

After Domino's ruling: franchisors, loosen up; employers, tighten up

By David Gurnick and Nicole Kamm

Franchising is a business relationship in which the owner of a brand and operational system grants a license letting a franchisee conduct their own business using the franchisor's brand and system. Franchising is widespread in the U.S. McDonald's has more than 12,000 domestic franchises, and Yum Brands has almost 14,000 Taco Bell, Pizza Hut and KFC franchised locations in the U.S. Thousands of franchised hotels, gas stations, real estate brokerages, childcare services, fitness and dance studios, and other businesses occupy the nation's business districts.

Franchisors and franchisees generally consider themselves to be independent contractors. Each makes its own decisions about key aspects of their business operation. As independent contractors, each party bears its own responsibility for acts and omissions that occur in its business.

Yet, with so many different persons acting as independent franchise owners, franchisors (like Subway, Hilton Hotels, Shell Oil and many others) often exert significant control over their chains of numerous franchisees. Many controls are necessary for franchisors to assure their outlets maintain standards of appearance, and uniform quality in their operations, products and service. The necessity of other controls may sometimes be questioned.

Extensive controls that some franchisors exert can create a legal tension by interfering with the critical independence the parties seek in their relationship.

A recent decision, *Patterson v. Domino's Pizza*, 2012 DJDAR 8891 (Cal. App. 2d Dist. June 17, 2012), holds that a franchisor can go too far in controlling its franchisee — so far that the relationship loses its independent contractor status, and becomes a principal-agent relationship. When this occurs, the franchisor, as a principal, can be liable for tortious misconduct that occurs at its franchisee's location.

Taylor Patterson was a teenage employee at a Domino's Pizza franchise. She claimed she was sexually harassed by the assistant manager and sued for assault, battery, sex harassment, emotional distress and other claims. When the franchisee filed bankruptcy, Patterson focused her claim on the Michigan-

based franchisor, Domino's Pizza, LLC, alleging it was vicariously liable.

The trial court granted summary judgment for Domino's. The franchise agreement said the franchisor and franchisee were independent contractors and made the franchisee responsible to supervise and pay store employees.

But the court of appeal reversed, holding there was a triable issue of fact whether Domino's exerted so much control over the franchisee's operation, management, employee relations and discipline as to potentially have established a principal-agent relationship, in which the franchisor could be vicariously liable.

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Instead of relying on the terms of the franchise agreement, the court looked at all the circumstances to determine who actually exercised control. The court of appeal concluded there was enough evidence of Domino's control over the franchisee that the issue should be decided by a jury.

Among the numerous indicia of control in the franchise relationship, the court found Domino's: set qualifications for the franchisee's employees; set standards for employee demeanor; determined the type of training for employees; had independent access to franchisee computer data; described in its manual the documents to be included in personnel files; set dress and grooming standards for employees; set franchisee store hours; determined the method and manner of customer payments; required that insurance policies name Domino's as additional insured; controlled whether a franchisee could have any interest or work outside the franchised business; set requirements for bank deposits, in-store safes, cash limits in the cash register and credit cards the franchisee must accept.

The court of appeal noted if these controls were needed only to control the franchisor's trademarks, products and service quality, there would be no vicarious liability. But viewing the evidence most favorably to the party opposing summary judgment (*Patterson*), the court ruled if all the above controls were proven, there would be a lack of independence by the franchisee.

The *Patterson* decision is significant in both the franchise and employment law contexts. Unlike cases of co-worker harassment, in *Patterson* the alleged harasser was an assistant manager, and thus a supervisor. For this reason, the employer could be strictly liable.

Moreover, when a supervisor is a harasser, even a single sexually offensive act could be severe enough to establish a hostile work environment, sufficient to create liability. Due to controls exerted over the franchisee, Domino's could be liable for a single act of harassment by an assistant manager at any of its thousands of franchised locations.

Among the lessons of the *Patterson* decision is that franchisors must reevaluate controls exerted over franchisees to assess whether they go beyond what is necessary to protect the trademark, and quality of products and service. Controls that are not necessary expose a franchisor to vicarious liability for acts and omissions occurring at any of their numerous franchise locations. Thus, the franchisee in *Patterson* claimed Domino's was extremely overbearing; that management constantly inspected the operation; and that he was "ticky-tacked to death."

Beyond franchising, businesses in general cannot rely entirely on contract language to protect against claims by employees of their independent contractors.

An agreement may be a starting point for analysis, but a court or government agency (like the Internal Revenue Service or state Employment Development Department) that has occasion to examine whether there is an independent contractor or employer-employee relationship, will also look at the realities between the parties. If a company exercises too much control over another party, the court or government agency may choose to ignore the parties' own characterization of their relationship.

Patterson is also a reminder that franchisors and other employers must concern themselves not only with the conduct of their employees — but with the conduct of an independent contractor's employees as well.



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