Drafting Franchise Agreements After *Patterson v. Domino's*: Avoiding the Minefield of Vicarious Liability and Joint Employment

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Lauded as one of the most important franchise cases in the recent past,[1] *Patterson v. Domino's*[2] established a new standard for addressing vicarious liability issues in California.[3] In reaching its decision that Domino's was not responsible for the sexual harassment of a franchisee's employee by the franchisee's manager, the California Supreme Court presented an analysis of franchising as a unique method of product and service distribution. The court acknowledged that a certain level of control is necessary to protect the intellectual property and the system of operations owned by the franchisor and licensed to the franchisee. The court stated that these types of control should not subject a franchisor to vicarious liability.

There have been many thoughtful articles written about *Patterson* in the two years since the California Supreme Court opinion was issued.[4] This article will explore important considerations of the decision in the context of drafting franchise agreements. We examine

1. Beth Ewen, *Top 10 Legal Cases in Franchising, and Who Should Worry*, FRANCHISE TIMES (Nov.–Dec. 2014).
2. Patterson v. Domino's Pizza, LLC, 333 P.3d 723 (Cal. 2014), *reh'g denied* (Sept. 24, 2014).
3. Snell & Wilmer, L.L.P., the law firm with which the authors are affiliated, represented Domino's in its appeal to the California Supreme Court.
4. *E.g.*, M.C. Sungaila & M. Ellison, *Joint Employer Liability in the Franchise Context: One Year After* Patterson v. Domino's, 35 FRANCHISE L.J. 339 (2016), which provides a detailed discussion of the *Patterson* case and how it was interpreted during the first year after the decision was issued.

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several key provisions that are frequently the subject of vicarious liability cases, identify examples of those provisions,[5] and analyze how they have been addressed in the context of various cases. We also examine how franchisors can structure communications with franchisees and customers to minimize exposure while protecting the franchisor's brand and system.

Of course, the decision in *Patterson* is pivotal, but since this area of the law is far from settled in other jurisdictions, we have also included other decisions in our analysis. In addition, it is important to note that, although the California Supreme Court reversed the lower court's decision, that reversal was decided on a five-to-four vote, and there have been changes in the composition of the court since *Patterson* was decided.

I. Background of Vicarious Liability and Joint Employment in Franchising

Following is a brief discussion of the background of approaches to vicarious liability and joint employment.

A. *Vicarious Liability*

Vicarious liability is a theory frequently asserted by third parties attempting to hold franchisors liable for the acts of their franchisees. Stemming from the legal doctrine of *respondeat superior*—or agency—as applied in the traditional employment context, vicarious liability makes an employer liable for the torts of its employees committed while acting within the scope of their employment.[6] "Actual authority" is the term often used to describe such actions. Outside of the employer-employee context, a non-employer principal may also be vicariously liable for the acts of its agent if the agent acts with the apparent authority of the principal.[7] Agency theory is based on the premise that the "principal has control or the right to control the physical conduct of the agent such that a master/servant relationship can be said to exist."[8]

Vicarious liability, when applied in the franchising context, would make a franchisor liable for the acts of a franchisee or a franchisee's employees, based on the assumption that the franchisor has control over, or the right to control, the franchisee's actions, thereby making the franchisee an agent of the franchisor.[9] Courts have struggled, however, with the practical application of the "control or right to control" test to franchising due to the

5. The sample clauses in this article are for illustration only, and the authors do not necessarily recommend them as clauses to be included in every franchise agreement.
6. Restatement (Third) of Agency § 2.04 (2006).
7. *Id.*
8. Kerl v. Dennis Rasmussen, Inc., 682 N.W.2d 328, 331 (Wis. 2004) (affirming summary judgment for the franchisor in a case involving an employee of an Arby's franchisee's restaurant, a work-release inmate who ambushed and shot his ex-girlfriend and her boyfriend, and then committed suicide in a nearby parking lot).
9. *Id.* at 337.

unique nature of the franchise relationship not present in a traditional master/servant relationship.[10] This has resulted in two divergent lines of cases: those applying the "means and manner" test and those applying the "instrumentality" test.

1. Means and Manner Test

Courts have traditionally applied the "means and manner" test, which focuses on whether the franchisor exercised "general 'control' over the 'means and manner' of the franchisee's operations."[11] This typically involves an analysis of whether the franchisor controls the day-to-day operations of the franchisee. Under this test, a franchisor could be liable for the acts of the franchisee if the franchisee is operating under the actual, or even under the apparent, authority of the franchisor.

Courts that find evidence of a sufficient amount of control by the franchisor over the franchisee's day-to-day operations often point to the extensive list of requirements imposed by a franchisor in the franchise agreement and operations manual.

For example, in *Billops v. Magness Construction Co.*,[12] the Supreme Court of Delaware reversed the lower court's grant of summary judgment in favor of the franchisor after finding sufficient facts to prove the franchisor's day-to-day control of the franchisee's Hilton Inn hotel, such that an actual agency relationship could exist. The court relied on various requirements imposed by the operating manual, which was incorporated into the franchise agreement. These included a requirement to keep detailed records so that the franchisor could ensure compliance with the manual and the franchisor's right to enter the premises to inspect compliance. The court also concluded that a jury might find that the franchisee was operating under the franchisor's apparent authority because the franchisee was required to identify itself solely as a Hilton-branded hotel, and the evidence suggested an ordinary person would likely have no reason to know he or she was dealing with anyone other than the franchisor.

On the other hand, in *Cislaw v. Southland Corp.*,[13] the California Court of Appeal affirmed summary judgment for the franchisor, concluding that the franchisee exercised full and complete control over the franchised store and made all operational decisions, including hiring and firing employees, determining discipline, setting compensation and work schedules, choosing and purchasing inventory, and marketing and advertising. The franchise agreement was limited in the requirements imposed on the franchisee and to the extent it did impose requirements, they were limited to protection

10. *Id.* at 331.
11. Patterson v. Domino's Pizza, LLC, 333 P.3d 723 (Cal. 2014), *reh'g denied* (Sept. 24, 2014).
12. 391 A.2d 196, 198 (Del. 1978).
13. Cislaw v. Southland Corp., 6 Cal. Rptr. 2d 386 (Ct. App. 1992).

of the franchisor's interest in its trademarks and goodwill. At its essence, the court opined,

> the agreement obligates the 7-Eleven store owners/franchisees to complete an operations training program, keep the store and its surroundings clean and maintain the equipment in good repair, carry an inventory of a "type, quality, quantity and variety" consistent with the 7–Eleven image, operate the store from 7:00 a.m. to 11:00 p.m. 364 days a year, make daily deposits of all receipts into a designated account, provide [the franchisor] with copies of purchase and sales records, make the books available for inspection during normal business hours and pay a percentage fee based on receipts from sales less cost of goods sold.[14]

Absent from the franchise agreement was a provision making the agreement terminable at will by the franchisor. Also absent was the right to control every detail of the store's construction.[15] This latter provision was key to distinguishing *Cislaw* from a prior case, *Kuchta v. Allied Builders Corp.* (finding a relationship of implied agency), which involved a franchise agreement that gave the franchisor most of the same rights that the franchisor in *Cislaw* reserved, but also the right to control construction.[16]

Thus, the use of the "means and manner" test can result in unpredictable rulings, which may be based on no more than one or two factors in any given franchise agreement.

2. Instrumentality Test

Over time, as courts began to recognize that the traditional master/servant agency and vicarious liability doctrines are ill-suited to franchising,[17] a second test has emerged that lends itself to greater predictability for franchisors. Namely, courts have been moving toward applying an instrumentality test, which focuses the vicarious liability analysis more narrowly on whether a franchisor controls, or has the right to control, "the daily conduct or operation of the particular 'instrumentality' or aspect of the franchisee's business that is alleged to have caused the harm."[18]

In adopting the instrumentality test, the Wisconsin Supreme Court in *Kerl v. Rasmussen* found that "a franchisor may be held vicariously liable for the tortious conduct of its franchisee only if the franchisor has control or a right of control over the daily operation of the specific aspect of the franchisee's business that is alleged to have caused the harm."[19]

Although the California Supreme Court did not specifically adopt the instrumentality test in *Patterson*, it did shift the focus away from the means and manner test and toward the instrumentality test. Pursuant to the *Patterson* ruling, a franchisor becomes potentially liable for actions of the franchisee's

14. *Id.* at 391–92.
15. *Id.* at 394.
16. *Id.* at 392.
17. *Id.*
18. *Id.* at 394.
19. Kerl v. Dennis Rasmussen, Inc., 682 N.W.2d 328, 332 (Wis. 2004).

employees only if "it has retained or assumed a general right of control over factors such as hiring, direction, supervision, discipline, discharge, and relevant day-to-day aspects of the workplace behavior of the franchisee's employees."[20] The court held that Domino's could not be vicariously liable for the acts of the franchisee's employee because there was no basis on which to find a triable issue of fact that an employment or agency relationship existed between Domino's and its franchisee.[21] In particular, Domino's had no right to establish a sexual harassment policy or training program governing the franchisee's employees. There was no procedure by which the franchisee's employees could report such complaints to Domino's, and the franchisee implemented its own sexual harassment policy and training program for its employees.[22]

In adopting this quasi-instrumentality standard, the court recognized that "[a]ny other guiding principle would disrupt the franchise relationship."[23] If the stated goal of vicarious liability is to protect the public interest and secure compensation from companies that can absorb the loss related to a tort, seeking compensation from a party that "did not directly control the workforce, and could not have prevented the misconduct and corrected its effects" does nothing to further such a policy goal.[24] As such, the court stated that it could not "conclude that franchise operating systems necessarily establish the kind of employment relationship" at issue in *Patterson* and that "[a] contrary approach would turn business format franchising 'on its head.'"[25]

The rising popularity of the instrumentality test is a positive trend for the franchising world. The test is more reliable and objective than the means and manner test and can generate more stability in franchise relationships by respecting the independence of the franchisee as an independent business owner while allowing the franchisor to impose the requirements necessary to protect its brand, trademarks, and goodwill.

B. *Joint Employment*

Joint employer liability, as a category of vicarious liability, has been a meaningful concern for franchisors for decades. Until recently, the well-established standard required a showing that a franchisor maintained direct and immediate control over day-to-day employment matters relating to the franchisee's employees for the franchisor to be held liable as a joint-employer.[26] In other words, for a franchisor to be held liable as a joint employer, there had to be evidence that the franchisor "meaningfully affects

20. Patterson v. Domino's Pizza, LLC, 333 P.3d 723, 726 (Cal. 2014), *reh'g denied* (Sept. 24, 2014).
21. *Id.* at 742.
22. *Id.*
23. *Id.* at 739.
24. *Id.*
25. *Id.*
26. *In Re* Airborne Freight Co., 338 NLRB 597, 597 n.1 (2002) (citing TLI, Inc., 261 NLRB 798 (1984)).

matters relating to the employment relationship, such as hiring, firing, discipline, supervision, and direction" of the franchisee's employees. [27]

In 2010, the established standard came under significant scrutiny following the submission of a report by Dr. David Weil, at the time a professor at Boston University, to the Wage and Hour Division (WHD) of the U.S. Department of Labor.[28] In the report, entitled *Improving Workplace Conditions through Strategic Enforcement*, Dr. Weil examined what he referred to as the "fissuring of the American workforce," which he asserted has caused a significant increase in "vulnerable workers."[29] According to Dr. Weil, the United States has witnessed the breaking down or "fissuring" of the traditional large employer by the reduction of direct employees through subcontracting, franchising, and outsourcing.[30] Vulnerable workers are those who work at or near minimum wage. According to Dr. Weil, they are subject to de facto reductions by being asked to work "off the clock," have no benefits, and are often subject to discrimination and capricious conduct by supervisors. [31]

To protect the vulnerable employees in a fissured industry (which, according to Dr. Weil, includes food service and hospitality where franchising is common), Dr. Weil suggested that enforcement must focus on both "workplaces where labor standards violations occur . . . and also at the higher level of industry structure, where 'lead firms' play a key role in setting the competitive and employment conditions for employers at 'lower levels' of the industry structure."[32] In franchising terminology, what Dr. Weil suggested amounted to an enforcement focus not just at the franchisee level, but also at the franchisor level. Among the strategies that Dr. Weil proposed to reach the "lead firms" was to "target several major brands that had documented histories of systemic violations among their franchisees. . . . Once identified, the WHD could undertake broad and coordinated investigations in multiple parts of the country and across multiple franchisees . . . and pursue statutory penalties for those violations."[33] In effect, the franchisor would be held liable if it intentionally violated laws itself or if the mere nature of the franchise system indirectly contributed to a deterioration of working conditions within an industry generally. In furtherance of that notion, the joint employer doctrine served as a convenient basis for the attempted imposition of liability and statutory penalties on franchisors. Dr. Weil further expanded on these theories in his 2014 book, *The Fissured Workplace*.[34]

27. Laerco Transp., 269 NLRB 324, 325 (1984) (citing N.L.R.B. v. Browning-Ferris Indus. of Pa., Inc., 691 F.2d 1117, 1124 (3d Cir. 1982)).

28. David Weil, Improving Workplace Conditions through Strategic Enforcement: A Report to the Wage and Hour Division (2010), https://www.dol.gov/whd/resources/strategicenforcement.pdf.

29. *Id.* at 9.

30. *Id.* at 21.

31. *Id.* at 18–19.

32. *Id.* at 76–77.

33. *Id.* at 78.

34. David Weil, The Fissured Workplace (2014).

In 2015, in *Browning-Ferris Industries of California*, the National Labor Relations Board (NLRB) tossed aside thirty years of joint liability precedent and extended joint employer liability to putative employers that exert "indirect" or "potential" control over an employee.[35] By extension to franchising, regardless of whether control is actually exercised, the franchisor can be held jointly liable for unfair labor practice liabilities of the franchisee as long as a franchisor has the potential to control its franchisees' employees.

Despite the *Browning-Ferris* decision, the NLRB has not gone so far as to say that all franchise relationships should result in franchisors being deemed to be joint-employers with their franchisees. In an April 2015 Advice Memorandum issued by the NLRB's Office of the General Counsel with respect to the Freshii fast food franchise system, the NLRB indicated that franchise relationships can be structured in a way to avoid creating a joint employer relationship.[36] In the Freshii system, franchisees are solely responsible for hiring, disciplining, and terminating employees and for setting employee salary and benefits. Noting such factors as lack of mandatory personnel policies or procedures, the General Counsel's office concluded that there was no evidence to establish that "Freshii meaningfully affects any matters pertaining to the employment relationship between [the franchisee] and its employees," and therefore, there was no joint employment relationship.[37]

The *Freshii* decision has given franchisors a ray of hope that *Browning-Ferris* will not represent a sea change in business format franchising by requiring franchisors to relinquish a disconcerting level of autonomy in their operations to franchisees. At the time this article is being published, countless joint employer liability cases are winding their way through the courts. These will ultimately shape the franchising landscape. For the time being, franchisors must rely on the few cases that have been finally resolved in this context, most notably *Patterson*, for guidance on how to structure their franchise systems.

II. Franchise Agreement Provisions

In this section, we examine specific provisions in franchise agreements and analyze examples of each in the context of the *Patterson* decision and other recent cases.

A. *Relationship of the Parties*

Most franchise agreements have a provision stating that the franchisor and franchisee are independent contractors and not responsible for the acts of one another.

35. Browning-Ferris Indus. of Cal., Inc., 362 NLRB No. 186 (Aug. 27, 2015).

36. Advice Memorandum, NLRB, Office of the General Counsel, *Nutritionality, Inc. d/b/a Freshii*, Case 12-CA-134294 (Apr. 28, 2015).

37. *Id.*

The California Supreme Court in *Patterson* confirmed that the contract should emphasize the independent contractor relationship and that the franchisee does not have any authority to act on behalf of franchisor. It noted that "[t]he contract said there was no principal-agent relationship between Domino's and [the franchisee]. The latter also had no authority to act on the former's behalf."[38]

Similarly, the U.S. District Court for the Southern District of California in *Vann v. Massage Envy*[39] addressed the issue of whether the franchisor was the joint employer of a franchisee employee who claimed wage and hour violations. The *Vann* court granted summary judgment to Massage Envy. The applicable provision in the Massage Envy franchise agreement stated that the franchisee was an independent contractor and had "no authority, express or implied, to act as agent of [franchisor]."[40] The franchise agreement also stated that the parties did not intend to be "partners, associates, or joint employers in any way" and that the franchisor had no relationship with the franchisee's employees.[41]

However, according to the Florida District Court of Appeal in *Parker v. Domino's Pizza, Inc.*, courts look beyond the "descriptive labels employed by the parties themselves" and analyze the facts as to whether the relationship between the parties can be said "to occupy the status of principal and agent."[42] In *Parker*, the court reversed summary judgment in favor of the franchisor in an action by plaintiffs who were injured in the aftermath of an automobile accident allegedly caused by a delivery driver employed by one of Domino's franchisees.[43] In applying the means and manner test for vicarious liability, the court noted that "whether one party is a mere agent rather than an independent contractor as to the other party is to be determined by measuring the right to control and not by considering only the actual control exercised by the latter over the former."[44]

Independent Contractor

An example of this type of provision is the following, which was proposed as part of an ABA Forum on Franchising program "The Annotated Franchise Agreement"[45]:

> The parties hereto hereby acknowledge and agree that, except as expressly provided in this Agreement, each is an independent contractor, that no party shall be considered to be the agent, representative, mas-

38. Patterson v. Domino's Pizza, LLC, 333 P.3d 723, 740 (Cal. 2014), *reh'g denied* (Sept. 24, 2014).
39. Vann v. Massage Envy, 2015 U.S. Dist. LEXIS 1002 (S.D. Cal. Jan. 8, 2015).
40. *Id.* at *5.
41. *Id.*
42. 629 So. 2d 1026, 1027 (Fla. Dist. Ct. App. 1993).
43. *Id.* at 1027.
44. *Id.*
45. K. Olson, R. Spencer & L. Weinberg, *The Annotated Franchise Agreement*, 33d Annual Forum on Franchising, Oct. 13–15, 2010, San Diego.

> ter, or servant of any other party hereto for any purpose whatsoever, and that no party has any authority to enter into any contract, assume any obligations or to give any warranties or representations on behalf of any other party hereto. Nothing in this Agreement shall be construed to create a relationship of employment, partners, joint venturers, fiduciaries, or any other similar relationship among the parties.

Franchisors should consider adding to this provision one that addresses the relationship of the parties in general and the status of the franchisee's employees in particular.

Conduct of Franchisee's Business

Following is a suggestion on an additional provision to consider:

> It is acknowledged that Franchisee is the sole and independent owner of its business, shall be in full control thereof, and shall conduct such business solely in accordance with its own judgment and discretion, subject only to the provisions of this Agreement. Franchisee shall conspicuously identify itself as the independent owner of its business and as a franchisee of Franchisor. Franchisor shall not be liable for any damages to any person or property, directly or indirectly, arising out of the operation of Franchisee's business, whether caused by Franchisee's negligent or willful action or failure to act. Neither party shall have liability for any sale, use, excise, income, property, or other tax levied upon the business conducted by the other party or in connection with the services performed or business conducted by it or any expenses incurred by it.

B. *Operations Manual/Brand Standards Manual*

A clear, thorough, and current manual is an essential component of every franchise system. It provides a franchisee with a roadmap to develop its business in a manner consistent with the franchisor's policies and procedures to ensure consistency of brand standards and improve the likelihood of success of the franchise relationship for both the franchisor and franchisee. As such, it is customary for a franchise agreement to contain a provision requiring the franchisee to comply with the provisions of the franchisor's manual.

That said, the California Court of Appeal in *Patterson* found that many aspects of Domino's Managers Reference Guide raised inferences supporting the idea that the franchisee was not an independent contractor. These included requirements related to

> bank deposits, safes, "front till" cash limits, type of credit cards that must be accepted, mobile phone use, store closing procedures, store records, refuse removal, radar detectors, phone caller identification requirements, security, delivery staff-

ing, holiday closings, stereos, tape decks, wall displays, franchisee web sites, "in-store conversations," and literature that is "allowed in store."[46]

Although the California Supreme Court did not find these factors conclusive, their citation by the California Court of Appeal reflects the approach by courts in jurisdictions that apply the means and manner test and, therefore, provides helpful guidance in drafting.

Similarly in *Parker*, the Florida District Court of Appeal pointed to the operations manual as key "documentary evidence demonstrating Domino's control over its franchisees."[47] According to the court, "[t]he manual which Domino's provided to the franchisees is a veritable bible for overseeing a Domino's operation. It contains prescriptions for every conceivable facet of the business."[48] Some of the requirements in the operations manual that the court identified included preparing pizza, tending the oven, maintaining accurate books, giving advertising and promotion ideas, giving routing and delivery guidelines, providing instructions on taking orders, and discussing organization and sanitation.[49]

Other courts have been more willing to accept some level of operational procedures in the manual. In 2015, the *Vann* court relied heavily on the California Supreme Court's decision in *Patterson* and noted that it is permissible for a franchisor to provide its franchisees with a manual that "contained mandatory and suggested specifications, standards, operating procedures and rules that [franchisor] periodically prescribe[s] for operating a [franchise]."[50]

While the line between a "veritable bible" for overseeing operations and permissible system controls and standards is admittedly blurry, one thing that is clear is that courts are more accepting of provisions in manuals that establish brand standards and are more concerned about provisions that delve into the minutia of day-to-day operations. In light of that, it would seem prudent for a franchisor not to handicap itself by labeling its manual an "Operations Manual." A term such as "Brand Standards Manual" is preferable because it suggests its purpose is to protect the standards exemplified by the trademark and franchise system and to preserve system goodwill rather than to mandate day-to-day operations of the franchisee's business. In addition, when describing the purpose of the manual in the franchise agreement, the franchisor should refrain from any language that suggests its purpose is to serve as a guide to day-to-day operations. This point should be emphasized in the franchise agreement provision requiring compliance with the manual.

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46. Patterson v. Domino's Pizza, LLC, 143 Cal. Rptr. 3d 396 (Ct. App. 2012), *review granted and opinion superseded sub nom*. Patterson v. Domino's Pizza LLC, 287 P.3d 68 (Cal. 2012), *rev'd*, 333 P.3d 723 (2014). Although the California Supreme Court reversed the decision of the California Court of Appeal, as noted above, it is instructive to study the provisions of the franchise agreement that the appellate court found salient in reaching its decision.

47. *Parker*, 629 So. 2d at 1028.

48. *Id.*

49. *Id.*

50. Vann v. Massage Envy, 2015 U.S. Dist. LEXIS 1002, at *3 (S.D. Cal. Jan. 8, 2015).

The provision might read as follows:

Brand Standards Manual

Franchisor will lend to Franchisee for use during the term of this Agreement a copy of Franchisor's proprietary and confidential brand standards manual which Franchisor may amend from time to time, containing specifications, standards, procedures, and rules for the System designed to protect and maintain the value of the Marks and the System ("Brand Standards Manual"). Franchisee must comply with specifications, standards, procedures, and rules prescribed from time to time in the Brand Standards Manual that Franchisor has designated as mandatory. Franchisee shall keep the Brand Standards Manual and its contents confidential. Franchisee will not at any time copy any part of the Brand Standards Manual, disclose any information contained in it to others, or permit others access to the Brand Standards Manual. Franchisee acknowledges and agrees that the Brand Standards Manual may be modified from time to time to reflect changes in the standards of authorized services or the System. All modifications to the Brand Standards Manual shall be binding upon Franchisee upon being transmitted to Franchisee. Franchisee agrees to accept, implement, and adopt any such modifications at Franchisee's sole cost. The Brand Standards Manual will contain proprietary information belonging to Franchisor and Franchisee acknowledges that the Brand Standards Manual is, and shall remain, the property of Franchisor. Franchisee shall promptly return the Brand Standards Manual to the Franchisor upon termination or expiration of this Agreement. Franchisee understands and agrees that it is of substantial value to Franchisor and other franchisees of Franchisor, as well as to Franchisee, that the System establish and maintain a common identity. Franchisee agrees and acknowledges that full compliance with the Brand Standards Manual is essential to preserve, maintain and enhance the reputation, trade demand, and goodwill of the System and the Marks and that failure of Franchisee to operate the Franchised Business in accordance with the Brand Standards Manual can cause damage to the Franchisor and all other franchisees within the System as well as to Franchisee. Notwithstanding the foregoing, and consistent with the goals of the System, Franchisee shall be responsible for the day-to-day operation of the Franchised Business.

C. *Training*

Training is also critical to most franchise systems, but the term "training" is ambiguous. Who is responsible to train whom, and the scope of that training, have proven to be key factors in courts' analyses of vicarious liability and joint employer liability cases.

The California Supreme Court in *Patterson* was swayed by the fact that Domino's took a hands-off approach when it came to sexual harassment training of the franchisee's employees. As the court noted, "Consistent with the exclusive control vested in [franchisee] over its own employees, neither the contract nor the MRG [Manager's Reference Guide] empowered Domino's to establish a sexual harassment policy or training program for [franchisee's] employees. Nor was there any procedure by which franchisee's employees could report such complaints to Domino's."[51] Also persuasive to the court was the fact that even though Domino's provided new employees with orientation materials in both electronic and handbook form, primary training was done by the franchisee and the materials provided by Domino's merely supplemented the franchisee's training program.[52]

Similarly, the U.S. District Court for the District of Arizona in *Courtland v. GCEP-Surprise, LLC* granted summary judgment in favor of the franchisor in a case brought by a former bartender and server at a franchised Buffalo Wild Wings restaurant alleging employment discrimination claims under Title VII of the Civil Rights Act of 1964.[53] The franchisor mandated training for the franchisee's general manager, operational manager, and assistant manager only. It did not train non-managerial staff. To the extent the franchisor provided the franchisee with human resources training material, it was provided on an advisory basis. The franchisor worked with and trained the franchisee's managerial staff only to the extent necessary to protect its brand name and dictate product presentation.[54]

Also influenced by the provision of training, but reaching a different result, the Illinois Appellate Court in *Greil v. Travelodge* reversed a lower court's grant of summary judgment in favor of the franchisor, finding it persuasive that the franchisee was required to send personnel responsible for management of its motel to the franchisor's training program.[55]

The trend that emerges from these cases is that courts generally accept that the franchisor can train the franchisee and its executive level management. A franchisor may also provide training materials. The franchisor should, however, require that the franchisee be responsible for training of lower level employees. As for employee conduct policies, these are best left as the

51. Patterson v. Domino's Pizza, LLC, 333 P.3d 723, 741 (Cal. 2014), *reh'g denied* (Sept. 24, 2014).

52. *Id. See also* Domino's Pizza, L.L.C. v. Reddy, Case No. 09-14-99958-CV, 2015 Tex. App. LEXIS 2578 (Tex. App. Mar. 19, 2015), where in dismissing a vicarious liability claim for death and injuries caused by a franchisee's delivery driver, the Texas Court of Appeal found it relevant that Domino's provided training materials to the franchisee, but did not train the franchisee's employees.

53. Courtland v. GCEP-Surprise, LLC, No. CV-12-00349-PHX-GMS, 2013 WL 3894981 (D. Ariz. July 29, 2013).

54. *Id.* The court in *Courtland* applied the instrumentality test.

55. Greil v. Travelodge Int'l, Inc., 541 N.E.2d 1288 (Ill. Ct. App. 1989). The court in *Greil* applied the means and manner test to determine whether the franchisor was responsible for injuries to a hotel guest who jumped from his second story hotel room to the sidewalk when a robber entered his room.

responsibility of the franchisee. While the franchisor can advise franchisees that they should consider adopting these policies and training their employees with respect to them, the franchisor should not take on that responsibility itself. Another consideration is outsourcing certain types of training or designating third party trainers as system suppliers. Mature franchise systems with independent franchisee associations should consider establishing training programs conducted under the auspices of the association.

Training provisions in franchise agreements vary widely depending on system needs. An example of a simple form of a requirement for initial training and for development of employment policies and procedures follows:

> *Initial Training*
>
> Franchisor will conduct an initial training program during such period of time as Franchisor designates at a location Franchisor designates ("Initial Training Program"). Franchisee and Franchisee's executive management must complete the Initial Training Program to the sole satisfaction of Franchisor before the Franchised Business is permitted to open to the public. Franchisee is responsible for all travel and living expenses and all wages payable to any members of Franchisee's executive management attending the Initial Training Program. Franchisee acknowledges that it will be solely responsible for training Franchisee's employees in the operation of the Franchised Business.
>
> *Franchisee's Employment Policies and Procedures*
>
> Franchisee acknowledges that Franchisor may, from time-to-time, make certain recommendations as to employment policies and procedures, including without limitation, a sexual harassment policy. Franchisee will have sole discretion as to adoption of any such policies and procedures and the specific terms of such policies and procedures. Training with respect to all such policies and procedures shall be Franchisee's sole responsibility.

D. *Ongoing Franchisor Guidance*

Most franchisors provide some type of ongoing support and guidance to franchisees. There is a distinction, however, between a franchisor providing advice and suggestions to its franchisees, and the franchisor making decisions on behalf of franchisees. Courts have made clear that this distinction is fundamental to the determination of vicarious liability, especially when the advice concerns employment issues.

In analyzing this distinction in the McDonald's system, the U.S. District Court for the Northern District of California did not have an issue with the franchisor making suggestions to a franchisee as long as the franchisee had

the final say in whether to accept McDonald's advice.[56] In *Ochoa v. McDonald's*, the court observed that McDonald's monitors its franchisees by hiring business consultants who review data from franchisee restaurants and speak to franchisees and their managers about practices and metrics that McDonald's wants to improve.[57] The business consultants' involvement goes so far as to include speaking to general managers about staffing levels when the franchisee and supervisor that managed employment and operations at the franchised restaurants were not present.[58] However, the court found that this did not create a joint employer relationship because even the franchisee admitted "that he sometimes rejected advice from the business consultant" and the franchisee did not argue otherwise.[59]

Particularly when it comes to employment related advice, however, the safest approach would be one of complete detachment. The California Supreme Court found this approach influential in its decision in *Patterson:* "If a franchisee asked Domino's for [advice on handling personnel issues], the company would recommend that the franchisee resolve the situation himself or retain counsel to do so. A similar response was expected of any area leader asked to answer a sexual harassment question posed by a franchisee."[60]

In light of the case law that has emerged in this area, following is a sample provision for a franchise agreement:

Periodic Advice and Consultation

> Franchisor will, from time to time, to the extent it deems necessary, furnish Franchisee advice or consult with Franchisee on the operation of the Franchised Business in order to communicate new developments, techniques, and services. Franchisor will periodically, with such frequency as Franchisor determines in its sole discretion, send field consultants to the Franchised Business to consult with Franchisee in the development of its business and may conduct on-site inspections. Any guidance, suggestions, or advice provided to Franchisee in the course of such consultation shall be deemed suggestions only, and the decision to follow any such guidance, suggestions, or advice will be made by Franchisee in Franchisee's sole discretion. In particular, and not in limitation of the foregoing, Franchisee will be solely responsible for all policies and decisions concerning its employees and will

56. Ochoa v. McDonald's Corp., 133 F. Supp. 3d 1228 (N.D. Cal. 2015). The court in Ochoa granted summary judgment in favor of McDonald's with respect to plaintiff franchisee employees' wage and hour claims in light of the *Patterson* decision, but declined to grant summary judgment with respect to ostensible agency claims, finding *Patterson* did not apply to those claims.

57. *Id.* at 1238.

58. *Id.*

59. *Id.*

60. Patterson v. Domino's Pizza, LLC, 333 P.3d 723, 731 (Cal. 2014), *reh'g denied* (Sept. 24, 2014).

consult with its own independent advisors with respect to those policies and decisions.

E. *Conduct of Franchised Business*

Subject to the specific nature of the franchise system, it is customary for franchise agreements to contain provisions governing certain aspects of the day-to-day conduct of the franchised business (as opposed to simply the relationship between the franchisor and franchisee). These types of provisions include required hours of operations, trade dress, signage, staffing, and method of operation. Many of these provisions are particularly problematic in the context of vicarious liability risk. Nevertheless, in some franchise systems these provisions may be associated with the essence of the franchise system.

1. Hours of Operation

Franchisors will sometimes require that the franchisee operate during certain hours of the day or even twenty-four hours a day. Although not all franchisors impose specific hours of operation, some may give general guidelines as to hours of operations and some will include requirements concerning hours of operation in the franchise manual.

Courts have sometimes deferred to franchisors that impose requirements on hours of operation, because, as one court put it, these are "precisely the types of controls that a franchisor may legitimately exercise over its franchisee without incurring vicarious liability."[61] In another case, *Smith v. Foodmaker, Inc.*, the Texas Court of Appeals observed that "[e]ven where the franchisor has instructed the franchisee on hours of operation, an agency relationship has not been established."[62]

In particular, in jurisdictions that have adopted the instrumentality test, courts have often considered a specification of the franchisee's hours of operation irrelevant to a decision when it is unrelated to the particular act resulting in the claim. In *Vann*, the court noted that the franchisor implemented standard business hours for all franchise locations, but because it was not the particular instrumentality causing the harm alleged, it was irrelevant to the court's ultimate refusal to hold the franchisor vicariously liable for the alleged wrongful act of the franchisee.[63]

61. *In re* Motor Fuel Temperature Sales Practices Litig., No. 06-2582-KHV, 2012 WL 1536161, at *6 (D. Kan. Apr. 30, 2012) (holding franchisor, Circle K, was not vicariously liable for its franchisee's alleged violation of the Kansas Consumer Protection Act because franchisor did not control or have the right to control franchisees in the particular instrumentality that harmed plaintiff (i.e., the selling of motor fuel)).

62. Smith v. Foodmaker, Inc., 928 S.W.2d 683, 688 (Tex. App. 1996) (citing Cislaw v. Southland Corp., 6 Cal. Rptr. 2d 386, 393 (Ct. App. 1992) (holding the franchisor not vicariously liable for the wrongful death of an employee killed by another employee because the franchisor did not have control or the right to control the hiring and firing of franchisee's employees).

63. Vann v. Massage Envy, 2015 U.S. Dist. LEXIS 1002 (S.D. Cal. Jan. 8, 2015).

Even where hours of operations were a possible contributing factor to the alleged harm, at least one court has not imposed liability on the franchisor. In *Hong Wu v. Dunkin' Donuts*, the U.S. District Court for the Eastern District of New York acknowledged that it was "undisputed that the franchise agreement provided that the [franchisee's] store would remain open 24 hours a day" and that such a "requirement that the donut store remain open through the night may well have heightened the need for adequate security."[64] However, because the franchise agreement did not "mandate specific security measures or otherwise control or limit [the franchisee's] response to this increased risk," the court declined to hold the franchisor vicariously liable for the plaintiff's injuries.[65]

If a franchisor chooses to include this type of provision because of its importance to the brand and the system, the provision should reflect that. Franchisors should consider including requirements relating to hours of operation only where necessary to the system.

Following is a sample provision:

Hours of Operation

> Franchisee will operate the Franchised Business during such days, nights, and hours as may be designated by Franchisor from time to time. Franchisee acknowledges and agrees that the hours of operation are integral to the value of the System and the Marks, and any failure by Franchisee to operate during the designated hours of operation is detrimental to the System and the Marks. Franchisee further acknowledges and agrees that the day-to-day operational decisions relating to the opening and closing procedures of the Franchised Business, including any security, staffing, and other similar matters, shall be made solely by the Franchisee.

2. Trade Dress

Trade dress generally refers to characteristics of the visual appearance of the franchised business that can include the décor, design, and color scheme of the premises; service professional appearance; grooming and uniforms; and the general look and feel that signify the source of the product or service to consumers.

For franchisors, the uniform appearance of franchised locations and employees can be essential to a consistent customer experience. Franchisors commonly impose requirements related to the uniforms, grooming, and appearance of the franchisee's employees as well as the design, layout, and construction of the premises, to ensure that the experience is the same—no mat-

64. Wendy Hong Wu v. Dunkin' Donuts, Inc., 105 F. Supp. 2d 83, 91 (E.D.N.Y. 2000), *aff'd sub nom.* Wu v. Dunkin' Donuts, Inc., 4 F. App'x 82 (2d Cir. 2001).

65. *Id.*

ter which location a customer visits. It is generally understood that these types of restrictions are meant to protect the franchisor's brand since one bad customer experience at a substandard franchise location can sully the reputation of the entire system.

This desire to ensure the consistent appearance of the business and employees can pose a challenge for franchisors when it comes to vicarious liability. Courts have vacillated on whether and to what extent such requirements provide evidence of sufficient control or right to control the franchisee's operations to justify a finding of vicarious liability on the part of the franchisor.

The *Patterson* case suggests that certain qualitative controls over the franchisee's relationship with its employees are permissible. The California Supreme Court specifically acknowledged that the franchisor's manual "set forth detailed clothing and accessory guidelines"; imposed "[v]arious grooming and hygiene standards," which "were designed to promote neatness and sanitation"; prohibited employees from possessing or consuming "alcohol or illicit drugs while working or on store premises"; and limited tobacco use.[66] Despite these controls, the court agreed with Domino's disclaimer of "any rights or responsibilities as to [the franchisees'] employees" and stated that "nothing in the contract granted Domino's any of the functions commonly performed by employers." Instead, it found that "[a]all such rights and duties were allocated to [the franchisee]."

Similarly, the court in *Kerl* concluded that "the standardized provision commonly included in franchise agreements specifying uniform quality, marketing and operational requirements, and a right of inspection does not establish a franchisor's control or right to control the daily operations of the franchisee sufficient to give rise to vicarious liability for all purposes or as a general matter."[67]

However, these courts' leniency toward such controls is in contrast to the more rigorous scrutiny by the courts in *Ochoa and Billops* of franchise agreement provisions giving franchisors the ability to control the appearance of the franchisee's business and employees. In *Ochoa*, the plaintiffs submitted declarations stating that they believed McDonald's was their employer, in part because they wore McDonald's uniforms; served McDonald's food in McDonald's packaging; receive paystubs and orientation materials marked with the McDonald's name and logo; and, with the exception of one plaintiff, applied for a job through McDonald's website.[68] The court held that there existed triable issues of fact under an ostensible agency theory under these facts.[69]

66. Patterson v. Domino's Pizza, LLC, 333 P.3d 723, 730 (Cal. 2014), *reh'g denied* (Sept. 24, 2014).
67. Kerl v. Dennis Rasmussen, Inc., 682 N.W.2d 328, 341 (Wis. 2004).
68. Ochoa v. McDonald's Corp., 133 F. Supp. 3d 1228, 1238 (N.D. Cal. 2015).
69. *Id.*

The *Billops* court highlighted the fact that the "Hilton logo and sign are required to be displayed to the exclusion of all others" and that the franchise agreement "forbids the mention of any name other than Hilton to the customers of the hotel as management of the Brandywine Hilton Inn."[70] The *Billops* franchise agreement required complete identification with the "Hilton 'system,' including color schemes and design of the Inn which must be consistent with the 'system.'"[71] It noted that even the franchisor admitted there was no reasonable basis for an ordinary person to know he or she was dealing with anyone other than the franchisor.[72] Thus, the court held there was sufficient evidence to suggest a jury might find that the franchisee was the apparent agent of the franchisor.

In light of the contradictory decisions by various courts, franchisors should consider limiting the extent franchisees can or are required to use its name and logos. In addition to the common requirement that a franchisee identify itself as an independent business, franchisors should also mandate that the franchisee's name appear where necessary to communicate to its employees that it (and not the franchisor) is their employer. Examples are printing only the franchisee's name and logo on employees' paystubs, employment applications, and employee communications.

Keeping in mind the seemingly contradictory decisions by the courts thus far, following is a sample provision:

Trade Dress

> Franchisee acknowledges that each and every detail of the design, layout, décor, color scheme, supplies utilized, services offered, appearance of the premises, and personnel of the Franchised Business and other elements of trade dress ("Trade Dress") is essential to Franchisor and the System. In order to protect the System, Franchisee shall comply with all mandatory specifications, standards and procedures relating to (1) the type and quality of the products and services offered by the Franchised Business; (2) the appearance, color, indicia, and signage of the Franchised Business premises; (3) appearance of employees; (4) cleanliness, standards of services, and operation of the Franchised Business; (5) submission of requests for approval of materials, supplies, distributors, and suppliers; and (6) safety procedures and programs prescribed by Franchisor. Franchisee also agrees to use all equipment, signage, and services as have been approved for the System from time to time by Franchisor. Mandatory specifications, standards, and procedures may be prescribed from time to time by Franchisor in the Brand Standards Manual, or otherwise communicated to Franchisee in writing.

70. Billops v. Magness Const. Co., 391 A.2d 196, 198–99 (Del. 1978).
71. *Id.* at 199.
72. *Id.*

As to the signage and other identifying indicators, following is a sample provision:

Signage

All signage and decorating materials at the Franchised Business site must conform to Franchisor's specifications. In particular, Franchisee must post a prominent sign in the Franchised Business identifying Franchisee as a franchisee in a format that Franchisor deems acceptable, including statements (1) that Franchisee independently owns and operates the Franchised Business, (2) that the Marks are owned by Franchisor, and (3) that Franchisee uses the Marks pursuant to a license Franchisor has issued to Franchisee.[73]

3. Staffing

Claims related to employment and staffing have led to some of the most high-stakes franchisor vicarious liability cases in recent years, including *Patterson*. Therefore, it is crucial that franchisors refrain from getting involved with franchisees' hiring and firing decisions.

The *Patterson* court observed that "[t]he contract stated that persons who worked in the [franchised] store were the employees of [the franchisee], and that no employment or agency relationship existed between them and Domino's. Domino's disclaimed any rights or responsibilities as to [the franchisee]'s employees."[74] Key to the California Supreme Court's decision in *Patterson* was the fact that the franchisee "exercised sole control over selecting the individuals who worked in his store. He did not include Domino's in the application, interview or hiring process."[75] The court in *Patterson* indicated that a franchisor could provide advice and consultation, even recommendations as long as the final decision to hire, discipline, or terminate an employee was within the franchisee's sole discretion. In *Patterson*, the court was not concerned that the Domino's area representative would occasionally encounter "an employee whose performance was so deficient that it was hurting Domino's brand or endangering the franchise" and would recommend or suggest that the employee might not be the right fit for the job.[76] Instead, because the franchisee had the ultimate decision-making power as to its own employees, including developing its own sexual harassment guidelines and training, the court declined to find Domino's vicariously liable for the acts of the franchisee's employee.

Other courts have echoed the position that as long as the franchisee retains the sole right to hire, discipline, fire, and set the schedules of its em-

73. Adapted in part from K. Olson et al., *The Annotated Franchise Agreement*, *supra* note 45.

74. Patterson v. Domino's Pizza, LLC, 333 P.3d 723, 741 (Cal. 2014), *reh'g denied* (Sept. 24, 2014). *See* suggested provision below under "Staffing."

75. *Id.*

76. *Id.*

ployees, the franchisor will not be subject to vicarious liability or joint employer status for merely providing advice, recommendations, and consultation in regards to employment issues. The *Ochoa* court was not bothered by the fact that McDonald's provided detailed recommendations to the franchisee on employee scheduling, staffing, and discipline because, as the court stated, the franchisee "was adamant that these were just suggestions."[77] Further, although McDonald's "extensively monitor[ed] and evaluate[d]" the franchisee and used mystery shoppers and business consultants, the court believed that "mere monitoring of these customer service metrics is not active employee control."[78] To the *Ochoa* court, "the fact that McDonald's would have to resort to economic and business relationship sanctions to motivate Smith [the franchisee] to implement service changes underscores its lack of direct authority or control."[79]

The franchisor will often not be found vicariously liable as long as the franchisee has the final say in decisions relating to its employees, the franchisor cannot step in and take over the management of the franchisee's employees, and the franchisor's right to terminate arises only because of an uncured violation of the franchise agreement. These types of scenarios have been determined not to create "the equivalent of the right to control the actual daily operation of the restaurant" by the franchisor.[80] Other activities found acceptable include:

- preparing a standard application for franchisees to use in hiring employees if the franchisee handles the details of the hiring process and makes the hiring decision[81];
- reviewing employees' work schedules and requiring that employees remain at work until another employee arrives[82];
- mandating that the franchisee "hire, train, maintain, and properly supervise sufficient, qualified, and courteous personnel for the efficient operation" of the franchised business[83];
- requiring that a designated person in charge attend a management training seminar conducted by the franchisor; and

77. Ochoa v. McDonald's Corp., 133 F. Supp. 3d 1228, 1236 (N.D. Cal. 2015).
78. *Id.* at 1236, 1239.
79. *Id.* at 1236.
80. Kerl v. Dennis Rasmussen, Inc., 682 N.W.2d 328, 341–42 (Wis. 2004).
81. Domino's Pizza, L.L.C. v. Reddy, Case No. 09-14-99958-CV, 2015 Tex. App. LEXIS 2578 (Tex. App. Mar. 19, 2015).
82. Orozco v. Plackis, 757 F.3d 445 (5th Cir. 2014). In this case involving the Fair Labor Standards Act, the court applied the economic reality test to determine whether the franchisor's owner was an employer of the plaintiff. Under the economic reality test, the court evaluates whether the alleged employer: (1) possessed the power to hire and fire the employees, (2) supervised and controlled employee work schedules or conditions of employment, (3) determined the rate and method of payment, and (4) maintained employment records.
83. *Kerl*, 682 N.W.2d at 332.

- providing "guidelines for hiring, training, and supervising employees in accordance with applicable labor laws and to achieve an efficient, courteous, and satisfied work force."[84]

However, if the California Supreme Court in *Patterson* had not overturned the appellate court's decision, franchisors in California may have been faced with having to take even more of a "hands off" approach. The appellate court's opinion strongly suggested that joint employer liability may apply if there was an atmosphere leading the franchisee to believe (rightly or wrongly) that termination of the franchise would result if it did not adhere to Domino's suggestion that one of its employees be terminated.[85] To the appellate court, there was at least a triable issue of fact as to whether there was a lack of local franchisee management independence because, in at least one incident, Domino's purportedly told the franchisee to fire an employee and the franchisee believed he "had to pull the trigger on the termination, [and] it was very strongly hinted that there would be problems if [he] did not do so."[86] This incident suggested to the court that the franchisee perceived he had to comply with Domino's advice "or else." The dissenting opinion from the California Supreme Court's decision was particularly swayed by the fact that the franchisee felt he had to follow Domino's recommendation to terminate the harasser, stating that "[w]hile no one factor is determinative, the power to discharge an employee offers 'strong evidence' both of the fact of control and of the ultimate existence of an employment relationship."[87]

Given these decisions, it is advisable to restrict franchisees' employment decisions as little as possible in the franchise agreement and manual. Any advice or guidance should make clear to the franchisee that all decisions regarding hiring, firing, and scheduling are to be made ultimately and exclusively by the franchisee. To that end, franchisors should reconsider providing sample employee manuals to be distributed to franchisee's employees; imposing personnel policies or procedures on the franchisee; and becoming involved in the hiring, firing, scheduling, compensation, review, discipline, promotion, demotion, or other supervision of franchisees' employees. Some franchisors have moved in the direction of instead approving third party human resource companies to provide guidance to franchisees.

Because provisions related, even tangentially, to a franchisee's employees typically appear throughout the franchise agreement and manual, it would not be practical to attempt to draft suggested provisions for every single situation where employee matters may arise. However, in line with the guidance the existing case law provides, franchisors should clearly indicate in the

84. *Kerl*, 682 N.W.2d at 340.
85. Patterson v. Domino's Pizza, LLC, 143 Cal. Rptr. 3d 396, 402, *review granted and opinion superseded sub nom.* Patterson v. Domino's Pizza LLC, 287 P.3d 68 (Cal. 2012), *rev'd*, 333 P.3d 723 (2014).
86. *Id.*
87. *Patterson*, 333 P.3d at 743 (Cal. 2014) (Werdegar, J., dissenting).

franchise agreement that the franchisee has sole and complete control over its own employees and that any suggestions made by the franchisor are optional and never mandatory.

See the following sample provision disclaiming any control over franchisee's employment matters:

Franchisee's Employees

> Franchisee's employees are under Franchisee's sole control. Franchisor is not the employer or joint employer of Franchisee's employees. Franchisor will not exercise direct or indirect control of Franchisee's employees' working conditions. Franchisor does not share or codetermine the terms and conditions of employment of Franchisee's employees or participate in matters relating to the employment relationship between Franchisee and its employees, such as hiring, promotion, demotion, termination, hours or schedule worked, rate of pay, benefits, work assigned, discipline, response to grievances and complaints, or working conditions. Franchisee has sole responsibility and authority for these terms and conditions of employment. Franchisee must notify and communicate clearly with its employees in all dealings, including, without limitation, its written and electronic correspondence, paychecks, and other materials, that Franchisee (and only Franchisee) is their employer and that Franchisor is not their employer.

4. Method of Operation

Provisions in franchise agreements addressing methods of operations can be wide ranging, depending on the franchise system.

One example of a common operational system is proprietary software. Often proprietary software will be used in the operation of the business, such as point-of-sale software in restaurants and other retail locations that tracks sales and provides useful information to both franchisors and franchisees.

Software that is involved in payroll processing has been addressed in the joint employment context. In the *Ochoa* case, one of the issues raised by the plaintiffs involved McDonald's proprietary software called "ISP" or "In-Store Processor" as well as a point-of-sale software called "NewPOS," both of which were mandatory. The *Ochoa* court even acknowledged that it was "entirely possible that the alleged labor law violations at issue here would not have occurred if the ISP had been programmed differently."[88] The court noted that the ISP's labor law parameters were pre-programmed and the franchisee did not change them.[89] However, the court held that "simply providing the ISP software is not enough to convert McDonald's into an employer" under clear precedent that "franchisors who mandate

88. Ochoa v. McDonald's Corp., 133 F. Supp. 3d 1228, 1237 (N.D. Cal. 2015).
89. *Id.*

use of their payroll processing services are not liable as joint employers, even when the labor law violations at issue allegedly arose out of the way the franchisor set up the payroll system."[90] Doing so would unreasonably expose companies that provide employment related software, which as a practical matter may be necessary for a franchisee to use, to employer liability for programming or bugs that result in labor law violations.[91]

In addition, the *Ochoa* court noted that McDonald's provides a voluntary software tool called R2D2 or Regional Restaurant and Data Diagnostics that is also pre-programmed to identify labor law violations. The court held that because the program was used only to monitor the performance of the restaurants and could not be used to exercise control over wages, hours, and working conditions, it did not result in joint employer liability.[92]

Another common provision in franchise agreements relates to quality assurance and involves periodic inspections and occasional mystery shopper programs. The *Courtland* court found that periodic evaluations and mystery shoppers sent to ensure that the franchisee was following the franchise agreement guidelines did not show the requisite degree of control to impose vicarious liability.[93]

On the other hand, the court in *Greil* indicated that the following provisions in the franchise agreement were indicia of control: the facility was required to be built and maintained in accordance with the franchisor's specifications, regular inspections by the franchisor were permitted, approval by the franchisor was required for all advertising, the relationship between the franchisor and franchisee amounted to profit sharing, the franchisor had the ability to audit the franchisee's books, and the franchisor had the right to cancel the agreement if there were substantial violations of any of the covenants in the franchise agreement.[94]

Because of the variety of provisions that could be included in this category, we do not have a specific example of one. However, in general, the franchise agreement should set forth the standards related to the work, but should make clear that the procedures utilized to implement those standards rest with the franchisee. "The franchise agreement merely sets forth the standards related to the work; the responsibility of implementing the details of those standards is left to [the franchisee's] discretion. Neither an occasional assertion of control or sporadic action directing the details of the work is sufficient to destroy the agreement forming the basis of the parties' independent contractor relationship."[95]

90. *Id.*

91. *Id.* at 1237–38.

92. *Id.* at 1238.

93. Courtland v. GCEP-Surprise, LLC, No. CV-12-00349-PHX-GMS, 2013 WL 3894981, at *6 (D. Ariz. July 29, 2013).

94. Greil v. Travelodge Int'l, Inc., 541 N.E.2d 1288, 1292 (Ill. Ct. App. 1989).

95. Domino's Pizza, L.L.C. v. Reddy, Case No. 09-14-99958-CV, 2015 Tex. App. LEXIS 2578, at *15 (Tex. App. Mar. 19, 2015).

5. Safety/Security

Depending on the nature of a franchise system, safety and security at the franchised business may be a particularly significant concern. For instance, a restaurant franchise that is required to serve customers twenty-four hours a day raises greater security concerns than a restaurant franchise that is open only during daylight hours. Although the franchisor undoubtedly has an interest in ensuring that the system on the whole has a reputation of providing a safe and secure environment for late night diners, the degree to which the franchisor mandates such safety and security measures will affect the degree to which the franchisor is exposed to claims of vicarious liability and joint employment.

Notably, the California Supreme Court's decision in *Patterson* was not affected by the fact that Domino's computer system touched on safety and security matters. The system did not train employees on how to treat each other at work or how to avoid sexual harassment.[96]

The *Reddy* case involved a requirement that vehicles used by delivery drivers be inspected.[97] This did not affect the Texas Court of Appeals' decision that Domino's was not vicariously liable for death and injuries caused by a franchisee's delivery driver. Domino's did not specify how the inspections should be performed nor did it conduct the inspections or receive the results of inspections.[98]

The above decisions are consistent with the standard applied in New York by the court in *Hong Wu*, a case involving an overnight assault on an employee of a Dunkin' Donuts franchisee.[99] In determining whether the franchisor could be held vicariously liable, the court analyzed whether the franchisor exercised a considerable degree of control over the instrumentality that caused the harm.[100] In deciding whether the franchisor's actions give rise to a legal duty, courts typically draw distinctions between recommendations and requirements.[101] Particularly relevant in *Hong Wu* were the following:

- Even though the franchisor required the store to remain open twenty-four hours a day, which did create an increased security risk, the franchisor did not mandate specific security measures or otherwise control or limit the franchisee's response to the increased risk.[102]
- Although the franchisor made security equipment available for purchase and suggested that alarm systems and other burglary prevention tech-

96. Patterson v. Domino's Pizza, LLC, 333 P.3d 723, 741 (Cal. 2014), *reh'g denied* (Sept. 24, 2014).

97. *Reddy*, 2015 Tex. App. LEXIS 2578.

98. *Id.* at *7.

99. Wendy Hong Wu v. Dunkin' Donuts, Inc., 105 F. Supp. 2d 83, 91 (E.D.N.Y. 2000), *aff'd sub nom.* Wu v. Dunkin' Donuts, Inc., 4 F. App'x 82 (2d Cir. 2001).

100. *Id.* at 87.

101. *Id.* at 89.

102. *Id.* at 91.

niques were important, the franchisor did not require the purchase of security equipment.[103]

- Although the franchisor's inspectors observed that certain safety measures had been taken, the inspectors did not evaluate the necessity or sufficiency of the security measures.[104]

Balancing the tension between providing greater recourse for victims and incentivizing franchisors to ensure security measures are in place, the court in *Kerl* held that "the imposition of vicarious liability has less effectiveness as an incentive for enhancing safety and the exercise of care in the absence of the sort of daily managerial supervision and control of the franchise that could actually bring about improvements in safety and the exercise of care."[105] Although "the rationale of encouraging safety and the exercise of due care is present in the domain of franchising, as elsewhere, it has less strength as a justification for imposing no-fault liability on a franchisor" because the "typical franchisee is an independent business or entrepreneur, often distant from the franchisor and not subject to day-to-day managerial supervision by the franchisor."[106]

Specific provisions concerning safety concerns are frequently addressed in a franchisor's manual. Following is a sample provision that is more generic:

Operation in Accordance with Public Health and Safety

> Franchisee shall operate the Franchised Business in a safe and secure manner that optimizes public health and safety. Franchisee is solely responsible for determining and addressing all safety concerns relating to the condition of the premises and surrounding areas, the operation of any vehicles in connection with the Franchised Business and otherwise.

6. Compliance with Laws

Most franchise agreements require franchisees to comply with all applicable laws in the operation of their businesses. This seems to be the extent of the involvement of franchisors in most franchise systems and, as a result, this type of provision has not caused issues in cases involving vicarious liability or joint employment allegations.

For example, in *Courtland* the extent of the franchisor's guidance to franchisees on employment discrimination, including sexual harassment, was to tell franchisees "to follow all federal state, local regulations and rules."[107] The California Supreme Court found it relevant that Domino's lacked contractual authority to enforce employment laws. "Domino's lacked contrac-

103. *Id.* at 91–92.
104. *Id.* at 92.
105. Kerl v. Dennis Rasmussen, Inc., 682 N.W.2d 328, 338 (Wis. 2004).
106. *Id.*
107. Courtland v. GCEP-Surprise, LLC, No. CV-12-00349-PHX-GMS, 2013 WL 3894981, at *8 (D. Ariz. July 29, 2013).

tual authority to manage the behavior of [the franchisee's] employees while performing their jobs, including any acts that might involve sexual harassment."[108]

Following is a sample of a typical provision requiring compliance with applicable law:

> *Compliance with Law*
>
> Franchisee will operate in full compliance with all applicable laws, ordinances and regulations, including, without limitation, such laws, ordinances and regulations relating to occupational hazards and health, worker's compensation insurance, unemployment insurance and withholding and payment of federal and state income taxes and Social Security taxes, trade name and advertising restrictions, building codes, and handicap access. In particular, and not in limitation of the foregoing, Franchisee shall comply with the Americans with Disabilities Act.

F. *Management by Franchisor*

Some franchisors include the right to step in and manage the franchised business if the franchisee is in default of the franchise agreement. The reason behind this provision is to allow the franchisor to continue operations on behalf of the franchisee in the event of death or serious default so as to avoid closing the location, even temporarily. The franchisor or its nominee typically receives a management fee for undertaking these additional duties.

Exercising the franchisor's right under such a provision would be more likely to result in vicarious or even direct liability issues for employee or other claims resulting from the operations by the franchisor. Also of concern is the degree of control the mere presence of such a provision communicates. While the authors are not aware of any determination based on the inclusion of such a provision, franchisors should consider whether such a provision is worth the effect it may have on the overall control a franchisor is imposing as part of its franchise program. In *Patterson*, the California Supreme Court found relevant that "Domino's had no duty to operate" the franchisee's store, "[n]or did Domino's have the right to direct [the franchisee's] employees in store operations."[109] In *Kerl*, the Wisconsin Supreme Court also took into consideration the fact that the franchisor "could not step in and take over the management of [the franchisee's] employees" when determining that the franchisor was not vicariously liable for the negligent supervision of employees by the franchisee.[110]

Courts have also more generally considered the ability of a franchisor to directly or even indirectly control the franchisee and its operations in their

108. Patterson v. Domino's Pizza, LLC, 333 P.3d 723, 741 (Cal. 2014), *reh'g denied* (Sept. 24, 2014).
109. *Id.*
110. *Kerl*, 682 N.W.2d at 340.

analyses of vicarious liability and joint employer claims. In *Ochoa*, the court noted that McDonald's had "the ability to exert considerable pressure on its franchisees" through many means, including termination,[111] but still held that McDonald's was not the joint employer of the franchisee's employees because "an entity's ability to convince an employer to carry out certain acts by threatening economic sanctions does not itself make it an employer."[112]

Should a franchisor feel that such a right is necessary, however, it should attempt to resolve any breaches or defaults through other means and only exercise its right to take over management as a last resort. If desired, the following language may help guide the drafting of such a management provision.

Option to Manage

> If Franchisee is in default under this Agreement, in addition to Franchisor's right to terminate this Agreement set forth in Section ___, and not in lieu thereof, Franchisor may elect to enter into and manage the Franchised Business until such time as Franchisor shall determine that the default of Franchisee has been cured and that Franchisee is capable of complying with the requirements of this Agreement. If Franchisor assumes the management of the Franchised Business, Franchisee must pay Franchisor a management fee equal to __________ Dollars ($___) per day ("Management Fee") and reimburse Franchisor for all expenses incurred by Franchisor's personnel so long as such personnel are necessary and in any event until the default has been cured. Franchisee acknowledges that the Management Fee shall be in addition to any other fees required under this Agreement and shall be paid in accordance with the methods of payment set forth in Section ___. If Franchisor assumes the Franchised Business' management, Franchisee acknowledges that Franchisor will have a duty to utilize only commercially reasonable efforts and will not be liable to Franchisee or its owners for any debts, losses, or obligations the Franchised Business incurs, or to any of Franchisee's creditors for any supplies or services the Franchised Business purchases.

III. Manual

As noted above, the contents of the traditional operations manual (or as we suggest labeling it, the "brand standards manual") that the franchisor provides to its franchisees should also be re-examined and re-focused to provide information and procedures that relate more directly to protection of the brand and the standards the franchisor has established to protect that brand.

111. Ochoa v. McDonald's Corp., 133 F. Supp. 3d 1228, 1237 (N.D. Cal. 2015).
112. *Id.* at 1239.

Some franchisors are considering excising from their manuals all materials relating to a franchisee's employees. The court in *Vann* emphasized that all personnel policies and procedures described in the Massage Envy manual were optional.[113] Anything that is included should be informational only, and the franchisee should be directed to formulate its own employment policies and procedures with the assistance of its advisor.

Some courts have expressed concern with the detail of operational control set forth in operations manuals. A list compiled by the California Court of Appeal in *Patterson* is instructive:

- The franchisee's computer system was not within its exclusive control. Domino's had independent access to the data.
- Domino's had the right to audit the franchisee's tax returns and financial data.
- Domino's determined store hours, advertising, handling of customer complaints, signage, the franchisee's email capabilities, equipment, furniture, fixtures, décor, and the method and manner of payment by customers.
- Domino's regulated the pricing of items at the counter and home delivery and set the standards for liability insurance.

Thus, according the California Court of Appeal, "Domino's claims the franchise agreement grants [the franchisee] the freedom to conduct its own independent business. But provisions of the agreement substantially limit franchisee independence in areas that go beyond food preparation standards."[114]

Similarly, the *Billops* court highlighted the fact that the Hilton operations manual was detailed and in part mandatory and was incorporated into the franchise agreement. The manual regulated a variety of operational matters, required the franchisee to keep detailed records so that the franchisor could ensure compliance with the manual, and reserved the right of the franchisor to enter the premises to inspect compliance. Some of the operational matters regulated by the manual included

> identification, advertising, front office procedures, cleaning and inspection service for guest rooms and public areas, minimum guest room standards, food purchasing and preparation standard, requirements for minimum supplies of "brand name" goods, staff procedures and standards for soliciting and booking group meetings, functions and room reservations, accounting, insurance, engineering and maintenance, and numerous other details of operation.[115]

Together with the ability of the franchisor to unilaterally terminate the franchisee for violation, these requirements provided sufficient evidence that cre-

113. Vann v. Massage Envy, 2015 U.S. Dist. LEXIS 1002, at *3 (S.D. Cal. Jan. 8, 2015).

114. Patterson v. Domino's Pizza, LLC, 143 Cal. Rptr. 3d 396, 400, *review granted and opinion superseded sub nom.* Patterson v. Domino's Pizza LLC, 287 P.3d 68 (Cal. 2012), *rev'd*, 333 P.3d 723 (2014).

115. Billops v. Magness Const. Co., 391 A.2d 196, 198 (Del. 1978).

ate a triable issue of fact and caused the court to reverse the lower court's grant of summary judgment in favor of Hilton.[116]

IV. Relations with Employees/Customers

Although it is important to properly draft the franchise agreement and the manual to address vicarious liability and joint employment issues, it is equally important that the supervision and guidance actually provided by franchisors comport with the principle that the franchisee is the sole employer of its employees. The actions of the Domino's area leader or field representative were significant factors in the *Patterson* case. The franchisee had testified that he felt pressured into acquiescing to the area leader's suggestions because "a franchisee who did not 'play ball' with the area leader might be 'in jeopardy,' 'in trouble' or 'out of business.'"[117] The franchisee also emphasized that his area leader had told him to get rid of the manager who allegedly harassed the plaintiff.[118] The California Supreme Court found, however, that the evidence showed that the franchisee acted with the understanding that the decision on what to do about the manager at issue was his alone to make.[119]

The lesson from *Patterson* is that the franchisor's field representatives should be trained to avoid becoming involved in a franchisee's relationships with its employees. Except for compliance with the requirements of the franchise system, the field representative's guidance should be limited to suggestions on operational improvements that the franchisee should consider making, and there should never be an implication that failure to follow these suggestions will result in termination of the franchise. Moreover, the field representative's communication should be restricted to the franchisee or its senior management and not directed to employees of the franchisee.

In *Patterson*, the California Supreme Court also found relevant that Domino's had no procedure for processing sexual harassment complaints by franchisees' employees.[120] Similarly, the *Courtland* case noted that if a franchisee or employee contacted Buffalo Wild Wings with an employment-related question, the franchisor would refer that person back to the franchisee's human resource personnel.[121]

Too often, a franchisor may try to be helpful by answering franchisees' questions on human resource issues. Franchisees should instead be instructed early in the relationship to secure the services of their own labor

116. *Id.*

117. Patterson v. Domino's Pizza, LLC, 333 P.3d 723, 730 (Cal. 2014), *reh'g denied* (Sept. 24, 2014).

118. *Id.* at 744.

119. *Id.* at 742.

120. *Id.* at 731.

121. Courtland v. GCEP-Surprise, LLC, No. CV-12-00349-PHX-GMS, 2013 WL 3894981, at *7 (D. Ariz. July 29, 2013).

and employment law/human resource advisor. Some franchise systems have designated outside vendors to provide these services to franchisees on an optional basis.

In addition, most franchise systems have established customer service procedures to field complaints and other operational issues that arise. Indeed, Domino's had a "1-800" telephone number for customer complaints about products and services.

If there is a complaint about how a customer was treated in a franchisee's store, franchisors should consider referring the complaint to the specific franchisee for resolution. This is another situation in which the franchisor should weigh the protection afforded for vicarious liability claims against the possible damage to the brand if customers are left without recourse for their complaints about franchisee conduct or service.

V. Conclusion

The inconsistent and sometimes contradictory case law on vicarious liability and joint employment has thus far generated a great deal of uncertainty for the franchising community and will almost certainly continue to do so. *Patterson* was a pivotal decision for franchisors and franchisees in California, but it is unclear whether other jurisdictions will follow suit or how far subsequent courts (including those within California) will extend the California Supreme Court's decision. This article highlights just a handful of the provisions of the franchise agreements and brand standards manuals that are affected by these decisions and provides suggestions on the language of these provisions, but should in no way be considered a definitive guide to how to draft a franchise agreement. Every franchise system must balance the importance of mandating certain controls to protect its brand against the specter of being found liable for its franchisees' actions. Therefore, franchisors should continue to review and update their franchise documents to adapt to evolving case law.