VICARIOUS LIABILITY

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VICARIOUS LIABILITY

One of the many advantages of franchising is the shifting of legal and operational risk to the operator of the franchised business – the franchisee. With the continuing growth of franchising coupled with the never-ending search for "deeper pockets," franchisors are increasingly becoming defendants in lawsuits by third parties. In these lawsuits, various plaintiffs attempt to impose liability on the franchisor for the acts or omissions of their franchisees (or their franchisees' employees) or due to events occurring on the premises of the franchised business. This process – where a franchisor is potentially liable for the damages caused by someone else – is known as vicarious liability.

I. **INTRODUCTION**.

Vicarious liability is the principle of law that holds one party liable for the acts (or inactions) of another. The franchise relationship generates vicarious liability claims because of the common use of the trademark coupled with quality controls and system standards designed to protect the goodwill associated with the trademark. Product distribution franchises generally face less risk of vicarious liability, at least outside of products liability claims. But business format franchises are particularly vulnerable to vicarious liability claims due to the need for uniform systems and standards. Because the success or failure of most vicarious liability claims turns on the degree or extent of controls imposed by the franchisor over the franchised business, there is increasing tension between a franchisor's legitimate interest in insuring adherence to quality controls and standards, and minimizing those controls so that the risk of vicarious liability is diminished.

A. **Nature of the Claims**.

Today, vicarious liability claims against franchisors extend to virtually every area of the law. Reported opinions on franchisor vicarious liability include claims seeking franchisor liability for a host of wrongs and harms including:

- Franchisee fraud, conversion and misrepresentation;
- Personal injury caused by negligence;
- Personal injury caused by intentional batteries or crimes;
- Product liability claims;
- Consumer protection laws and deceptive practices;
- Consumer product and warranty claims;
- Environmental clean-up liability;
- Claims under the Americans with Disabilities Act;
- Civil rights claims;
- Trademark infringement;
- Employment law claims involving violations of the Fair Labor Standards Act;
- Employment discrimination and harassment claims;
- Violations of various federal and state statutes and licensing laws.

These claims appear to be on the rise, but their preponderance is probably more a reflection of the growth of franchising in the economy. There are literally dozens of reported appellate opinions on franchise vicarious liability covering most, if not all, of the states in the United States. There are no federal or state statutes on the subject, and the cases are largely decided on the common law principles of agency or apparent agency. However, there are a number of cases dealing with the nuances of statutory interpretation that specifically render multiple parties liable for violations, although none explicitly mention franchising. Examples of these include cases involving alleged labor law violations, environmental clean-up costs and ADA violations.

Historically, courts have focused on whether the franchisor controlled, or had the power to control, the overall business of the franchise. More recently, some courts have narrowed the focus on whether or not the franchisor had control, or the ability to control, the particular instrumentality or activity that allegedly caused the harm or committed the violation. Under this line of cases, a franchisor can be liable for activities undertaken at a franchised unit even when the franchisee is not otherwise an agent of the franchisor, because the franchisor controlled some aspect of the operational activity that was directly involved in causing the injury.

B. **Disposition of the Cases**.

The courts continue to apply traditional agency theories in determining whether a franchisor can be vicariously liable due to a franchisee's action or inaction. Both actual agency theories and apparent agency theories are examined. Virtually all of the reported decisions are appeals from a motion to dismiss or a motion for summary judgment where the issue is essentially whether or not the case will go to trial. In many cases that appear unfavorable to the franchisor, the appellate courts are simply stating that the plaintiff should have the opportunity to prove the existence of either: (a) an actual agency relationship; or (b) the elements of an apparent agency.

An increasing number of appellate courts will give the plaintiffs the opportunity to prove their case to the jury, as long as the pleadings satisfactory allege the facts establishing the basis for vicarious liability -- whether or not supported by discovery. Many courts employ a low threshold, sending the case to trial if plaintiffs can present any evidence, however remote, that could lead a judge or jury as factfinder to find an agency relationship. But many other courts are less tolerant and appear willing to clear the trial docket when they are not satisfied with either the factual allegations or the facts presented at the summary judgment stage. Although cynics assume that jurors will regularly impose liability on franchisors as a perceived deep pocket, the cases demonstrate that franchisors can still prevail at trial, even in front of a jury. Nonetheless, trials are expensive. Given the unpredictability of juries, prudent franchisors (and their insurers) try to settle and cut potential losses if they lose on dispositive motions.

Unfortunately, the long line of cases throughout U.S. jurisdictions appear to be irreconcilable. There are no bright dividing lines separating circumstances in which franchisors will be liable from situations in which they will not. This unpredictability continues because the determination of an agency relationship is essentially a fact question, and not a question of law. While franchisors still prevail early on in most cases, summary judgment is becoming much more difficult to obtain as plaintiffs' lawyers become better educated at pleading the necessary elements in their complaints. Thus, franchisors will more frequently have to endure a full trial on the merits instead of summarily disposing of vicarious liability claims at an early juncture.

II. **AGENCY THEORIES**.

The courts have wrestled for decades with the issue of a franchisor's responsibility for the conduct of its franchisees. Courts have identified two basic agency law theories for holding a franchisor vicariously liable; namely, the "apparent" or "actual" authority of the franchisee to cause its franchisor to be responsible for its conduct. These concepts are not unique to franchising; rather, they are based on traditional common law. These theories of vicarious liability have been applied to tort, statutory and contract claims, and to the franchise relationship.

A. **<u>Actual Agency</u>**.

As a general rule, a principal is vicariously liable for the acts or omissions of its agent. A franchisor, like any other principal, is responsible for the acts or omissions of a franchisee who is, in fact, operating as the franchisor's agent. Most franchise agreements explicitly state that the parties are independent contractors and expressly disclaim any agency relationship. But the contract will not be dispositive and the courts will nevertheless examine the true nature of the relationship in making its decision. The courts will review other contractual terms, operations manuals and the underlying circumstances in determining whether an actual agency relationship exists.

The courts evaluate actual agency claims by examining the degree to which the franchisor controls the franchisee's operation of the day-to-day franchised business. The courts continue to struggle between whether the control exercised by the franchisor to create liability needs to be pervasive generally over the franchised business' operations or whether the control needs to be over the particular instrumentality or conduct that caused the harm. Many courts will not impose liability on a franchisor whose operational controls are pervasive if they do not affect the particular activity that caused the damage (i.e., kitchen controls may not create liability for delivery accidents).

An actual agency relationship between a franchisor and a franchisee exists if a franchisor has reserved sufficient controls over the operation of a franchisee's business to be deemed in control of its day-to-day operations. Conversely, an actual agency relationship does not exist if the franchisor controls only the end result of the franchisee's efforts. Generally, the degree of control necessary to establish an actual agency relationship is considered the right to control the ***means*** used in operating a business as opposed to the ***results*** to be obtained. If the franchisor controls the time and manner of the franchisee's performance (i.e., the means), then the franchisee may be considered the franchisor's agent. In contrast, if the franchisor simply mandates the standards of performance (without controlling the means), then the franchisee will not be considered the franchisor's agent.

Most franchises fall into one of two categories: product distribution and business format. Product distribution franchises are franchises in which the franchisees market products manufactured or supplied by, and closely associated with, the franchisor. Business format franchises are franchises in which a franchisee distributes goods or services following a prescribed business operating system. Product distribution franchisors often place fewer controls over the franchised business since the franchisor also controls the product. On the other hand, business format franchises – largely service-oriented – generally involve more controls over the underlying business. The means of delivering the service, not just the result (good taste, clean house, etc.), becomes distinctive, and associated with the trademark. As a result, product distribution franchises like oil companies and automobile dealerships often prevail at very early stages against vicarious liability claims. But vicarious liability claims against business format franchises like hotels, restaurants and other service businesses are sometimes more difficult to defeat prior to trial. While the majority of vicarious liability cases still find in favor of the franchisor and defeat actual agency claims, most of the exceptional cases can be explained because the franchise relationship is either not typical or the franchisor may have retained control, or the right to control, certain aspects of the franchised business – like security.

To assist in defeating actual agency claims, franchise agreements should continue to clearly disavow a principal-agent relationship. Although a provision negating agency will not itself be dispositive, it will be a factor. Courts finding that no agency relationship exists almost always cite the contract as a factor in the decision. But courts will not just examine the agreement in detail. They may also review any operations manuals, any other contracts and the overall circumstances. Therefore, all communications should be scrutinized to minimize the number and kind of statements that authorize, or purport to empower, the franchisor to control the "means" of operating the franchised business. Instead, the controls should be result-oriented as opposed to specifying the methods to be employed. When specifying methods, they should be cast as recommendations intended to assist in achieving the desired results.

If the franchisor does not intend to enforce compliance with a particular system standard, it should not retain the right to do so in the franchise agreement. Failing to enforce unnecessary system standards may imply that the franchisor is negligent in performing its own duties – even though self-imposed. The operations manual should include both mandatory standards in order to protect the trademark and suggested matters which are purely advisory and are identified as such. Inspections and reports should be consistent with the distinction between mandatory standards and recommendations.

At some point, the courts will focus on proof of franchisor control over the aspects of the business that caused the injury. The cases clearly point in this direction. Franchisors should closely examine the riskiest aspects of the franchised business. The riskiest parts should either be combined with the greatest means to combat agency claims or protected through other forms of risk reduction, even third party control.

B. **Apparent Agency**.

In addition to actual agency, a franchisor may be vicariously liable for a franchisee's acts or omissions under a theory of apparent agency. Thus, even if the franchisee is not the franchisor's actual agent, and even if the franchisor has not reserved any significant controls over the franchised business, the franchisor may still be liable for the franchisee's conduct if an "apparent" agency has been established.

An apparent agency exists if a franchisor, through its action or inaction, leads an innocent third party to reasonably believe that the franchisee is the franchisor's agent or that the third party is dealing with the franchisor (like an outlet of a vertically integrated network of outlets). If the third party relies on this misrepresentation or belief to its detriment, an apparent agency will exist, regardless of the nonexistence of an actual principal-agent relationship. Reliance by the third party is critical.

Three elements must be proven to establish an apparent agency:

1. A representation by the principal;
2. Reliance on the representation by a third person; and
3. A change of position, or damage suffered by the third person.

In franchise vicarious liability cases on apparent agency, the reported cases usually focus on the "reliance" element since the first and third elements are often present.

In the franchise context, an apparent agency claim arises out of the uniform appearance of franchised outlets and the prominent use of the franchisor's trademarks. Thus, in the franchise context, the first element is almost always satisfied. Most courts find that the representation by the principal exists by the franchisee's use of the franchisor's marks on signs and in advertising. In the absence of any notice (or sufficient notice) to the public that the franchisee outlet is independently operated, the risk of apparent agency is heightened. Notices of independent ownership can either defeat the first element if done prominently enough, or the "reliance" element if accomplished before the events causing the injury occur.

Since the case would not have been brought unless there had been some damage, the "damage" element is almost always satisfied as well. Thus, most apparent agency cases turn on whether or not the plaintiff relied on the representation or whether its reliance was reasonable. Thus, to defeat vicarious liability claims brought under apparent agency theories, franchisors must show that the plaintiff either did not rely on the signage or marks as indicia of franchisor's ownership or that any such reliance was unreasonable. Discovery showing that the customer stayed at the hotel because it was closest to the destination, as opposed to affinity for the brand, can defeat apparent agency claims.

Claims of apparent agency can be defeated by adequate notices of independent ownership. Franchise agreements should provide, and franchisors should ensure, that franchisees display notices of independent ownership of their business in as many places as possible. Moreover, some franchise businesses utilize two names – the trademark of the franchisor coupled with the tradename of the franchisee. This approach is not unusual in franchises that began through conversions – as in the real estate industry, and in some hotels (e.g., Century 21® Smith Realty, Inc.).

Notices of the franchisee's separate identity and the independent ownership should be placed wherever possible. These notices should be on signage, brochures, business cards, menus, stationery, checks, purchase orders, contracts, advertising, and elsewhere. These notices of independent ownership can often be done in a positive way without detracting significantly from a common marketing theme.

If franchisees enter into contracts with customers, the contracts should include a conspicuous admonition that the franchisee is independent from the franchisor, and the franchisor will not be liable or responsible for performance or for warranty work. Invoices, purchase orders and the like should contain similar notices, and preferably issued under the franchisee's name. Paychecks and notices for employees should also be issued in the franchisee's independent business name, not simply under the franchisor's trademarks. These procedures may negate both elements of a representation by the principal and reliance by the plaintiff.

C. **<u>Combined Claims</u>**.

Most cases in the franchise context discuss both actual agency and apparent agency theories. Courts uniformly hold that the determination of actual and apparent agency is a question of fact to be determined on a case-by-case basis. Clearly, if a plaintiff adequately alleges the necessary elements and if those elements are supported by the plaintiff's evidence, however scant and even against evidence to the contrary, then the case may survive a motion to dismiss or summary judgment.

While most claims of franchisor vicarious liability are decided on traditional doctrines of actual agency and apparent agency, there are exceptions. These exceptions typically involve interpretations of whether or not the franchisor is one of several parties potentially liable under principles of statutory construction. These claims virtually always revolve around the meaning of certain terms of federal or state statutes. Cases in this regard involve violation of labor and civil rights statutes, environmental cleanup claims and ADA claims.

D. **<u>Employment Claims</u>**.

Claims against franchisors in the employment context, ranging from wrongful termination, civil rights discrimination claims and violation of various labor statutes, continue to arise. Fortunately, most of these cases continue to hold that franchisors are not liable for the alleged discrimination or wrongful termination by franchisees of their own employees. Certainly, employees know who their employer really is and so the chances of assessing liability against the franchisor are dim. To ensure that this is the case, franchise agreements should require franchisees to utilize payroll checks and systems solely in their individual business name without referencing the franchisor. Employment manuals used by franchisees should clearly indicate that the franchisor is not the employer and has no right to hire or fire.

Generally, only an employer can be liable for the violation of labor laws such as the Fair Labor Standards Act, the National Labor Relations Act, and others prohibiting discrimination. Under certain circumstances, however, a franchisor may be liable under federal and state labor law even when the franchisor or the franchisee agree that the franchisor is not the employer, and the franchisor is not the employer at common law. Under these statutes, courts have found that a franchisor may be liable for violations of a franchisee’s employee’s employment rights under three tests: the Enterprise Test, the Joint Employer Test and the Economic Realities Test.

In determining what entity or entities may be held liable as an employer in Title VII or ADA cases, courts note the broad remedial purposes behind those laws and construe them liberally. As a result, courts in discrimination cases do not limit liability to a single employing entity when another entity nevertheless exercises sufficient control over the employment of the other entity. Thus, an individual may be an “employee” of more than one “employer” for purposes of these laws. In these cases, the entities responsible are often referred to as “joint employers.”

1. **Enterprise Test**. Under the Enterprise Test, generally used in cases brought under the Fair Labor Standards Act, a franchisor may be considered part of a single enterprise with its franchisee where the two of them:

(a) engage in related activities;

(b) through unified operation or control; and

(c) with a common business purpose.

The more discretion that a franchisee has to run its business as the franchisee sees fit, the less likely it is that a single enterprise will be found. When the franchisor substantially limits the franchisee's discretion concerning products, prices, profits, management and especially personnel policies such as wages and hours, a conclusion may be drawn that the franchisee is not an independent business person making its own choices, and a single enterprise may be found to exist. Therefore, franchisors should refrain as much as possible from imposing controls over employment relationships.

2. **<u>Joint Employer Test</u>**. Many courts employ the joint employer test where a franchisor and franchisee may be considered a single joint employer where there is:

(a) Centralized control of labor relations;

(b) Interrelation of operations;

(c) Common management; and

(d) Common ownership or financial control, or control by the franchisor of the working conditions of the franchisee's employees.

Like the Enterprise Test, this test may make a franchisor liable for the acts of a franchisee where the franchisor exercises substantial control over the franchisee's policies – here, its labor relations policies in particular. More specifically, the franchisor may be considered a joint employer with the franchisee if the franchisor:

(i) has the power to hire and fire the franchisee's employees;

(ii) supervises and assigns work, sets work schedules and establishes working conditions of the franchisee's employees;

(iii) determines the rate and method of payment for the franchisee's employees; and

(iv) maintains the employment records concerning the franchisee's employees.

If those elements are not met, then the franchisor will not be responsible under the Enterprise Test.

3. **<u>Economic Realities Test</u>**. Some courts also apply traditional common law tests of agency referring to it as an "economic realities test." Under this test, the court examines the relationship between a franchisor and the franchisee's employees – as opposed to that between the franchisor and the franchisee – to determine whether there was an employment relationship invoking the jurisdiction of Title VII. The court reviews whether the franchisor provides equipment and a place of work for the employee, whether the franchisor compensates the employee, and whether the franchisor has the power to terminate the employee. Where those requirements are not met, the franchisor is not liable under Title VII.

Some franchisors provide employment manuals for use by their franchisees and their employees. While doing so may constitute a factor militating towards joint employer responsibility on the part of the franchisor, many cases have nevertheless reviewed the totality of the relationship and found that providing the manual in and of itself did not create a joint employer relationship.

E. **<u>Other Statutory Claims</u>**.

Franchisors have been sued by both the U.S. Government and private plaintiffs for alleged violations of the ADA. These cases focus on whether or not the franchisor can be deemed an "operator" for purposes of the ADA – a term that the ADA does not define.

Although most courts have found that franchisors were not responsible for the alleged ADA defects of franchised units, at least one major franchisor entered into a comprehensive settlement with the U.S. Government in several lawsuits over hotel accommodations. While the franchisor was not responsible for any fines, penalties or damages, it was required to institute procedures to ensure franchisees would meet their ADA obligations. Many other elements of a franchise relationship may come into play in determining whether a franchisor can be deemed an operator for purposes of ADA liability. If the franchisor owns the site, or leases and then subleases sites to franchisees, there is more likelihood that the franchisor will be responsible for ADA claims. But in these cases, the liability may hinge more on the franchisor's status as a property owner or landlord than due to the franchisor-franchisee relationship.

Liability under environmental laws – like CERCLA – also hinges on the determination of the meaning behind the term "operator." Several cases have held that franchisors could be deemed "operators" as that term is defined under environmental laws. Like other vicarious liability cases, these reported opinions usually do not actually pin liability on the franchisor. Rather, they find that the claims may proceed to trial and if the facts demonstrate that the franchisor had the ability to control the activity causing the pollution then it very well may be liable for the cleanup costs and damages. Interestingly, these cases are focusing more on the control of the actual conduct causing the pollution rather than generalized or traditional concepts of principal-agent relationships.

III. **ASSUMED RESPONSIBILITY**.

Axiomatic to this problem is that a franchisor that assumes or maintains responsibility over a particular aspect of the franchise business cannot avoid responsibility just because it is involved in a franchise relationship. Courts will impose liability on franchisors for injuries or violations that occur in areas where it is clear that it maintains or has assumed responsibility. Thus, a franchisor that maintains control over security aspects of a franchise business will be responsible if it fails to exercise reasonable care when discharging that duty. Moreover, if the franchisor voluntarily assumes responsibility for some aspect of the franchise operations, it will also be responsible if it is negligent in doing so. These cases do not involve vicarious liability per se because the franchisor is held liable for its own conduct, albeit stemming from a franchised business. In these situations, the franchisor is being exposed to liability on two different theories of recovery. A franchisor may be subject to liability based on vicarious liability for the actions of its franchisee but may also be separately responsible for its own negligence for voluntarily assumed responsibilities.

IV. **SHIFTING BACK THE RISK**.

Recognizing that the risk of vicarious liability cannot be totally eliminated, franchisors should utilize other methods to limit financial exposure. These measures are designed not only to deal with responsibility for ultimate liability, but also shifting the risk of defense costs to others. Franchisors can shift this risk through indemnification and contribution provisions of the franchise agreement, requiring the franchisee to carry insurance that also covers the franchisor, and supplementing that insurance with its own coverage.

A. **Indemnification**.

The franchise agreement should contain a specific provision requiring the franchisee to indemnify, defend and hold the franchisor harmless from any claims from third parties that relate in any way to the operation of the franchised business. Indemnification is a means of shifting responsibility for legal consequences. Generally, the presence of an indemnification provision will not be cited as justification for imposing vicarious liability on the franchisor. Unfortunately, too often the indemnification provision of the contract is simply an afterthought. But it is one of the most important provisions of the franchise agreement and requires careful drafting.

Indemnity agreements are strictly construed and courts will not enforce vague, ambiguous or overly burdensome provisions. They will not impose indemnification obligations, even if they would otherwise make sense, if not expressly stated in the contract. Nonetheless, courts have imposed indemnification obligations on franchisees even when the claims allege the franchisor's sole or direct negligence on the ground that the contract so provided and that the franchisee is better able to control the risk of an accident. But most courts require clear and unambiguous language before imposing indemnification against the indemnitee’s own sole negligence. Also, some state statutes may prohibit indemnification in some instances. Indemnification for gross negligence, intentional acts or for violations of law is often unenforceable as against public policy.

Every indemnification clause of a franchise agreement should include the following:

- The parties to be indemnified should include the franchisor, its affiliates, subsidiaries and their officers, directors, employees, agents, successors and assigns.
- The franchisee must be bound by the indemnification and any personal guarantees by the principal owner should also extend to the indemnification obligation.
- In addition to indemnification, the franchisee must be obligated to defend the franchisor. However, the franchisor should have the option to control its defense and select counsel. The duty to defend should be independent from the obligation to indemnify. Having separate counsel for the defense will assist in establishing

the franchisor's argument that it is an independent entity and should not be treated jointly with the franchisee.

- Claims subject to the indemnification obligation should include any litigation, arbitration, investigations, administrative proceedings, tax matters, government inquiries and the like.
- The indemnification should include all damages of whatever nature, fines, penalties, costs and expenses associated with the claims, attorneys' fees, court costs, etc.
- The indemnification should clearly specify that the franchisor is indemnified even if its sole negligence or its intentional conduct is alleged.

To assist in situations in which the franchisee's indemnification obligation may be unenforceable, the franchise agreement may contain a contribution provision. In these situations, the franchise agreement can require that the parties contribute to any loss or liability or damage claim based on the proportionate degree of fault. If the underlying judgment is not specified in degrees of responsibility, then an arbitrator can decide the appropriate contribution. Although these measures relate to the relationship between the franchisor and the franchisee, they nevertheless can provide a means for the franchisor to be reimbursed if it is compelled to pay a judgment or settlement to a third party.

B. **Insurance**.

Of course, indemnification and contribution agreements are not satisfactory if the franchisee does not have the financial wherewithal to fulfill the obligation. Accordingly, the franchise agreement should also mandate that the franchisee obtain insurance necessary to properly cover all potential claims. This coverage is intended to supplement the indemnification protection. As with the indemnification provisions, the insurance requirements should be broad enough to cover all of the franchisor's related parties. Thus, the insurance policy should name not only the franchisor and its affiliates as additional insureds, but also the franchisor's employees, officers and directors, etc. Insurance may supplement the indemnification obligation – covering areas even beyond the indemnity.

The details regarding the insurance can be in the agreement itself, but preferably should be left to the operations manual. In this way, the franchisor can more readily alter the terms and conditions for the insurance coverage as it identifies new risks and as the dollar volume of judgments continue to increase. Nevertheless, regardless of the source, the insurance requirements should include the following:

- The franchisee should be required to obtain insurance with a financially sound company, subject to the franchisor's approval. Various services are available that rate insurance companies and the franchisor should keep current information from those ratings services.
- The franchisor should maintain flexibility with respect to the amount and type of coverage over the term of the franchise agreement. The minimum limits of coverage should be subject to increase or decrease based on experience. Specifying coverage requirements in the manual permits periodic changes. Moreover, new forms of insurance products continue to be developed and the franchisor should have the ability to require those additional coverages.
- Generally speaking, coverage should include comprehensive general liability insurance, employers and workmen's compensation insurance, liquor liability (if

applicable), automobile liability (if applicable), and any other insurance coverage particular to the industry.

- The franchisor, its affiliates, officers, directors and employees should be added as additional insureds to the franchisee's policy. Many insurance policies contain a provision which voids coverage if the claim if brought by one insured against another insured. These provisions must be excluded from the policies. The policies should not, therefore, contain an "insured v. insured" exclusion.
- The policy should contain a severability clause which provides coverage to each insured as though a separate policy has been issued to each of them. In this way, each of the insureds obtains the benefit of the full coverage amounts.
- The franchisor should specify a maximum deductible to insure that the amount is a reasonable one for the franchisee to absorb as well as total coverage amounts for each category of insurance.
- If available, the required insurance should be "occurrence" coverage as opposed to "claims made." "Claims made" policies only provide protection for claims made during the policy period. If a claim is made after the "claims made" policy expires, the insurance is not available unless an expensive "tail" policy is obtained. On the other hand, "occurrence" policies provide coverage for damages and injuries which occur during the policy period, whenever the actual claim is made. Accordingly, under an "occurrence" policy, the franchisor is protected as long as the insurer remains in existence, as long as the injury occurred during the policy period.

- The policy should permit the franchisor to proceed directly against the insurer and control the claim if the franchisee is reluctant to do so.
- The franchisor should require the franchisee to send it copies of policies and prohibit cancellations, alterations or lapses without advance notice to the franchisor. Franchisors are often lax in reviewing franchisee insurance policies, but need to be vigilant to ensure coverage is maintained. The franchisor should have the right to procure substitute coverage if the franchisee does not timely do so with a right to reimbursement of the policy costs.
- The policy should contain an explicit waiver of subrogation to prevent the insurance carrier from making an affirmative claim for recovery against the franchisor.
- A franchisor sponsored insurance program should enable a franchisor to monitor more effectively compliance with its insurance requirements. The insurers, knowing in advance the franchise agreement's requirements, can help administer the program so that policies are issued meeting the franchisee's standards for coverages.

Obviously, the franchisor's own liability policies should be scrutinized to ensure that they are not vitiated by the coverage it obtains through its franchisees. Moreover, recent insurance products to protect franchisors, known as "franchisor errors and omissions" liability insurance, should be obtained to supplement these risks. Most of these policies cover vicarious liability claims against franchisors.

V. **CONCLUSION**.

Due to the common use of trademarks and the maintenance of certain specifications, standards and controls, franchisors face some risk of vicarious liability for the activities of their franchisees. Although these risks may be minimized through careful structuring of the contracts and the franchised businesses, there is no way to eliminate the risks entirely. Moreover, direct involvement by the franchisor and franchisee operations will result in franchisor responsibility for injuries or legal violations that result.

Nonetheless, much of the risk of vicarious liability can be shifted to franchisees through the careful use of indemnification provisions in the franchise agreement. Given the franchisee's day-to-day control of the business, this is a fair shift of business risks, but if not supported by contract will not be present. Franchisors should also require franchisees to obtain appropriate insurance and diligently review the franchisee's policies to ensure that they remain in place. This insurance can provide a fund to handle catastrophic damage awards. Finally, the franchisor should supplement the franchisee required insurance with supplemental coverages of its own. By taking these steps, franchisors can manage and reduce vicarious liability risks to acceptable levels.