices “explicitly stated that customers were dealing with an independently owned and operated repair shop.”

In God’s Glory & Grace, Inc. v. Quik Int’l, Inc., the court concluded that the franchisor-ISP never gave the franchisee-web designer “authority to bind it to any contract.” The court found that the franchisor was not a party to the plaintiffs’ contract with the franchisee, and that the franchisor “in fact, had no contact with [plaintiffs].” The franchisee’s “comments,” “assurances,” and use of the franchisor’s logo on its employees’ business cards, were insufficient to bind the franchisor.

Similarly, in Coldwell Banker Real Estate Corp. v. DeGraft-Hanson, the franchisee’s actions failed to establish a realty-franchisor’s apparent agency for violations of the Fair Housing Act and the resulting infliction of emotional distress. The plaintiffs argued that the franchisee’s listing agreement and advertisements, “which failed to clearly state [the franchisee’s] independent status,” established apparent agency. However, the plaintiffs conceded that they had “no contact” with the franchisor and that the franchisor was not involved in the listing of local

33 Maybin, 121 P.3d at 1213; see also Groob v. Key Bank, 843 N.E.2d 1170, 1179 (Ohio 2006) (“the principal’s acts must be found to have clothed the agent with apparent authority”).


35 Rosser v. AAMCO Transmissions, Inc., 923 So.2d 294, 300 (Ala. 2005) (finding no apparent agency); see also Maybin, 121 P.3d at 1213-14 (finding no apparent agency based on “omnipresent McDonald’s logo” where plaintiff had actual knowledge of franchisee’s independence).

36 Rosser, 923 So.2d at 300.

37 Id.; see also Allen v. Choice Hotels Int’l, 942 So.2d 817, 827 (Miss. Ct. App. 2006) (finding franchisor’s requiring franchisee to “display, in a prominent location in the hotel’s lobby, a sign indicating that the [hotel] was run by an independent party, and not [franchisor] sufficient to negate existence of apparent authority).

38 938 So.2d 730, 735 (La. Ct. App. 2006).

39 Id. at 736.

40 Id.


42 Id. at 410-11.
homes. The court held that absent any representations by the alleged principal, the plaintiffs' apparent agency theory “must fail.” Conversely, in *Loyle v. Hertz Corp.*, the court reversed a summary judgment order in favor of a franchisor based on Hertz Corporation’s “multi-national” advertisements and branding. The plaintiff rented a car in Canada by calling the United States reservation line and was allegedly mistakenly arrested when a loaded handgun was found in the returned car. The lower court denied the plaintiff’s apparent agency claim because the “tortious conduct alleged was committed by Hertz Canada.” In reversing, the superior court reasoned that “manifestations of the principal . . . made to the community by signs or advertising,” were sufficient for finding apparent authority if the plaintiff relied on those “indicia of authority originated by the principal.”

2. The Principal’s Inaction

Some jurisdictions allow an agent’s actions to bind the principal, if the principal by willful inaction permits the agent’s exercise of authority. In *Synergy*, an employee placement agency brought suit against an employer seeking payment of a placement fee. The court found the existence of an apparent agency relationship between the defendant corporation and the defendant corporation’s sales manager where the defendant’s president admitted that on at least one occasion he “expressly authorized” the sales manager to hire and contract with another employee for a full time position.

In *Oliveira-Brooks v. Re/Max Int’l, Inc.*, the court reserved judgment on the sufficiency of a purported agent’s actions in establishing an apparent agency relationship. The franchisee’s real estate agent testified that he “mentions Re/Max to his clients to draw upon the big name and credibility of [the franchisor], wears a Re/Max pin, and has a sticker with a Re/Max logo on his car.” The court determined that even if the evidence established the element of “holding out,”

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43 *Id.* at 411.
44 *Id.*
46 *Id.* at 402-03.
47 *Id.* at 406.
48 *Id.* at 407 (citing Restatement (Second) of Agency §§ 8, 8B, 27 (1957)).
50 *Id.* at 388.
51 *Id.* at 393-94.
53 *Id.* at 260.
it would be insufficient for a finding of apparent authority without evidence of the plaintiff’s reliance on the alleged relationship.54

3. **Estoppel & Justifiable Reliance**

Consistent with the Restatement (Second) of Agency, the majority of jurisdictions require that the plaintiff have justifiably relied upon the belief that another is the agent of the principal in order to find a relationship of apparent agency.55 In *D.L.S. v. Maybin*,56 a minor plaintiff’s belief that “she worked for McDonald’s Corporation” based on the “omnipresent McDonald’s logo on her uniform, her paycheck, restaurant products and other materials” was insufficient for a finding of apparent authority where the plaintiff received actual notice of franchisee’s independent owner/operator status from an employment application and the plaintiff “knew” that the franchisee was the owner/operator of the restaurant. The court stated that even absent actual notice, the plaintiff’s claim for apparent authority would have failed without evidence that “she did anything in reliance upon the belief that she was employed by McDonald’s [(the franchisor)] . . . in accepting or maintaining her employment.”57 However, the plaintiff’s father claimed to have permitted her employment relying on the belief that “‘McDonald’s is a McDonald’s’ and would offer a safe, wholesome environment . . . based on McDonald’s marketing and advertising.”58 The court held that without further action by the principal, McDonald’s marketing, advertising, and charitable work were insufficient to create an apparent employment relationship between a franchisor and a franchisee’s employees.59

Similarly, dependence on a third party’s perception of an agency relationship is insufficient as a matter of law to establish the existence of an apparent agent relationship.60 In *Oliveira-Brooks*, the plaintiff-client was injured in an accident while riding in a real estate agent’s car with her son.61 The plaintiff alleged that the franchisor was liable under a theory of apparent agency because the real estate agent had previously told her son that “he worked for Re/Max International,” although no evidence existed that the agent had told the plaintiff this information.62 The court held that the plaintiff’s apparent agency claim failed because she merely relied on “her son’s perception of an agency relationship and not on anything that

54 Id. at 260-61.
56 121 P.3d at 1213.
57 Id. at 1214.
58 Id.
59 Id. at 1214-15.
61 Id. at 253.
62 Id. at 257.
Re/Max International or [the real estate agent] ‘held out’ to her.” Furthermore, the court determined that the plaintiff’s claim failed as a matter of law because there was no evidence that she “actually relied on an apparent agency relationship between Re/Max International and [the real estate agent] in choosing him for her real estate needs.” To the contrary, the evidence indicated that the plaintiff had chosen to work with the real estate agent because he was Brazilian, spoke Portuguese and “friends and relatives had purchased properties through him.”

In *Rosser v. AAMCO Transmissions, Inc.* a minor passenger was injured when an automobile malfunction caused it to collide with another vehicle on the road. The plaintiffs brought suit against the franchisee repair shop and the franchisor, alleging that AAMCO was liable for the franchisee’s negligent and wanton failure to repair the auto under a theory of actual or apparent agency. However, an agency relationship was not found where the repairs done to the plaintiffs’ car were initiated by a third party auto dealer without advance notice to the plaintiffs, and they “[n]ever had any dealings with . . . or ever visited the premises of” either the franchisor or the franchisee. The plaintiffs were not permitted to depend on a third party’s belief that the franchisor owned and operated franchised outlets to prove their agency claim, where the plaintiffs did not share that belief at the time of repair and therefore could not have reasonably relied on that belief to their detriment.

C. **Control – Requirements versus Recommendations**

For purposes of determining vicarious liability, franchisor-enforced operational requirements are treated differently from discretionary recommendations. In *Townsend v. Goodyear Tire & Rubber Co.*, the franchisee employee sustained fatal injuries installing tires on a customer’s motor home. The plaintiffs alleged that both the dealer agreement and trademark license agreement made the manufacturer-franchisor contractually liable to the employee and vicariously liable for the dealer’s negligence. The court disagreed and ruled that “[m]erely exercising or retaining a general right to recommend a safe manner for the independent contractor’s employees to perform their work is not enough’ to establish liability.”

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63 *Id.* at 261.
64 *Id.*
65 *Id.*
66 923 So.2d 294, 296 (Ala. 2005).
67 *Id.* at 299-300.
68 *Id.* at 301.
69 *Id.* at 301-02.
70 249 Fed. App’x. 327, 328 (5th Cir. 2007).
71 *Id.*
72 *Id.* at 329.
agreements did not furnish the franchisor-manufacturer with “supervision of the specific methods and means” of the franchisee-dealer’s operation necessary to establish liability.73

In Simpkins v. 7-Eleven, Inc.,74 a drunken customer attacked and injured another customer inside the store. However, since “franchisees were free to reject corporate 7-Eleven’s supervision in security training for the franchisee’s employees,” and no evidence established the franchisor’s participation in day-to-day security affairs, the franchisor was not deemed liable for the security breach and resulting harms.75 Thus, franchisor recommendations are not deemed to evince the same degree of control over a franchisee’s operation as would requirements.

III. THE EFFECT OF TYPICAL FRANCHISOR CONTROLS

A. Trademarks & The Lanham Act

Pursuant to the federal Lanham Act,76 a “trademark owner must preserve his asset and protect the public against deceptive uses of the trademark, which typically means the franchisor must regulate the franchisee.”77 However, the law’s purpose is not “to create a federal law of agency.”78 Therefore, operational standards typically included in franchise agreements should not be the sole basis for a determination of franchisor liability.79

B. System Standards – Operations Manuals & Franchise Agreements

System standards provide franchisors with a way to manage the franchise system while lessening their potential exposure to liability.80 In Hunter, the plaintiff-hotel guest tripped over an uncoiled garden hose while walking through the franchisee’s premises, injuring her foot and hip.81 The plaintiff claimed that the franchisor was vicariously liable for the franchisee’s negligence based on the level of control established by the franchise agreement.82 The court disagreed, holding that “retaining certain rights such as the right to enforce standards, the right to terminate the agreement for failure to meet standards, the right to inspect the premises, the

73 Id.
75 Id. at *8.
77 Allen v. Choice Hotels Int’l, 942 So.2d 817, 826 (Miss. Ct. App. 2006); see also Oliveira-Brooks v. Re/Max Int’l, Inc., 865 N.E.2d 252, 258 (Ill. App. Ct. 2007) (“mere protection of a trade name does not create an agency relationship”); Kerl v. Rassmussen, 682 N.W.2d 328, 338 (Wis. 2004) (“[O]perational standards and inspection rights specified in the franchise agreement are integral to the protection of the franchisor’s trade or service mark under the Lanham Act”).
78 Kerl, 682 N.W.2d at 338.
80 See Allen, 942 So.2d at 825 (concluding that a “franchise agreement . . . is meant to provide a system of uniformity,” and does not prove that the franchisor retained the “right of control”).
81 Hunter, 2005 WL 1490053 at *1.
82 Id. at *6.
right to require that franchisees undergo certain training, or the mere making of suggestions and recommendations does not amount to sufficient control."\(^{83}\)

Similarly, in \textit{Corrales v. Days Inn Worldwide, Inc.},\(^{84}\) a hotel guest alleged that the franchisor was directly or vicariously liable for burns sustained in the franchisee-hotel’s shower. The plaintiff argued that the licensing agreement and the imposition of system standards established the franchisor as a principal in an agency relationship.\(^{85}\) The court disagreed, ruling that the license agreement and the franchisor’s actions “establish no more than standards to safeguard the uniformity, value and integrity of the franchise system” and do not amount to day-to-day control of the franchisee’s operation necessary to impose liability.\(^{86}\)

Additionally, the reality that “violations of the franchise agreement can result in loss of the franchise . . . does not amount to actual control over the franchisee’s operation,”\(^{87}\) If anything, “the imposition of quality and operational requirements by contract suggests that the franchisor does not intervene in the daily operation and management of the independent business of the franchisee.”\(^{88}\)

\section*{C. Quality Assurance Programs – Inspection Rights & Training}

“[T]he right to conduct unannounced inspections does not give rise to the power to control the daily maintenance of the premises.”\(^{89}\) Similarly, the practice of requiring a franchisee’s employees to “attend certain orientation seminars does not amount to control over the hotel employees’ activities.”\(^{90}\) If the purpose of inspection rights or training is to maintain uniformity within the franchise system, then absent other showings of day-to-day control a franchisor cannot be held vicariously liable.\(^{91}\)

\section*{D. Product Specifications}

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\(^{83}\) \textit{Id.}


\(^{85}\) \textit{Id.}

\(^{86}\) \textit{Id.}


\(^{88}\) \textit{Kerl v. Rassmussen}, 682 N.W.2d 328, 338 (Wis. 2004).


\(^{90}\) \textit{Id.}

\(^{91}\) See \textit{Id.}
Like inspection rights and training, product specifications have regularly been found insufficient, absent other relevant forms of control, to establish franchisor liability.92

IV. THE EFFECT OF DISCLAIMERS

A. Agency Disclaimer & Declaration of Independent Status in the Franchise Agreement

Agency disclaimers and declarations of a franchisee’s independent status contained in the franchise agreement are insufficient in and of themselves to insulate a franchisor from liability. “[T]he label the parties attach to their relationship is informative but not dispositive.”93 “[I]f a franchise contract so regulates the franchisee as to vest the franchisor with control within the definition of agency, the agency relationship arises even though the parties expressly deny it.”94

B. Disclaimers Made To Franchisee’s Customers & Employees – Signage/Materials/Internet

Conversely, proper disclaimers made to customers and employees averring a franchisee’s independent status may insulate the franchisor from liability. In Allen v. Choice Hotels Int’l.,95 the franchisor’s requirement that its franchisee “display, in a prominent location in the hotel’s lobby, a sign indicating that the [hotel] was run by an independent party” was sufficient to defeat vicarious liability under a theory of apparent authority. Similarly, in Rosser v. AAMCO Transmissions, Inc.,96 the franchisor was not deemed liable for breach of express warranty where the warranty issued in connection with the repair twice specified that the issuer was an “independently owned and operated AAMCO Transmission Center” and the franchisor did not control the “manner” of the franchisee’s performance.

V. TYPES OF VICARIOUS LIABILITY CLAIMS

Vicarious liability claims against franchisors can arise in a wide variety of substantive areas, including torts, statutory violations, and breach of contract cases.

A. Personal Injury – Negligence

When customers are injured at a franchise business, they often assert negligence claims against both the franchisee and the franchisor. The key issue for imposition of vicarious liability over the franchisor is whether the franchisor exercises sufficient control over the day-to-day decisions and operations of the franchisee to give rise to a legal duty. Depending on the facts and jurisdiction, courts have reached different results on the issue of control in negligence cases.


93 Kerl, 682 N.W.2d at 341.


95 942 So.2d 817, 827 (Miss. Ct. App. 2006).

96 923 So.2d 294, 303 (Ala. 2005).
1. No Liability Imposed – Summary Judgment Granted

In *Jones v. Filler, Inc.*, the court found that because the franchisor did not control the operations of the franchisee auto repair shop, including control over employment matters or the manner of service, there was no actual agency. Requirements related to hours of operation and design of the shop were insufficient to find liability.

In *Oliveira-Brooks v. Re/Max Int'l, Inc.*, the court granted summary judgment finding no genuine issue of material fact with respect to actual or apparent agency. The franchisor provided general standards for operation, but the franchisee had control over the day-to-day operations related to the sale of real estate properties.

Summary judgment was also granted in *Ely v. General Motors Corp.*, a wrongful death case in which the plaintiff's decedent was struck and killed by a mechanic employee of a General Motors franchisee. The court found there was no issue of fact with respect to an agency relationship, because General Motors had no right to control the mechanic's test drive of the car. To impose vicarious liability, Texas courts require control over the injury-causing activity, and the plaintiff could not prove this essential element of the case.

2. Summary Judgment Denied

In *Dubois v. Kepchar*, the plaintiff claimed that the franchisor was vicariously liable for negligent handling of a real estate transaction. The court denied liability under actual agency, stating that in order for the franchisor to be held liable for its franchisee's acts, there must be evidence that the franchisor had some degree of control, whether or not actually exercised, over that activity. In that case, the franchisor did not retain control over the franchisee's services in selling real estate. On the issue of apparent authority, however, the court found an issue of fact and denied summary judgment. This decision was based on testimony that the plaintiff believed that it had signed a listing agreement with the franchisor.

In *Drexel v. Union Prescription Centers, Inc.*, a case where the plaintiff's decedent died after taking a prescription that was improperly filled by a franchised drug store, the franchisor moved for summary judgment arguing that there was no agency relationship. The trial court granted summary judgment, but the court of appeals reversed, finding an issue of fact with respect to apparent agency based on common advertising, telephone listings, and trademark usage.

Courts have also refused to grant summary judgment on the issue of actual agency. For example, where a car rental franchisor retained the right to control the operations of the franchisee, there was a genuine issue of material fact with respect to whether it actually...
exercised sufficient control. In Balderas, negligence claims were made after an employee of the franchisee was involved in a car accident while driving a car on behalf of the franchisee that was not owned or leased by the franchisor. The court also denied summary judgment based on a right to control in Miller v. McDonald’s Corp. In that case, the plaintiff had been injured when she bit into a sapphire while eating a sandwich she purchased from the franchisee. The court found that the franchise agreement gave McDonald’s the right to control food handling and preparation, and because the plaintiff alleged deficiencies in those functions, there was sufficient evidence to find actual agency.

B. Personal Injury – Criminal Activity

Vicarious liability claims against franchisors frequently arise when customers or employees are injured at a franchised location, allegedly because of franchisee breaches of security procedures or safety protocols.

Delivery of a safe environment for customers and employees is critical to any bricks and mortar franchise chain. However, the method of delivery is generally not a component of a brand’s identity. Consequently, many franchisors provide only voluntary guidelines for franchisees with respect to safety and security procedures. Courts have held that the voluntary nature of such guidelines further distances the franchisor from the “instrumentality of the harm”, making imposition of vicarious liability inappropriate.

In a recent case, Allen v. Choice Hotels Int’l, Inc., the Fourth Circuit affirmed summary judgment for Choice Hotels on the plaintiffs’ direct and vicarious liability claims arising from a hotel fire. The plaintiffs chose only to appeal the dismissal of the direct liability claims, alleging that Choice Hotels was negligent for failing to require its franchisee to retrofit the hotel with sprinklers because, among other things, its franchise agreement required the franchisee to meet or exceed local codes. In holding that Choice Hotels had no such duty, the court recognized the distinction between ensuring uniformity, which a franchisor must do, and controlling hotel life safety systems. Interestingly, the Allen court noted that in “related cases arising from the same incident,” the state court in South Carolina denied summary judgment for Choice Hotels, holding that whether or not the franchisor owed a duty sufficient to support plaintiff’s direct liability

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105 See Vandemark v. McDonald’s Corp., 904 A.2d 627, 631 (N.H. 2006) (finding no direct or vicarious liability for employee injured in a robbery attempt where franchisor’s O&T manual specifically provides that security procedures are mandatory for company-owned restaurants while “[i]ndependent owner/operators are encouraged to adopt appropriate policies”); Wu v. Dunkin’ Donuts, Inc., 105 F. Supp. 2d 83, 91 (E.D.N.Y. 2000) (no vicarious liability where the “undisputed evidence” shows that franchisor “merely made security equipment available for purchase and suggested that alarm systems…were important”).
106 2008 WL 1925110 (4th Cir. 2008).
107 Id. at * 3.
108 Id.
liability claim against the franchisor was a “mixed question of law and fact to be resolved by the fact finder.”

C. Products Liability

The issue of actual control is also key to the liability of a franchisor in the context of products liability. In the Michigan case of Kosters v. Seven-Up Co., a consumer who was carrying a cardboard container of 7-Up bottles was blinded when one of the bottles broke free and exploded, sending a piece of glass into her eye. A jury awarded the plaintiff $150,000 against the Seven-Up Company, even though the defective carton and bottle were manufactured by third parties. The Sixth Circuit held that “[t]he franchisor’s sponsorship, management and control of the system for distributing 7-Up, plus its specific consent to the use of the carton, in our view, places the franchisor in the position of a supplier of the product for purposes of tort liability.” Additionally, the court found that liability attaches when the franchisor’s conduct creates a public assumption that it controls and vouches for the conduct at issue.

In Harris v. Aluminum Co. of America, another case of a consumer being blinded by a soft drink bottle, a Virginia court, discussing Kosters, applied Virginia law and came to the same conclusion as the Sixth Circuit. It examined three factors to decide whether liability under an implied warranty theory was appropriate: 1) the franchisor’s responsibility for placing the products in the stream of commerce; 2) the franchisor’s ability to prevent the loss by eliminating the defective character of the product; and 3) the consumer’s reliance on the franchisor’s actions. Because Coca-Cola had a significant amount of control over the bottling process, and the bottle was labeled as being bottled under its authority, the court found Coca-Cola liable for the defective condition of the bottle.

If the franchise agreement does not give the franchisor significant control over the sale or usage of a product, however, the franchisor may avoid liability. In Hofherr v. Dart Industries, the Fourth Circuit ruled that the franchisor of a retail pharmacy was not liable to a woman who ingested DES when that franchisor was not responsible for the manufacturing of the drug. The Fourth Circuit based its decision on agency principles, finding that the franchise agreement did not grant the franchisor control over the day-to-day operations of the franchisee. The Fourth Circuit also held that there was no liability on the part of the franchisor for failure to warn of the dangers of the drug.

109 Id. at *1.
110 595 F.2d 347, 353 (6th Cir. 1979).
111 Id.
112 Id.
114 Id. at 1028.
115 853 F.2d 259 (4th Cir. 1988).
116 Id. at 262.
117 Id. at 263.
There have been exceptions carved out from this general rule. In *Wilson v. Good Humor Corp.*,\(^{118}\) the D.C. Circuit reversed a directed verdict in favor of the Good Humor Ice Cream Company in a wrongful death suit. The court found that while agency theory did not create liability, the company was aware of the peculiar risk of children running out into traffic when their trucks were parked on busy streets. Because Good Humor was aware of such risk, the court was willing to impose liability under a peculiar risk exception.

Likewise, in *Wise v. Kentucky Fried Chicken Corp.*,\(^{119}\) a federal court in New Hampshire refused to grant summary judgment to the franchisor where the plaintiff employee argued that KFC was liable for an injury caused by a faulty pressure fryer. While KFC argued that the franchisee was an independent contractor, the district court found that there were fact issues as to the level of control KFC exercised over its franchisee. Because the court had questions as to whether KFC merely approved the use of the fryer or actively directed its installation, the court found that issues of material fact precluded summary judgment.\(^{120}\)

### D. Sexual Harassment

Title VII of the Civil Rights Act prohibits employers from discriminating against employees on the basis of sex.\(^ {121}\) Because Title VII provides for liability by “employers,” the discrimination must be attributable to the plaintiff’s employer for a claim to be valid. Sexual harassment lawsuits by an employee of a franchisee are often filed against both the franchisee and the franchisor. Accordingly, when the franchisor is named as a defendant, the issue is whether the franchisor can be considered the employer of the franchisee’s employees. In deciding whether a franchisor may be held vicariously liable for sexual harassment, courts most commonly apply the single employer test or agency theories.

#### 1. The Single Employer Test

A test that has been gaining popularity and is now used in many jurisdictions is the single employer test, also called the economic realities or integrated enterprise test. This test has four factors: (1) interrelation of operations; (2) centralized control of labor relations; (3) common management; and (4) common ownership or financial control. The issue is whether the franchisee and franchisor are so integrated that the franchisor can be considered the employer of the plaintiff.

The key factor is centralized control of labor relations. To satisfy this element of the test, “a parent must control the day-to-day employment decisions of the subsidiary.”\(^ {122}\)

In *Lockard*, an employee of a Pizza Hut restaurant sued the franchisor and franchisee for sexual harassment and a jury returned a verdict for the employee against both defendants. On appeal, Pizza Hut argued that it was not the plaintiff’s employer for Title VII purposes, and the 10th

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\(^ {118}\) 757 F.2d 1293 (D.C. Cir. 1985).


\(^ {120}\) *Id.* at 995.

\(^ {121}\) 42 U.S.C. § 2000 et seq.

\(^ {122}\) *Lockard v. Pizza Hut, Inc.*, 162 F.3d 1062, 1070 (10th Cir. 1998) (emphasis in original).
Circuit applied the single employer test. The court reversed the district court’s denial of Pizza Hut’s motion for judgment as a matter of law, holding that the plaintiff had not submitted any evidence from which one could determine whether Pizza Hut controlled the day-to-day employment decisions of the franchisee, whether it made the final decision regarding employment matters, or the degree of interrelatedness of the two companies.\textsuperscript{123}

In \textit{Alberter v. McDonald’s Corp.},\textsuperscript{124} a case in which a 15-year-old employee sued a McDonald’s franchisee and McDonald’s Corporation alleging a hostile work environment under Title VII, the United States District Court in Nevada applied the single employer test and granted McDonald’s motion for summary judgment. The court focused on the centralized control of labor relations factor and considered which entity, the franchisee or franchisor, had the power to make employment decisions concerning the plaintiff. In this case, the franchisee employed the individuals who worked at the restaurant and made all of the decisions concerning hiring and firing, employee discipline, performance evaluations, awards, promotions, demotions, scheduling, work assignments, training, time off, and compensation.\textsuperscript{125} McDonald’s on the other hand, did not have any authority to make these employment decisions. In addition, while McDonald’s provided personnel policies in its manuals, the franchisee was not required to abide by those policies as a condition of the franchise agreement. Instead, the franchisee could use those policies or adopt its own policies, which it did. The franchisee even had its own sexual harassment policy. Because McDonald’s exercised no control over employment matters at the restaurant, it was not the plaintiff’s “employer” for Title VII liability.

\section*{2. Actual Agency}

Courts look at the day-to-day operations of the franchisor, but especially control over employment matters. For example, courts have stated that a franchisor will not be held liable when it imposes basic guidelines but does not make the specific hiring and firing decisions. Setting out general standards for employees is not enough to find actual agency – the franchisor must control the precise methods.\textsuperscript{126} Where a franchisor had no control over hiring, retention, firing, scheduling, wages, benefits, and vacations, it was not the plaintiff’s “employer” under the actual agency test.\textsuperscript{127} Courts have also relied on franchise agreements which state that the franchisee is “solely responsible” for employment decisions.\textsuperscript{128}

In \textit{Kennedy v. Western Sizzlin Corp.},\textsuperscript{129} where there was no evidence that the franchisor controlled the day-to-day operations of the franchise, but only ensured that the franchisee complied with the franchise agreement and operations manual, the franchisee was not the

\begin{footnotes}
\item[123] Id. at 1071.
\item[125] Id. at 1143–44.
\item[127] \textit{Freeman v. Suddle Enterprises, Inc.}, 179 F. Supp. 2d 1351 (M.D. Ala. 2001). In finding no actual agency, the court discussed the existence of an agreement between the franchisee and franchisor containing a waiver of vicarious liability, but stated that such agreements are not dispositive.
\item[129] 857 So.2d 71 (Ala. 2003).
\end{footnotes}
actual agent of the franchisor. Western Sizzlin trained employees, but the franchisee had sole control over the employment decisions at the restaurant.

3. **Apparent Agency**

Apparent agency exists when the principal holds the agent out as having authority to act on its behalf and the plaintiff believed that the agent possessed the necessary authority. The first question in this context is who did the plaintiff believe her employer to be? Apparent authority arguments have been made in the sexual harassment context where the plaintiff believed that she worked for the franchisor, rather than the independent franchised business. Even if the plaintiff had this belief, however, there is no apparent agency if that belief is not reasonable. Therefore, courts analyze whether the employment documents support the plaintiff’s belief that she was employed by the franchisor.

For example, in *D.L.S. v. Maybin*, the plaintiff submitted a declaration stating that she believed that she worked for the franchisor, based on the presence of the logo on her uniform, paycheck, and other items. The plaintiff had signed documents, however, making clear that the franchisee, and not McDonald’s, was her employer. The court found that since the plaintiff knew that she is working at a franchise, and not a company store, there is no apparent agency.

In *Kennedy*, although the plaintiff testified that she thought that the franchisee and franchisor were the same entity, there was no evidence to demonstrate that the franchisor, Western Sizzlin Corp., did anything to create an appearance of authority in the franchisee. Moreover, the franchise agreement included language prohibiting the franchisee from acting as the agent of Western Sizzlin Corp. Therefore, the court refused to impose liability on the franchisor on the basis of apparent authority.

4. **Denial of Summary Judgment**

Many courts have refused to impose liability on franchisors for sexual harassment by employees of franchisees. There are cases, however, where courts have found the agency issues to be an issue of fact and denied summary judgment. One such case is *Miller v. D.F. Zee’s, Inc.* In *Miller*, the court held that the franchisor, Denny’s, could be liable for the harassment based on agency theories. The court made this finding despite a provision in the franchise agreement stating that the franchisee was not the franchisor’s agent. The court noted that what matters is not the actual control exercised by the franchisor, but the franchisor’s right to control. It relied on several factors in concluding that the franchisor retained sufficient control to support a finding of an actual agency relationship. The franchise agreement required adherence to detailed operations manuals, Denny’s sent inspectors to the restaurant regularly to check compliance,

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131 See *Hamlin*, Bus. Franchise Guide (CCH) ¶ 11,876 at 4 (where plaintiffs testified that they knew the motel where they worked was owned by the franchisee, and the name of the franchisee was on their paychecks and W-2 forms, there was no apparent agency).

132 857 So.2d at 71.


134 Id. at 806.
and Denny’s retained the right to cancel the agreement.135 Further, the franchisee agreed to “hire, train and supervise” employees in compliance with the manual, and the manuals gave Denny’s the right to train employees and to set disciplinary measures against employees.136

Thus, whether an issue of fact will preclude summary judgment may depend on the jurisdiction of the case. In *Kennedy*, the plaintiff made the same argument—that the operations manuals gave the franchisor the right to conduct inspections and train employees—but the court reached the opposite conclusion.137 Therefore, the same set of provisions in the franchise agreement and actual controls exercised by the franchisor may lead to a dismissal in one jurisdiction and a denial of summary judgment based on genuine issues of material fact in another.

The court in *Miller* also found an issue of fact on apparent authority issues. Important factors for the court were that there was no indication in the restaurant that it was owned by a franchisee and not Denny’s, the Denny’s logo was prominently displayed, and the plaintiffs believed they were Denny’s employees.138

E. Americans With Disabilities Act

1. Background of the ADA

The Americans With Disabilities Act of 1990 was designed “to provide a clear and comprehensive national mandate for the elimination of discrimination against individuals with disabilities.”139 The ADA is divided into three areas: (1) employment (Title I); (2) public services (Title II); and (3) places of public accommodation (Title III).140

Title III of the ADA specifically provides, “No individual shall be discriminated against on the basis of disability in the full and equal enjoyment of the goods, services, facilities, privileges, advantages, or accommodations of any place of public accommodation by any person who owns, leases (or leases to), or operates a place of public accommodation.” (emphasis added)141 Claims against franchisors under the ADA generally involve suits under Title III by customers who visit a franchise location and find that the particular location is not accessible or discriminates against the disabled. The question is whether the principles of vicarious liability would allow a plaintiff to sue a franchisor under Title III for discrimination based on incidents which occurred on the premises of a franchisee.

2. *Neff* and ADA Claims Against Franchisors

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135 Id. at 806–07.
136 Id. at 807.
137 857 So.2d 71.
138 31 F. Supp. 2d at 808.
139 42 U.S.C. § 12101(b)(1).
141 42 U.S.C. § 12182(a).
The first major case to explore the issue of the vicarious liability of franchisors involved Margo Neff, a wheelchair-bound woman who found that two San Antonio-area Dairy Queen locations were not handicapped-accessible. She filed a suit against the individual store owners as well as American Dairy Queen Corporation (ADQ), the franchisor. Neff claimed that ADQ was vicariously liable on the basis that the franchise agreement gave ADQ operational control of the franchises.

ADQ moved for summary judgment arguing that as a matter of law it did not own, lease or operate the two stores involved in the lawsuit. And therefore it could not be liable under Title III. The standard for liability under Title III, it argued, required ownership or operational control. The federal district court in Texas agreed with ADQ that the terms of the franchise agreement between the two stores and ADQ did not give ADQ sufficient control over the operations of the stores to allow for vicarious liability.

The Fifth Circuit affirmed, finding that the language of the franchise agreement was not sufficient to establish that ADQ was the “operator” of the two stores for the purpose of Title III. The court was concerned with the level of control necessary to force compliance with the ADA, and nothing in the language of ADQ’s franchise agreement prevented the two stores from becoming compliant with the ADA.

The same approach was followed in Dahlberg v. Avis Rent a Car System, Inc., a case in which a disabled plaintiff sued Avis based on the practices of the Avis branch at LAX airport. The District Court followed the analysis in Neff to arrive at the conclusion that Avis was not vicariously liable for the acts of its LAX branch. The use of Avis’ centralized reservation system was not sufficient to give the franchisor, Avis, “control” under the terms of the ADA, and, as in Neff, the presence of a franchise agreement was not sufficient to make Avis an “operator” of the LAX facility. The court found that the terms of the franchise agreement did not give Avis enough control over the franchisee to justify liability.

The key factor is the amount of control granted by the franchise agreement, and specifically whether the franchise agreement gives the franchisor the power to directly influence compliance with the ADA. In U.S. v. Days Inns of America, Inc., an Illinois federal court found that a franchisor had exercised sufficient control over compliance to be liable under the ADA. The court held that because the franchisor, Days Inn, was directly responsible for the construction of a Chicago-area hotel, it was liable for any failure to make that building acceptable to the handicapped under a section of the ADA governing parties who design and construct new commercial facilities. The court found that participation in and guidance of the planning and

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143 42 U.S.C. § 12182(a).
144 Neff, 879 F.3d at 1068.
145 id. at 1067.
147 id. at 1101.
building of franchised hotels constituted “designing and constructing” commercial buildings. Days Inn argued that this section implicitly incorporates the “own, lease or operate” language applied in Neff, and therefore it was not liable. The court disagreed and reasoned that even if it accepted that argument, it would have not allowed Days Inn to escape liability. The court pointed to language in the legislative history that suggested that Congress had intended for franchisors to be liable for the accessibility of their franchises. 149

The Neff rule may make it more difficult for a plaintiff to prevail against a franchisor for the lack of ADA compliance on the part of a franchisee, but it is not a bar to vicarious liability. Neff left the door open to the possibility of liability if a franchise agreement gives enough control to the franchisor over a franchisee’s ADA compliance. 150

F. FACTA

In 2003, Congress updated the Fair Credit Reporting Act with the Fair and Accurate Credit Transactions Act (“FACTA”) to respond to growing consumer concerns about credit card identity theft. 151 Among other things, FACTA requires that merchants ensure their receipts contain no more than the last five digits of a credit or debit card number and exclude the card’s expiration date. 152 There is a private right of action for violations of FACTA, permitting the recovery of actual damages for a negligent violation, and actual or statutory damages, as well as punitive damages, for “willful” violations. 153 Hundreds of individual and class action lawsuits have been filed under FACTA.

In Patterson v. Denny’s Corp., 154 a case of first impression, the United States District Court for the Western District of Pennsylvania denied a franchisor’s motion to dismiss a FACTA claim premised on the franchisor’s vicarious liability for a franchisee’s violation of the Act. Although FACTA provides no statutory basis for vicarious liability, the court noted that corporations have been held vicariously liable for FACTA violations committed by their agents under common law agency principles. 155 Finding no reason to treat the franchisor-franchisee relationship differently, the court held that the “decisive issue” is whether the franchisor exercises sufficient control. 156 Although Denny’s Corp. may well demonstrate on summary judgment or at trial that it lacks sufficient control, this is an important case for the franchise community to watch given the proliferation of FACTA litigation.

149 Id. at 1084–85.

150 Neff v. American Dairy Queen Corp., 48 F.3d 1063, 1066 (5th Cir. 1995).


155 Id. at *2, n. 7.

156 Id. at *2.
VI. PRACTICAL ISSUES IN LITIGATING THE VICARIOUS LIABILITY CASE

A. Franchisor and Franchisee Should Align Around Dismissal of the Franchisor.

As a general rule, franchisors and franchisees have a unity of interest in having the franchisor dismissed from a third party lawsuit that seeks to impose vicarious liability for acts of the franchisee. Indeed, a franchisee may be amenable to substitution for an improperly named franchisor defendant.157 Is such a franchisee merely being accommodating to its franchisor? No. Removing the franchisor eliminates the “deep pocket” corporate defendant, reducing the settlement value, potential verdict, and media exposure of a case.

But that is not the only consideration. If a system follows a strategy of cooperating to dismiss franchisors from such claims, it may favorably impact the settlement values and verdicts for claims across the system. Lower loss runs mean lower premiums for the franchisee community with an approved carrier program. Moreover, many franchisees want the opportunity to defend their own business practices, and are in a better position to do so. Lastly, a dismissal of, or substitution of, the franchisor can avert the franchisor asserting an indemnity or contribution claim against the franchisee.

1. The Plaintiff May Voluntarily Dismiss Claims Against the Franchisor.

Not every attempt to dismiss vicarious liability claims against the franchisor will be contested. Often, plaintiff’s attorneys sue the franchisor in a straightforward negligence suit simply because they are not aware that the location at issue is franchised. In other cases, the plaintiff’s attorney may be persuaded to dismiss the franchisor when there is no clear financial benefit to including the franchisor (for example, where the franchisor is an additional insured on the franchisee’s policy). There may also be a downside from the plaintiff’s perspective if forced to defend costly summary judgment motions on control and contend with another set of lawyers.

Because many plaintiffs may be willing to dismiss vicarious liability claims against the franchisor in routine cases, the franchisor should immediately take the initiative to educate the plaintiff’s attorney that it has been improperly named as a defendant. A common approach is to send a letter clarifying that the franchisor does not own or operate the location at issue, and citing applicable portions of the franchise agreement, operations and training manual and other guidelines that demonstrate that the franchisor lacks control of the “instrumentality of the harm.” In the appropriate case, the franchisor should also consider sending an affidavit from a corporate representative to bolster its position.

Although such a voluntary exchange of information will not deter every plaintiff’s attorney, it is certainly worthwhile to pursue in order to eliminate the claim before either side incurs unnecessary attorneys’ fees on the issue.

2. The Franchisee Can Help Force the Dismissal of Claims Against the Franchisor.

When reasoning with the plaintiff’s attorney fails, the franchisee may be in the best position to help support the franchisor’s motion to dismiss the vicarious liability claims against it. For all the

reasons discussed above, the franchisee will almost always prefer that the franchisor be dismissed. To help accomplish this, the franchisee can provide additional information or a separate affidavit demonstrating that the franchisor lacks day-to-day control.

In a case where a plaintiff improperly names the franchisor, not the franchisee, as a defendant, the franchisee may conclude that its interests are best served by substituting in as the defendant. By cooperating with the franchisor, the franchisee can force a reluctant plaintiff’s attorney to agree to a substitution of parties or potentially face sanctions for pursuing a frivolous claim. Although this strategy will benefit both franchisor and franchisee in the vast majority of cases, they should reconsider it if the statute of limitations has run against the unnamed franchisee. In that case, the parties may be better off filing a strong motion to dismiss or for summary judgment on the grounds of lack of control.

3. If a Motion to Dismiss Fails, the Franchisor Should Consider Filing a Summary Judgment Motion.

As discussed above, determining the existence of an agency relationship is a question of fact. However, summary judgment may still be appropriate to dismiss a vicarious liability claim against a franchisor where the undisputed facts support it.

As a practical matter, it is generally worth filing a summary judgment motion even if the jurisdiction is unfriendly to summary judgment or there are disputed facts that may be deemed material. The franchisor’s summary judgment motion can help educate the judge about the nature of the franchise relationship. As franchising has become an increasingly popular business model, many judges will understand the fundamental tension between setting system standards and exercising day-to-day control. Even if the motion fails, it can lay the groundwork for later evidentiary motions. Therefore, a franchisor should not overlook this opportunity to help some judges better understand the franchise model, and why vicarious liability is inappropriate in most cases.

B. Joint Defense Agreements or Joint Representation Should Be Part of a Collaborative Litigation Strategy Between Franchisor and Franchisee.

From the outset, a franchisor and franchisee involved in a suit alleging direct negligence against the franchisee and vicarious liability against the franchisor should design a strategy to protect the privileged nature of joint defense communications. In some cases, the franchisor and franchisee will be jointly represented; other times, they will not.

1. Pros of Joint Representation

Where the franchisor is an additional insured on the franchisee’s insurance policy, the carrier is likely to suggest joint representation of the franchisor and franchisee by one set of lawyers. In many cases, such an arrangement is helpful. With one set of lawyers, the franchisee and franchisor can provide privileged information to counsel for the purpose of their joint defense without much concern that such communications will be subject to discovery. Of course, it is important for franchisee and franchisor to provide the information to the attorney, rather than each other, which might blur the line between a defense purpose and a business purpose. In

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most jurisdictions, similar protection can be achieved even with separate sets of lawyers so long as the parties enter a joint defense agreement, preferably in writing, at the beginning of the case.

Joint representation also allows both parties a hand in guiding the overall defense of the case. Even assuming no conflict of interest between a franchisor and franchisee, they have different points of view—the franchisor seeking to protect the system, the franchisee seeking to protect his business. By providing their different points of view to a single attorney, the litigation strategy can combine both perspectives. This may be particularly important to the franchisor. A strategy that seems expedient to the franchisee in a particular case may potentially cause significant brand damage for the system. Of course, if the points of view are too divergent, a conflict may arise, requiring separate counsel.

2. Cons of Joint Representation

Despite the benefits of joint representation in many cases, getting separate counsel is advisable—in others. Clearly, if there is an actual conflict of interest, separate counsel is required. A conflict may arise because the franchisee believes the franchisor’s specification led to the injury, while the franchisor wants to prove that the franchisee improperly followed the standard causing the particular harm. Both parties would be well-advised to follow a common trial strategy, even under such circumstances, preserving their dispute to be resolved after litigation with the injured plaintiff is over. However, once such a conflict has been identified, joint representation is virtually impossible even if the parties agree to wait to resolve the dispute between them.

Generally, the reason for separate counsel is more subtle. As discussed above, the franchisor and franchisee may have a different perspective on litigation strategy. For example, the franchisee may want to settle the case, while the franchisor is concerned about the system impact of doing so. It is just as likely for the converse to be true—the franchisor may want to settle to minimize brand damage, while the franchisee wants to fight to defend his conduct. Or there may be a theoretical conflict, one that has not yet materialized. A franchisor may want to take advantage of such a theoretical conflict to seek separate counsel, particularly if it is dissatisfied with counsel appointed by the insurer or selected by the franchisee to jointly represent them. In any event, it is generally advantageous to have separate counsel for the franchisor and franchisee at trial, so that the franchisor’s control issues can be heard by the jury separate from the franchisee’s defenses.

3. Other Shared Resources

Whether or not joint representation is appropriate in a particular case, the parties should consider sharing expert witnesses to save costs. Sharing experts also protects any individual defendant from being left without an expert at trial on a critical issue because of a last minute settlement by the other defendant. A joint defense or common interest agreement can document this understanding. Likewise, the franchisor and franchisee should pursue a common media strategy in virtually every case. Although franchisees are independent businesspeople, they speak for the brand from a media perspective and for many customers.
C. Practical Considerations in Trying the Case

1. Juror Preconceptions & The Common Knowledge Doctrine

The common knowledge doctrine is a product of the gasoline franchise industry, but has been applied in other franchised industries. “[It] provides that, absent unusual circumstances, a third party is deemed to know that the independent contractor actually operates the local retail outlet, and is solely responsible for his actions.”

In *Howell*, the plaintiff alleged that a franchisor was liable for its franchisee’s purported violations of the Fair Labor Standards Act (paying her a fixed salary instead of an hourly wage) based on a two tier theory of liability. She claimed that based on the “high level of control Chick-Fil-A exercised . . . [the franchisee] was in reality an employee of Chick-Fil-A, not a franchised independent contractor.” Therefore, she argued that, consistent with a Secretary of Labor’s published opinion, “all employees of [the franchisee] are automatically employees of Chick-Fil-A.” The court held that the common knowledge doctrine applied to franchisee’s employees. It reasoned that the plaintiff “knew she was employed by [the franchisee], not Chick-Fil-A,” because she “received her income tax documents each year” and “a paycheck each week signed by [the franchisee].”

However, this purported common knowledge is not to be taken for granted. “The general populace tends to be ignorant of the basic structures of franchising.” There is a “deep misunderstanding as to which parties are held accountable for harm caused by the franchisees. . . . [and] even when people understand the basic law. . . that knowledge in no way guarantees acceptance of the law as being good policy.” Specifically, “[t]he concept of vicarious liability may be difficult for a jury to understand even with the best of evidence.”

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161 1993 WL 603296, at *2.

162 *Id.*

163 *Id.*

164 See *Id.* at *6.

165 *Id.*


167 *Id.*

Consequently, courts have held that unified national advertising campaigns are legally sufficient for a jury finding of apparent agency against a franchisor. In Miller, the plaintiff sued a franchisor after discovering a foreign object in her food. The court held that the defendant created a “common image for all McDonald’s restaurants . . . through national advertising, common signs and uniforms, common menus, common appearance, and common standards.” Therefore, the court ruled that “an issue of fact” existed regarding the apparent agency relationship.

Conversely, in Jones, the court rejected the plaintiff’s argument that a franchisor’s use of “we” and “our” in national advertising campaigns created an apparent agency relationship. The court reasoned that advertisements intended to “assure the public that all BP stations offer fast, top quality service” were insufficient to undermine the common knowledge doctrine, unless they “represent[ed] that every BP-branded gasoline station comes within BP’s control.”

Therefore, franchisors face a “Catch 22” in trying to simultaneously establish national brand uniformity while not binding themselves to the acts of franchisees in the eyes of potential plaintiffs and juries.

2. Deep Pocket

“Commentators have said often enough that vicarious liability is really based on a need to reach the assets of the veritable ‘deep pocket’.” The general perception of the corporate defendant as the “deep pocket” leaves franchisors at the whim of juries. This perception of the “deep pocket defendant” is “in accord with the general common law notion that one who is in a position to exercise some general control over the situation must exercise it or bear the loss.” Despite

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169 Miller v. McDonald’s Corp., 945 P.2d 1107, 1114 (Or. App. 1997); see also O’Banner v. McDonald’s Corp., 670 N.E.2d 632, 637 (Ill. 1996) (Freeman, J. dissenting); but see BP Exploration & Oil, Inc. v. Jones, 558 S.E.2d 398, 403–04 (Ga. App. 2001) (finding franchisor’s use of “we” and “our” in national advertising campaign insufficient to undermine common knowledge doctrine).

170 945 P.2d at 1108.

171 Id. at 1113.

172 Id.


174 Id. at 403–04.


the perception, the courts have been unpersuaded by corporate defendants’ fears of jury mistreatment.\textsuperscript{179}

Certain provisions, however, protect large corporations from being penalized for their economic position. In \textit{Kelley v. Wurzbach},\textsuperscript{180} the plaintiff, a drive-thru customer, was robbed, hit in the face and shot while pulling up to a McDonald’s order board. The plaintiff filed suit against the franchisor and the franchisee for premises liability and negligence.\textsuperscript{181} The court held that the franchisor owed no legal duty to customers, where it did not have “specific control over the safety and security of the premises.”\textsuperscript{182} Neither the existence of a Security Manual nor a national 24 hour drive-thru promotional campaign pursued by the franchisor evidenced sufficient control over the injury causing instrumentality by the franchisor.\textsuperscript{183} In her claim against the franchisee, the plaintiff intended to present the franchisee’s liability insurance as evidence of his ability “to pay a judgment.”\textsuperscript{184} Evidence of liability insurance was excluded at trial to preclude the jury from misconstruing the potential effects of their judgment.\textsuperscript{185} Similarly, suppressing evidence of the plaintiff’s total expenditures on litigating a claim “is essential to avoid[ing] [the] risk” that “the jury will be influenced by the wealth or power of one party . . . or sympathy for a party’s weakness, poverty or misery.”\textsuperscript{186}

3. \textbf{Jury Instructions}

There are no pattern jury instructions regarding vicarious liability directly applicable to the franchise relationship.\textsuperscript{187} Consequently, jury instructions must be derived from impositions of vicarious liability in non-franchising contexts, with special instructions clarifying the duties and rights of the parties under the franchise agreement.\textsuperscript{188} Vicarious liability cannot be imposed absent an instruction submitting the issue to the jury.\textsuperscript{189}

\begin{itemize}
  \item \textsuperscript{179} See \textit{King v. State Farm Mut. Auto Ins. Co.}, 850 A.2d 428, 435 (Md. 2004) (overturning circuit court’s partial blackout on public information allowing defendant State Farm to maintain its anonymity for fear that “disclosure as the defendant would adversely affect the jury’s verdict); \textit{Donoughe v. Lincoln Elec. Co.}, 936 A.2d 52, 71 (Pa. Super. Ct. 2007) (affirming reverse-bifurcated trial in light of defendant's contention that pre-trying issue of damages promotes jury preconceptions regarding potential liability).
  \item \textsuperscript{180} 1999 WL 33640, at *1 (Tex. App. Jan. 28, 1999).
  \item \textsuperscript{181} \textit{Id.}
  \item \textsuperscript{182} \textit{Id.} at *6.
  \item \textsuperscript{183} \textit{Id.}
  \item \textsuperscript{184} \textit{Id.} at *4.
  \item \textsuperscript{185} See \textit{Id.} at *5; \textit{but see Pope v. Pope}, 179 S.W.3d 442, 464 (Mo. App. 2005) (“[W]here [such] evidence is competent and material on one issue in the case, it is not error to admit it, however prejudicial it may be”).
  \item \textsuperscript{186} \textit{Batlemento v. Dove Fountain, Inc.}, 593 So.2d 234, 242 (Fla. Dist. Ct. App. 1992).
  \item \textsuperscript{188} \textit{Id.}
\end{itemize}
In *Cummins, Inc. v. Nelson*, a fishing boat engine’s manufacturer and distributor were found vicariously liable after the engine caught fire and the plaintiff’s commercial fishing boat sank. The defendants alleged that jury instructions regarding the plaintiffs’ other liability theories prejudiced the jury’s consideration of the vicarious liability claim. The court held that “[a]ny potentially erroneous jury instructions unrelated to the claims of vicarious liability . . . [are] not prejudicial.” Similarly, the court held that the special verdict form questions regarding vicarious liability did not undermine or confuse the applicable jury instruction.

4. **Strategies for Defending Apparent Agency and Actual Agency Claims**

The defense of the merits of the claim of vicarious liability begins with distinguishing the controls retained by the franchisor in the franchise agreement, operations manual, and related documents from the control of the day-to-day operations of a particular franchise. This strategy begins with the identification of every control retained by the franchisor and continues with the development of evidence showing that each control retained serves a legitimate objective of the franchise system without invading the day-to-day operations of the franchise. A franchisee that is prepared to testify strongly that it alone has the right to control day-to-day operations is a great asset in the advancement of the strategy that the franchisor’s control of standards does not equate to control of the day-to-day operations of the franchise. To be successful, the defense must also advance a theory of what constitutes the “day-to-day operations” of a franchised business.

Critical components of what constitute control over “day-to-day operations” are control over the financial aspects of the business and control over the employees—in essence, control over the ultimate success of the business. The defense should establish that the franchisee controls the elements of the business that are used in the preparation of profit & loss statements. Specifically, the defense should establish that the franchisee controls pricing of the goods and/or services, the allocation of financial resources, the investment in the business, the salaries and benefits to employees, as well as other financial aspects of the business. The defense should also establish that the franchisee alone fills the critical role of controlling employees and possesses the decision to hire and to fire those employees.

To establish vicarious liability based on apparent authority against a franchisor, a plaintiff will have to prove that he or she reasonably relied upon a representation that dealing with the franchisee was the same as or constituted dealing with the franchisor. Plaintiffs often fail to meet this burden, instead conceding that they knew they were dealing with a franchised business.

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190 115 P.3d 536 (Alaska 2005).
191 *Id.* at 546.
192 *Id.*
193 *Id.* at 545.
195 See *Crinkley v. Holiday Inns, Inc.*, 844 F.2d 156, 166 (4th Cir. 1988).
business. However, some courts will allow juries to resolve reliance issues when there is even “marginal” evidence of reliance.\footnote{Id. at 167.}

**D. The Franchisor and Franchisee Should Reserve Any Finger-Pointing Or Indemnification Claims Until After Trial Against the Injured Plaintiff.**

In the franchisee-franchisor context, as with most joint defense situations, finger-pointing among the defendants will only increase the ire of the jury and, consequently, the verdict. There may be legitimate disputes between the franchisee and franchisor. The franchisee may believe that it was only following the franchisor’s guidelines and that the franchisor should therefore be liable, not the franchisee. Likewise, the franchisor may believe that the plaintiff would not have been injured if the franchisee had only followed the standards set by the franchisor. Or, the franchisor and franchisee may both believe that a supplier is responsible if, for example, the plaintiff was injured because of a latent defect in a product sold to the system by the supplier. In all of these cases, it may make sense to sort out the responsible party (indeed, if the parties have different insurance carriers, they may have no choice). If possible, however, the parties should agree to defer indemnification claims or cross claims until after the trial of the injured plaintiff’s claim.

Similarly, the franchisor and franchisee should wait to litigate any disputed indemnification claims. Commonly, franchise agreements contain a provision requiring the franchisee to indemnify the franchisor for any claims and attorneys’ fees arising from the franchisee’s conduct. To prove a right to indemnification, the franchisor may have to prove that the franchisee deviated from its standards, which could only benefit the injured plaintiff. Obviously, the interest of the system is in minimizing the overall liability to a third party, so this type of dispute should be reserved until liability to the plaintiff is fixed.

**VII. THE IMPORTANT ROLE OF INSURANCE IN VICARIOUS LIABILITY CASES**

**A. An Approved Carrier Program Often Provides Significant Potential Benefits for the Franchisee and the Franchisor.**

Having an approved carrier program can help align the interests of the insured and insurer. A carrier who represents a single franchisee has little financial incentive in selecting defense counsel or settling cases to protect the reputation of the brand. This can lead to bad legal precedent, adverse media, and potentially many more claims against the system. If, however, the carrier insures a significant portion of the system’s franchisees, its interests merge with that of the system, as its financial interest shifts from minimizing costs for a particular claim to minimizing claims across the system.

Also, as mentioned above, having an approved carrier program helps align the franchisor and franchisee around a common strategy of having the franchisor dismissed. Dismissal of the franchisor reduces settlements and verdicts, which lowers loss runs for the system and therefore premiums for the individual franchisees.
B. Insurance Requirements in the Franchise Agreement

Most franchise agreements require that the franchisee name the franchisor as an additional insured on its policy. Often, the agreements will set required limits of liability as well. In setting limits, the franchisor should consider the length of the franchise term. Limits of $5,000,000 may look very different at the end of a twenty year franchise term than they did at the beginning. The franchisor should also consider the nature of the franchised business. For example, the insurance requirements for an airport hotel may be much less than a resort hotel with a water park.

This raises the problem of the uninsured or underinsured franchisee. For some franchisors, it may be impossible as a practical matter to ensure that every franchisee has the appropriate amount of insurance every year. For others, it is advisable to require annual verification that the franchisor has indeed been named as an additional insured and that the franchisee has obtained the required liability limits. If a franchisee is uninsured or underinsured, the injured plaintiff’s attorney will have every incentive to use vicarious liability claims against the franchisor to keep a deep pocket in the lawsuit.

C. Common Interest Agreements Between the Insured and Insurer Will Help Facilitate Communication Without Creating “Bad” Documents.

Whether the insurer involved is an approved carrier or not, the insured franchisor or franchisee and its insurer should consider from the outset whether their communications will be privileged. Although there is no “insured-insurer” evidentiary privilege as such, most states recognize some extension of the attorney-client privilege for insured-insurer communications in the context of a third party claim against the insured for which the insurer owes a duty to defend.\textsuperscript{197} To bolster an argument that such communications should be considered privileged in a particular case, the insured and insurer should consider signing a common interest agreement. A common interest agreement, also known as a joint defense agreement, sets forth the parties’ common legal interest in anticipated or pending litigation, allowing them to share and protect privileged communications. Some jurisdictions recognize and enforce such common interest agreements; others do not. The trend is toward requiring an insurance adjuster to disclose his case file.

It doesn’t take much imagination to see the problems created for the defense if insured-insurer communications are not protected. The insured is required under its policy to provide information to the insurer necessary for it to evaluate the case and provide a defense, this may include otherwise privileged communications between the insured and its counsel. Using this information, the insurer will assess the risk profile of the case, potentially concluding that the insured is liable to the plaintiff and thus should settle. This analysis, in the hands of a plaintiff’s attorney, can be used to force a larger settlement, embark on new lines of discovery, or otherwise increase the value of the claim, to the detriment of both insured and insurer.

VIII. CONCLUSION

In conclusion, vicarious liability claims present unique challenges for a franchised system. The main challenge lies in finding the right balance between the franchisor and franchisee with respect to controlling the franchised business. On the one hand, the franchisor must maintain

system standards in order to protect the brand and comply with the requirements of the Lanham Act. On the other hand, day-to-day operations must rest with the franchisee in order to avoid vicarious liability for a host of potential third-party claims – personal injury, product liability, employment and ADA, to name a few. To best position the system for success, the franchisor and franchisee must strategically approach the allocation of responsibilities under the franchise agreement, design of an insurance program, and coordination of a defense once a vicarious liability claim arises.
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