Am I My Brother's Keeper?

Franchisor Liability for a Franchisee's Conduct

by Justin M. Klein

When a consumer visits a Dunkin' Donuts store, they may recognize on some level that the store is a franchised business owned and operated by an individual or corporate entity separate and apart from Dunkin' Donuts (*i.e.*, the franchisor). But while the consumer may be aware that the store is owned by a franchisee, and not Dunkin' Donuts, most are unaware of the identity of the franchisee operating the store. Simply stated, as a result there often is no perceived distinction between the individual store operator and the franchisor, primarily due to the shared name and concurrent use of trademarks and trade dress by the parties. However, despite this blurring of legal independence, the franchisor and franchisee are, in fact, separate legal entities with a business relationship that is formed at arms length.[1]

This fundamental misunderstanding of how a franchise relationship works creates a multitude of issues for the legal system. One such issue arises when an injury occurs at a franchised location. Because consumers (and their lawyers) are not familiar with the respective roles of the franchising parties, franchisors often are named as defendants in lawsuits for alleged misconduct on the part of one of its franchisees. This may be because the franchisor is the assumed 'deeper pocket,' or, more likely, because the injured party does not know against whom the suit should be brought.

To be successful against a franchisor, a plaintiff will need to adequately allege and prove the franchisor can be held vicariously liable for the acts of its franchisee. Vicarious liability claims must involve allegations that the injury occurred because the franchisor either mandated the wrongful conduct or failed to monitor the franchisee's operations appropriately.[2] While prevailing in an action against a franchisor for the acts of its franchisee is possible—if the plaintiff has the right set of factual circumstances and submits a very precise pleading—it is rare.

This article discusses when a franchisor may be held liable for the conduct of its franchisees. Many lawmakers view the franchisor/franchisee relationship to be akin to an employer/employee relationship.[3] While a variety of arguments can be made with respect to the accuracy of such a comparison, the resulting analysis becomes one based on an agent/principal theory of relationship. It is through this lens that the vicarious liability inquiry in this article is scrutinized.

Demonstrating Actual Authority

In order to establish vicarious liability of a party, a plaintiff must prove the existence of either actual or apparent authority.[4] In the franchise context, a showing of actual authority requires a principal/agent relationship be established between the franchisor and franchisee.[5] This type of relationship can be difficult to prove because it is common practice in franchise agreements for the parties to explicitly state that the franchisee is not an agent of the franchisor, is a separate and independent businessperson, and cannot bind the franchisor in connection with any of its actions.

Beyond the four corners of the franchise agreement, however, courts will look to the level of control exerted by the franchisor relating to the particular type of alleged wrongful conduct. For example, in *J.M.L. ex rel. T.G. v. A.M.P.* the New Jersey Appellate Division addressed the issue of the liability of a karate chain franchisor for the tortious acts of its franchisee.[6] In this case, the court found "the relationship between [the franchisee] and [the franchisor]…[did] not evince the degree of control that would warrant the imposition of vicarious liability under agency principals or liability as an aider or abettor."[7] Here, the Appellate Division looked to see the extent to which the franchisor "compelled, coerced, encouraged or assisted" the franchisee to determine the degree of control held over them.[8] As such, the franchisor was successful on summary judgment.

Similarly, in *Simpkins v. 7-Eleven, Inc.* the Appellate Division again analyzed the issue of the franchisor's alleged liability for its franchisee's actions.[9] The court determined the franchisor could not be held vicariously liable under the theory of actual authority for the wrongful acts of its franchisee.[10] In that case, "there [was] no evidence that 7-Eleven participated in the day-to-day affairs of the [franchised] store, other than in respect to certain financial activities."[11]

Likewise, the Appellate Division in *Bahrle v. Exxon Corp., et al.* also concluded that an oil company franchisor may not be held liable for injuries caused by its service station franchisee on a vicarious liability theory.[12] The *Bahrle* court contrasted the United States Court of Appeals for the Third Circuit's decision in *Gizzi v. Texaco*, which held the plaintiff's reliance upon Texaco's advertisements inviting patrons to use the service station could be enough to impose liability on Texaco for the service station's negligence.[13]

The Appellate Division, in *Bahrle,* stated:

> Unlike *Shadel*[14] and *Gizzi*, this is not a case where a patron had relied on the oil company's insignia or its advertising in seeking out the service of a local station, and was injured as a result of that service being rendered. Plaintiffs produced absolutely no evidence that they in any manner relied upon the fact that [Franchisee's] station was a Texaco station. Not a single plaintiff testified that they moved into the area ultimately contaminated in reliance on the fact that the station displayed the Texaco insignia. Nor is there any proof that plaintiffs remained residents in the neighborhood during the Texaco/[Franchisee] era because they had relied on the fact that Texaco was in control of the station and would thus prevent it from becoming a source of contamination. Therefore, there was no factual or legal basis to hold Texaco liable on a vicarious liability theory.[15]

Note, however, that while the plaintiffs in *Gizzi* were unable to show they had specifically relied on the advertising, the court's *dicta* in *Gizzi* opened the door to the notion that such reliance, if properly pled and evidenced, may be sufficient to establish vicarious liability.

New Jersey courts are in agreement with many other states around the country on the issue. In New York, for example, in *Cullen v. BMW of North America, Inc.*, the United States Court of Appeals for the Second Circuit reversed the decision of the Eastern District of New York and held that the franchisor in question—BMW—could not be held liable on either an agency or negligence theory based upon the alleged tortious acts of its franchisee, which included theft and conversion of customer funds.[16] The Second Circuit determined that BMW, as franchisor, had no obligation to protect customers from unforeseeable injuries caused by its franchisee's intervening and unforeseeable tortious acts. The court rejected the lower court's holding that BMW was liable for the franchisee's fraud because it was "apprised of [the franchisee's unscrupulous] business transactions" and had an obligation to "police the operation of the BMW name and supervise the operation of its franchise."[17]

However, when actual authority cannot be proven, plaintiffs may rely on apparent authority with the goal of achieving the same result.

Demonstrating Apparent Authority

If an argument for actual authority cannot be made based on the facts of the individual case, a claimant may attempt to prove the existence of apparent authority. The law in New Jersey regarding the doctrine of apparent authority is well settled—apparent authority exists only "where the actions of a principal have misled a third party into believing the relationship of authority existed."[18] The doctrine looks to the actions of the principal and not those of the alleged agent.[19] In addition, before the doctrine of apparent authority can be applied, it is essential that the "element of reliance...be present."[20]

In actions against franchisors based on an apparent authority theory, it is also crucial for the plaintiff to establish that he or she reasonably believed the franchisee's representations were binding on the franchisor.[21] Consequently, these are fact-intensive claims that require specific circumstances and detailed pleading.

Finding a franchisor liable on the theory of 'apparent authority' is the exception and not the rule—so it is not advisable for litigators to focus their complaints on such a theory. While the amount of cases in New Jersey addressing this issue is scant, the issue has been addressed by a number of state and federal courts across the United States, and the relevant authority in support of dismissing these claims is overwhelming.[22]

Conclusion

Industry statistics demonstrate that, in the United States, a newly franchised business opens every eight minutes of every business day.[23] As this trend toward franchising continues, the number of claims brought against franchisees and their franchisors will likely increase as well. In an attempt to create leverage and go after the 'deep pocket,' consumers will continue—more often unsuccessfully than not—to pursue claims against franchisors on a vicarious liability basis. Before suing a franchisor for the acts of its franchisee, plaintiffs and their counsel should weigh the costs, risks and benefits of bringing such an action—and, most significantly, consider the scope of factual support they will need to sustain these claims under the current state of the law. ⚖

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ENDNOTES

1. *See Katsiavrias v. Cendant Corp.*, Civ. Action No. 06-4465, 2009 U.S. Dist. LEXIS 25744 (D.N.J. March 30, 2009) ("[T]he parties contract at arms' length and...the parties are negotiating at arm's length for a franchise.").
2. *See J.M.L. ex rel. T.G. v. A.M.P.*, 379 N.J. Super. 142 (App. Div. 2005) (noting that vicarious liability claims typically follow the Restatement (Second) of Agency § 219).
3. *See Morgan v. Air Brook Limousine*, 211 N.J. Super. 84, 105 (Law Div. 1986) (weighing whether or not an employer/employee relationship existed in a franchisor/franchisee context).
4. *See Lehmann v. Toys 'R' Us, Inc.*, 132 N.J. 587, 601 (1993) ("An employer will be found vicariously liable if the supervisor acted within the scope of his or her employment. Moreover, even if the supervisor acted outside the scope of his or her employment, the employer will be vicariously liable if the employer contributed to the harm through its negligence, intent, or apparent authorization of the harassing conduct, or if the supervisor was aided in the commission of the harassment by the agency relationship.").
5. *See J.M.L. ex rel. T.G.* 379 N.J. Super. at 142.
6. *See id.* at 151.
7. *Id.* at 152.
8. *Id.*
9. *See Simpkins v. 7-Eleven, Inc.*, 2008 N.J. Super. Unpub. LEXIS 2450 (App. Div. April 7, 2008).
10. *See id.*
11. *Id.*
12. *See Bahrle v. Exxon Corp., et al.,* 279 N.J. Super. 5, 27-28 (App. Div. 1995).
13. *See Gizzi v. Texaco*, 437 F.2d. 308 (3d. Cir. 1971).
14. In *Shadel v. Shell Oil Co.*, 195 N.J. Super. 311 (Law Div. 1984), the superior court of New Jersey, Law Division, Passaic County, denied Shell Oil Company's motion for summary judgment on the issue of apparent authority. The trial court found that the evidence, if believed by the jury, presented a cause of apparent authority, and there was nothing peculiar about the independent contractor agreement that would preclude the doctrine from applying to the defendant.
15. *Id.* at 26–27.
16. *See Cullen v. BMW of North America, Inc.*, 691 F.2d 1097, 1101 (2d Cir. 1983).
17. *Id.* at 1101-1102; *see also Ciofo v. Hungry Howie's Pizza*, 1997 Mich. App. LEXIS 1676, at *1 (Mich. Ct. App. May 16, 1997) (stating that "to determine whether a...franchisor and franchisee had a principal-agent relationship sufficient to impose vicarious liability on the franchisor, [the court should] examine the defendant's control of the franchisee in terms of the defendant's right to take part in the day-to-day operation of the franchisee's business"); *see also Kerl v. Rasmussen*, 682 N.W.2d 328, 341 (Wisc. 2004) (requiring for a vicarious liability claim that the franchisor had "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"); Philip F. Zeidman, *Franchising and Other Methods of Distribution: Regulatory Pattern and Judicial Trends,* 1408 P.L.I./CORP. L. & PRAC. 529, 683 (2004) (in determining whether vicarious liability exists, "courts have measured the extent of the franchisor's control over the day-to-day operations of the franchised business").
18. *Lobiondo v. O'Callaghan*, 357 N.J. Super. 488, 497 (App. Div.), *cert. denied*, 177 N.J. 224 (2003) (*quoting Rodriguez v. Hudson County Collision Co.*, 296 N.J. Super. 213, 221 (App. Div. 1997)).
19. *See Busciglio v. Della Fave*, 366 N.J. Super. 135, 140 (App. Div. 2004).
20. *See Wilzig v. Sisselman*, 209 N.J. Super. 25, 36 (App. Div.), *cert. denied*, 104 N.J. 417 (1986); *see also Bahlre*, *supra*, 295 N.J. Super. at 28 (opining that in the absence of reasonable reliance, claims for vicarious liability based upon apparent authority cannot be sustained).
21. *See, e.g., Mann*, *supra*, 1990 WL 205286, at *5 (holding that the facts alleged failed to support any inference that the plaintiffs "could reasonably have believed" that the franchisee's alleged misrepresentations concerning the viability of its business were authorized or binding on the franchisor); *O'Banner v. McDonald's Corp.*, 670 N.E.2d 632, 634-35 (Ill. 1996) (approving lower court's entry of summary judgment in favor of defendant-franchisor, noting that the plaintiff failed to show that "he actually did rely on the apparent agency in going to the restaurant where he was allegedly injured"); *Theos & Sons, Inc. v. Mack Trucks, Inc.*, 729 N.E.2d 1113, 1121-22 (Mass. 2000) (holding that neither the use of a trademark or logos of the defendant nor the representation by the franchisee as an authorized dealer of the defendant was sufficient to raise a genuine issue of material fact that the plaintiff reasonably believed that an agency relationship existed for non-warranty work); *Little v. Howard Johnson Co.*, 455 N.W.2d 390, 394 (Mich. Ct. App. 1990) (noting the absence of evidence that the plaintiff "was harmed as a result of relying on the perceived fact that the franchisee was an agent of defendant" or "which indicated that plaintiff justifiably expected that the walkway would be free of ice and snow because she believed that defendant operated the restaurant"); *Phillips v. Rest. Mgt. of Carolina, L.P.*, 552 S.E.2d 686, 695 (N.C. Ct. App. 2001) (summary judgment for franchisor, holding no evidence that the plaintiff "would have chosen to eat elsewhere or done anything differently had he known that the restaurant at issue herein was not owned and operated by Taco Bell").
22. *See e.g. Mann v. Prudential Real Estate Affiliates, Inc.*, No. 90-C-5518, 1990 WL 205286, at *5 (N.D. Ill. Dec. 10, 1990) (granting the franchisor's motion to dismiss an apparent agency vicarious liability claim, finding that the plaintiffs failed to allege "acts or words" by the franchisor that would create an impression of an agency relationship); *see also Mobil Oil Corp. v. Bransford*, 648 So. 2d 119, 120-21 (Fla. 1995) (granting summary judgment in favor of the franchisor, holding that the facts alleged against Mobil, as the franchisor, were "legally insufficient" to support apparent agency theory because they did not reach the "minimum level of a 'representation' necessary to create an apparent agency"); *BP Exploration & Oil, Inc. v. Jones*, 558 S.E.2d 398, 403-04 (Ga. Ct. App. 2001) (finding that "it is common knowledge that independent gasoline stations use the trademarks, emblems, and colors of national oil companies," and, therefore, given this knowledge, the failure to post a sign indicating that the station was independently operated does not, standing alone, "permit an apparent agency finding").
23. *See* Roger D. Blair and Francine Lafontaine, *The Economics of Franchising*, 23 (2005).