



Labor & Employment ADVISORY ■

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California Supreme Court Limits Employment Claims Against Franchisors

In an acknowledgment of the modern reality of the franchise business model in California, and indeed in the United States, the California Supreme Court provided franchisors with a significant victory by reaffirming the contractual benefits that both parties to a franchise relationship receive, while further defining the limits of liability for employment claims brought by employees of franchisees who seek to name the franchisor as a defendant.

In *Patterson v. Domino's Pizza, LLC*, the issue before the California Supreme Court was whether a franchisor stands in an employment or agency relationship with the franchisee and its employees for purposes of holding the franchisor liable for workplace injuries allegedly inflicted by one employee of the franchisee while supervising another employee of the franchisee. In this case, the plaintiff, Taylor Patterson, had brought claims for sexual harassment under California's Fair Employment and Housing Act and named her employer, franchisee Sui Juris, her individual supervisor, and the franchisor, Domino's Pizza LLC, as defendants. Domino's was named on the theory that it was Patterson's "employer" and that each defendant was the agent, employee, servant and joint venturer of the other defendants.

In holding that Domino's Pizza LLC was not the employer of Patterson, the court concluded that a franchisor's enforcement of uniform marketing and operational plans on its franchisees cannot automatically create an employer/employee relationship and that liability for a franchisor must be based on a finding that the franchisor 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.

The Trial Court Grants Domino's Motion for Summary Judgment

At the trial court level, Domino's filed a motion for summary judgment on the grounds that it was not Patterson's employer because the internal day-to-day control needed to create an employment relationship was lacking. Domino's pointed out that it had no ownership or partnership with its franchisee, that the franchisee obtained all necessary licenses and permits, that the companies did not share profits or losses, and that under the franchise contract, Sui Juris maintained property and liability insurance at its own expense. Most importantly, the franchisee was solely responsible for recruiting and hiring employees to operate its store. While the franchisee's owner had agreed to undergo training with Domino's as a condition of opening and operating the store, the franchise agreement removed from Domino's any right or duty to implement a training program for the franchisee's employees. Moreover, there was no evidence that Domino's provided any sexual harassment training to the franchisee's employees, and,

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in fact, the franchisee had implemented his own sexual harassment policy. The franchise agreement also included language in which Domino's disclaimed any right or duty to operate the store or to direct the franchisee's employees in their jobs.

The contract also identified the parties as independent contractors. While it did require compliance with a separate "manager's reference guide" (MRG) and such program did provide for initial training by Domino's, as well as detailed uniform dress policies which the franchisee's employees were required to follow, the ultimate decision to hire and fire was left with the franchisee. The trial court determined that Domino's did not control day-to-day operations or employment practices such that the franchisee was an agent of Domino's or that its employee was also an employee of Domino's.

The Appellate Court Reverses

On appeal, however, the California Court of Appeal found that reasonable inferences could be drawn that Domino's exercised control over the franchisee's employment decisions and thus found a triable issue of fact on Domino's role as employer or principal for vicarious liability purposes. The court focused, in part, on the fact that the Domino's area leader had "suggested" to the franchisee that the supervisor be terminated, although no threat to terminate the franchise relationship was made if such termination was not carried out. According to the appellate court, the combination of such "suggestions" and the detailed and expansive standards and procedures imposed on Domino's franchisees left a reasonable inference that the franchisee lacked managerial independence.

The California Supreme Court Decision

The California Supreme Court granted review and focused on the issue of determining a franchisor's potential vicarious liability for wrongful acts committed by one employee of a franchisee while supervising another employee of the franchisee. The court thoroughly analyzed the economic effects and changes in the franchising world over the last 50 years and pointed out that older decisions dealing with vicarious liability did not comport with the present day reality of a franchising business relationship.

Patterson argued that because Domino's exercised detailed control over the franchisee's general operations, liability for personal harm sustained in the course of a franchisee's business should be borne by the franchisor. Domino's countered by pointing out that the critical factor is whether the franchisor had day-to-day control on the "specific instrumentality" that caused the alleged harm—in this case, sexual harassment of one employee of the franchisee by another. While recognizing that the general rule is still the same—that the right to control the means and manner in which the result is achieved is significant in determining whether the principal agency relationship exists—the court focused on the fact that the franchisee had the sole right to employ and discharge its employees.

The California Supreme Court was clear to point out that the means and manner tests generally used by the lower appellate court cannot stand for the proposition that a comprehensive operating system alone constitutes the "control" needed to support vicarious liability claims like the ones raised by Patterson. The court concluded that a franchisor becomes potentially liable for actions of the franchisee's 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. Any other guiding principle would disrupt the franchise relationship." Thus, the court found that it could not conclude that a franchise operating system necessarily establishes the kind of employment relationship that would essentially turn the franchise business model "on its head." The court went on to hold that nothing in the franchise agreement granted Domino's any of the essential functions commonly performed by employers.

Significantly, the court pointed out that Domino's lacked contractual authority to manage the behavior of its franchisee's employees while performing their jobs, including any acts that might involve sexual harassment. Neither the contract nor the MRG gave Domino's the authority to establish a sexual harassment policy or training program for its franchisee's employees. Moreover, there was no procedure by which the franchisee's employees could report such complaints to Domino's, nor did Domino's have a procedure for monitoring or reporting sexual harassment complaints between its franchisees and their employees.

While Domino's represented that it did discuss employment issues with the franchisee, the franchisee acknowledged that the Domino's representative's statements were not accompanied by any specific threat, express or implied, that the franchisee would risk any sanction if it did not terminate the supervisor's employment. Therefore the court concluded that the plaintiff could not raise a reasonable inference that Domino's retained or assumed the traditional right of an employer to hire, direct, supervise, discharge and oversee other relevant day-to-day aspects of the workplace behavior of the franchisee's employees.

Conclusion & Takeaways

The court concluded that a franchisor will be liable if it has retained the right of general control over the relevant day-to-day operations at its franchise locations, but that such a showing is necessary in order to impose liability.

A key takeaway for franchisors is that it is critical to review franchise agreements to ensure that the agreements explicitly define the franchise relationship such that, in both legal and functional terms, it is clear that franchisee employees are not employees of the franchisor. Additionally, guidelines or day-to-day operating manuals should clearly note that it is the franchisee, and not the franchisor, that has the sole power and responsibility to implement day-to-day workplace behavior policies and decisions. Equally as important, the actual practice and implementation must be consistent with these critical provisions of the franchise agreement and the operating manuals.

The line between providing for detailed operational requirements to protect the brand name and exercising control over employment decisions, while clarified by the *Patterson* decision, will still be subject to a factual analysis, and employee-friendly courts will likely attempt to apply a "totality of the circumstances" analysis to conclude that a franchisor in fact had the power to force a franchisee to terminate its employees or make other employment decisions. While *Patterson* is favorable for franchisors, serious challenges remain, as acts taken by franchisee employees can damage the goodwill and operations of a franchisor in a material manner. Moreover, the California legislature has continued to revise the California Franchise Relations Act. Most recently, it did so with Senate Bill 610, which will apply a "good faith and fair dealing" requirement on franchise agreements and, in essence, necessitate further interaction with franchisees that may be used as evidence that the "totality of the circumstances" points toward a joint employment relationship. For all of these reasons, the line between protecting a franchisor's business interests and property and limiting franchisor liability for the acts of a franchisee's employees will continue to be a challenge.

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