



September 2, 2014

Who's in Control Here? California's Supreme Court Establishes New Standards for Potential Franchisor Liability for Employee Tort Claims

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On August 28, 2014, the Supreme Court of California, in *Patterson v. Domino's Pizza, LLC*, decided whether a franchisor was entitled to summary judgment on the plaintiff's claims that the franchisor was vicariously liable for alleged tortious conduct by the franchisee's employee. In a 4-3 decision, the court held that a franchisor becomes potentially liable for the actions of a franchisee's employees only if the franchisor:

... 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.

The court determined that the plaintiff's evidence presented in opposition to the franchisor's motion for summary judgment in the trial court did not establish the required amount of control by the franchisor. On that basis, the court found in favor of the franchisor. This resulted in the reversal of the court of appeal's decision that overturned the trial court's grant of summary judgment in the franchisor's favor (restoring the summary judgment for the franchisor).

Events Leading up to the Supreme Court's Decision

The plaintiff, an employee of a Domino's Pizza franchise (or "franchisee"), alleged she was sexually harassed and assaulted by the franchise's assistant manager. After resigning from her job, the plaintiff sued the assistant manager, the franchise, and Domino's Pizza, LLC (the "franchisor")—the latter as one of her employers. Early in the litigation, the franchise filed for bankruptcy protection, leaving the franchisor as the only "deep-pocket" defendant.

During discovery, the franchise owner testified he, and not the franchisor, (1) hired employees to work at the restaurant (including both the plaintiff and the alleged harasser); (2) implemented his own "zero tolerance" sexual harassment policy; and (3) supervised the franchise's employees. At

his deposition, the franchise owner testified that during a discussion with the franchisor's "area leader" about the alleged harasser, the area leader told the owner: "You've got to get rid of this guy [the alleged harasser]." However, there was no evidence that the area leader ever instructed the franchise to terminate the alleged harasser.

Before trial on the merits, the franchisor moved for summary judgment, arguing that all claims should be dismissed because: (1) the franchise was an independent "owner and operator" of the restaurant under a standard franchise agreement; and (2) there was no principal-agent relationship between the franchisor and the franchise. The trial court agreed with the franchisor, concluding that the franchisor could not be vicariously liable for plaintiff's wrongful termination claims, as the franchisor was not the plaintiff's employer.

In 2012, the intermediate appellate court reversed the trial court's entry of summary judgment in favor of the franchisor. The court found sufficient triable issues of material fact about whether the franchisor exercised "substantial control" over the franchise, and that a jury could conclude the franchisor was vicariously liable on the plaintiff's employment claims. In reaching this conclusion, the court relied on (1) evidence of the franchisor's day-to-day control over the franchise; and (2) what the court saw as the franchisor's significant involvement in the franchise's personnel decisions—specifically, the "get rid of this guy" comment made by the area leader to the owner.

The California Supreme Court's Decision

The court first discussed significant differences in operation and effect between franchises and other business models. Franchises are a "ubiquitous, lucrative, and thriving business model" that benefits both franchisor and franchisee. While the franchisor controls the enterprise only to protect its brand and operate its franchises in a uniform way, the franchise owner implements the operational standards in its franchise on a day-to-day basis.

The court noted that the relevant facts included the master agreement's designation of the franchise as an independent contractor, the acknowledgement by the franchise owner that he was solely responsible for the day-to-day employment decisions in his franchise, and that the franchisor provided neither training of franchise employees concerning sexual harassment (the franchise owner did that for his employees), nor a procedure by which franchise employees could contact the franchisor with sexual harassment complaints. The franchise owner was solely responsible for investigating sexual harassment complaints, and imposing discipline if it were detected.

The court then reviewed the primary California cases relevant to the analysis of the issue before it. In *Nichols v. Arthur Murray, Inc.*,¹ a 1967 case against a dance studio franchise, the court concluded that the franchisor was responsible for the contractual obligations of the franchise, based on the extensive evidence of the franchisor's control of the franchise's operations. "In particular, the franchisor retained the right to control the employment of all persons working in any capacity for the franchisee;..." The court then observed that California appellate court decisions after *Nichols* have "declined to impute to franchisors the harm inflicted on the public by their franchisees."

The court next reviewed a 1992 case, *Cislaw v. Southland Corp.*,² contrasting it with the 1967 case. The court focused in *Cislaw* on whether the franchisor had the right to control the means and manner in which results were achieved. *Cislaw* involved a claim against both the franchise and the franchisor that the franchise's sale of clove cigarettes had caused a customer's death. The court concluded that the evidence showed that the franchise had complete control of its inventory, was responsible for the operation of the franchise on a day-to-day basis, and made all employment decisions in the store.

Turning to the case at hand, the court disagreed with the plaintiff's contention that the degree of control exercised by the franchisor made it an agent for all business purposes, and rendered each franchise employee an employee of the franchisor by vicarious liability. It stated that a franchisor's comprehensive operating system alone does not constitute the control needed to support vicarious liability claims such as the plaintiff's. A franchisor becomes potentially liable for the franchise's employees' actions only if the franchisor 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 franchise's employees. Uniform workplace standards are not enough, standing alone, to impose "employer" or "principal" liability on the franchisor. The franchisor had no right or duty to control employment or personnel matters for its franchises. Finally, there was no evidence that the franchise solicited the franchisor's advice or consent on any key personnel decisions, or that he was required to do so.

¹ 248 Cal.App.2d 610 (1967).

² 4 Cal.App.4th 1284 (1992).

The court noted also that the area leader's "get rid of this guy" comment was not accompanied by an express or implied threat, or that the franchise owner would risk any sanction if the alleged harasser's employment was not terminated.

In its conclusion, the court emphasized that it did not mean to imply that franchisors can never be held accountable for sexual harassment at a franchised location:

A franchisor will be liable if it has retained or assumed the right of general control over the relevant day-to-day operations at its franchised locations that we have described, and cannot escape liability in such a case merely because it failed or declined to establish a policy with regard to that particular conduct.

Conclusion

In reversing the appellate court, the California Supreme Court endorsed a position consistent with the vast majority of other courts throughout the country that have considered the liability of a franchisor for the torts or other employment law claims against a franchise.

The decision indicates that, if the parties are clear in allocating responsibilities in a franchise agreement, courts will enforce those choices where followed in practice.

Associated Developments

In a related national development, the issue of whether a franchisor can be considered a "joint employer" with its franchises has recently gained considerable attention due to the National Labor Relations Board General Counsel's decision to authorize several unfair labor practices complaints against individual McDonalds' franchises as well as the franchisor.³

The California Supreme Court is not the only state governmental entity revisiting the franchisor-franchise relationship. At this writing, California Senate Bill (SB) 610, having passed the Legislature on August 21, is on the desk of California Governor Jerry Brown. If signed by the Governor, SB 610 will substantially readjust the current relationship between franchisors and franchises in California. Among other changes, the bill calls for changing the legal standard required for a franchisor to terminate a franchise from "good cause" to a "substantial and material breach" by the franchise of the franchise agreement.⁴

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³ See Michael J. Lotito, *McDonald's is not lovin' a recent NLRB ruling*, Los Angeles Daily Journal (Aug. 1, 2014).

⁴ The term "substantial and material breach" is one that appears nowhere in California's 29 Codes or the State Constitution, and has never been interpreted in a commercial context by any California appellate court decision.