Franchisors and Vicarious Liability for Actions of Franchisees or Their Employees

By Marc A. Lieberstein and Christopher M. Caiaccio | August 23, 2023 at 10:00 AM

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Franchisors are frequently targeted in litigation after an individual is injured based on the actions of a franchisee or its employees. And in the ever-expanding universe of matters that may keep franchisors up at night, concerns about their potential vicarious liability for the actions of franchisees or their employees likely tops the list. This concern is heightened when a complaint is filed for wrongful death based on a franchisee or its employee's actions.

Our article discusses whether a franchisor may be held vicariously liable for the actions of a franchisee or the franchisee's employee in a wrongful death action and suggests ways a franchisor may be able to avoid such liability.

When an agency relationship exists between a franchisor and a franchisee, the franchisor may become vicariously liable for wrongful death acts committed by the franchisee or its employee, provided the act is within the scope of the franchisee's/employee's authority. A court may also hold a franchisor vicariously liable if the franchisee's operations lead people to reasonably believe that the franchisor owns/operates the company.

While the law regarding vicarious liability varies from state to state, courts traditionally assess the agency relationship between a franchisor and franchisee, as well as the franchisor's control under two theories: actual and apparent authority. Actual authority exists when an agent has the power to act on behalf of a principal, because such power was expressly or impliedly conferred.

For actual authority, many states focus their assessment of the parties' relationship based on the franchisor's "right to control," as expressed in the franchise agreement, rather than actual exertion of control. In doing so, courts frequently cite standard contractual powers as indicators of actual authority including control over employees, accounting procedures, operating hours, supply and equipment sources, manuals, termination rights, inspection rights, marketing activities and tax payment by the franchisor.

Although language in franchise agreements cannot override actual control, contradictory clauses in any agreement may lead to factual questions regarding control. Apparent authority is the power of an agent to act on behalf of a principal, even though not expressly or impliedly granted. This authority arises only if a third party reasonably infers, from the principal's conduct, that the agent was granted such power by the principal. For apparent authority, franchisors may be liable where the franchisee—by words or conduct—creates the perception of an agency relationship.

A franchisor may ultimately avoid vicarious liability if it can prove it had no right to (and did not) control the franchisee or its employee, and the public did not perceive that the employee was affiliated with the franchisor.

In short, the less control or appearance of control the franchisor has over the franchisee and the franchisee's employees, the less likely it is that a court will find the franchisor vicariously liable.

In one case a franchisor was not held vicariously liable for the negligence of a franchisee's driver, who caused a motor vehicle accident that injured a child. The controlling principle in the determination of an actual agency relationship is the extent of "control and supervision" of the franchisor over the franchisee's day-to-day operations.

Courts generally recognize that franchisors "have a legitimate interest in retaining some degree of control in order to protect the integrity of the marks," but retaining certain rights, like enforcing standards, terminating agreements for failure to meet standards, inspecting premises, requiring training and making suggestions, does not constitute sufficient control to establish an agency relationship.

For example, one court found that despite the franchisor-franchisee agreement containing certain standards, such as periodic inspections and appearance guidelines, it did not establish enough control to create an agency relationship.

However, another court denied summary judgment to a franchisor in a wrongful death action based on the franchisor's "right to control the 'operative details' of the franchisee's business" even though the franchisor had not actually exercised that right. The court's decision was based on language in the franchise agreement allowing the franchisor to enter the premises and exercise "complete authority with respect to the operation and administration" of the franchised business in the event of a default.

In one recent case, a delivery driver employed by a franchisee struck another vehicle, resulting in injury and death. The injured party's estate sued both the franchisee and franchisor for negligence under vicarious liability.

On appeal, the court found that the evidence presented at trial did not support holding the franchisor liable based on its lack of necessary control over the franchisee's actions and dismissed the claims against the franchisor. The court reasoned those various rights retained by the franchisor, such as authority over termination, evaluations, inspections, and compliance requirements, did not establish the type of supervisory control sufficient for imposing a duty on franchisor. Additionally, the fact that the franchisor set general minimum operational standards did not negate the independent contractor provision in the franchise agreement.

The franchise agreement will play a key role here. As even if the agreement provides for indemnification from the franchisee for vicarious liability, and seemingly portrays an independent contractor relationship, liability may still arise if the franchisor has expressly reserved rights to control (e.g., sources of supply and distribution of goods and equipment).

Even if there were no actual franchisor authority, liability may still exist under an apparent authority theory. Apparent authority is based on a third party's perception of the principal's actions or intention to grant power to an agent to act on behalf of the principal.

Courts have relied on several representations to support a finding of vicarious liability on the basis of apparent authority, including uniform appearance and architecture; advertising in the name of the franchisor; telephone listings in the name of the franchisor only; letterhead stationery bearing the franchisor's name only; and answering the telephone with the franchisor's name.

For example, in one recent case, a court concluded that a hotel franchisor could be held vicariously liable in negligence based upon an apparent agency theory where the franchisee used the franchisor's trade name and trademarks, the franchisor engaged in national advertising that promoted its system, and the franchisor published a directory listing of its properties within the system—all without distinguishing between company-owned and franchised properties. The court reasoned that a jury could reasonably conclude that the franchisee "was operated in such a way as to create the appearance that it was owned by" the franchisor.

Whether a franchisor had apparent authority over a franchisee will depend on manifestations of the franchisor's seeming control over the franchisee and employee. In a recent case, a franchisor-like entity could not be held vicariously liable for actions of the local entity on a theory of apparent authority where the franchisor-like entity made no overt manifestation that it controlled or consented to the local entity actions and the local entity handbook stated that what was done was planned by the local entity.

In sum, while the idea of being vicariously liable for the actions of a franchisee and its employees may seem daunting for a franchisor, there are certain measures franchisors can take to minimize the risk of a vicarious liability: 1) minimize the actual control exercised by a franchisor over a franchisee and its employees; 2) carefully draft the franchise agreement to retain control over only those matters that are necessary for the successful operation of the business; 3) provide ample discretion to the franchisee over employee and other local operational matters; and 4) publicly acknowledge that franchisees operate independent businesses and encourage franchisees to make that clear to the public; 5) consider insurance coverage for such liability and mandating franchisees maintain such coverage for the benefit of the franchisor.

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Marc A. Lieberstein *is a partner and* **Christopher M. Caiaccio** *is counsel at Kilpatrick Townsend.*