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**NEW APPROACHES AND CHALLENGES IN INTERNATIONAL FRANCHISING**

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**VICARIOUS AND OTHER FRANCHISOR LIABILITY**

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## 1. Introduction\*

As entrepreneurs throughout the world know, franchising is an excellent method by which one can expand a business, or start one's own business by leveraging the knowledge and brand recognition that others have already created. At the heart of the franchise relationship are two separate businesses, symbiotic and interdependent, but legally independent. Despite the independence of franchisor and franchisee, third parties have often tried to have a franchisor held accountable for its franchisee's actions. Vicarious liability, the attribution of liability to one party for the acts of another, is the primary source of such liability in many jurisdictions. As our world grows ever smaller and more franchise systems look to expand internationally, understanding how other countries approach vicarious liability in the franchise context has become a critical question for a growing number of systems.

Not surprisingly, countries have adopted different legal standards for analyzing and imputing vicarious liability in the franchise context. Not only do common law and civil law countries approach the issue differently, but differences exist within each legal framework.

This paper presents an overview of these different approaches, focusing on the United States, Australia, Italy, Canada, France and Spain. After an introduction to each country's basic approach to the issue, specific examples are addressed under several of these countries' laws. Next, the paper examines other less common bases for imposing liability. Suggestions for managing the risk of being held vicariously liable are then addressed and finally a summary chart addresses the primary legal issues concerning franchisor vicarious liability in 17 jurisdictions.

While the facts of a particular claim will always be paramount regardless of where the claim is brought, this paper will provide the reader with a solid understanding of the underlying issues and legal concepts utilized in several countries for resolving question of vicarious liability in the franchise context.

## 2. Bases for Imposing Vicarious Liability

### 2.1 Possible legal bases for vicarious liability: the law of agency, statute, other?

In this section of the paper, the various legal theories used to argue for franchisor vicarious liability for the actions of, or inaction by, franchisees will be considered, by country and legal system. As will be seen, while there is some consistency to the issues raised, the rationale for holding a franchisor liable, if at all, can be based on similar principles articulated in different ways in different jurisdictions. As we will see, however, rarely, if ever, does liability arise under franchise legislation. In most cases, the general law of agency or employment will be the source of the liability.

The doctrine of vicarious liability is said to have its roots in two competing common law maxims, *qui facit per alium facit per se* ("he who acts through another, acts for himself"), and *respondeat superior* ("let the master answer"). Vicarious liability therefore primarily denotes the liability of an employer for an agent or employee. With respect to agency, the liability derives from the deemed authorization of the conduct in question by the one held vicariously liable. And with respect to employment, the principle is that the person who is the employer is in a position to control the conduct of the employee such that it is appropriate to hold the former liable for the conduct of the latter. As can be seen, neither theory is particularly satisfactory, as there is difficulty around the margins in terms of characterizing conduct as

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either authorized or subject to control. Consequently, vicarious liability is defensible more in terms of policy than anything else.<sup>1</sup>

## 2.2 The situation in the United States

Since franchising's earliest days in the United States, courts from across the country have been called on to adjudicate vicarious liability claims against franchisors based on the actions of franchisees and their employees. Although many of the early cases struggled with determining the correct legal theory to apply to such claims, over the last ten years a consensus majority approach has developed in many U.S. jurisdictions.<sup>2</sup> At the heart of these decisions is the recognition that the franchisor-franchisee relationship gives franchisors certain limited rights of control, but not others. So, if a general proposition can be articulated, it is that in the United States, where a franchisor has real control over the cause of the injured party's harm, courts have imposed vicarious liability on franchisors for those harms. Where, however, the franchisor has no real control over the proximate cause of harm, courts have been reluctant to hold a franchisor vicariously liable.

Despite the growing popularity of the majority approach, certain decisions continue to hold franchisors vicariously liable under a patchwork of different legal theories. Recently, some of these minority decisions have received considerable attention due to their potential wide-ranging implications for franchisor vicarious liability. After a short review of agency law in the United States, upon which almost all vicarious liability analyses rely, the doctrinal approaches of both the majority and minority approaches to vicarious liability are reviewed and analysed.

### (i) *Agency Law in the United States*

To understand the vast majority of vicarious liability claims in the United States, one must first understand the basics of its agency law. At its simplest, agency law governs the "relationship that results from the manifestation of consent by one person to another that the other shall act on behalf and subject to his control, and consent by the other so to act."<sup>3</sup> Absent an agency relationship, the bases for imposing vicarious liability are very limited. If an agency relationship is established, however, U.S. law recognizes that in certain circumstances the principal is liable to third parties for the agent's acts.

When specifically a principal will be liable depends in large part on whether the agent is an "employee" or "independent."<sup>4</sup> Generally, principals that "employ" their agents will be responsible for all torts committed by the employees while acting within the scope of their employment.<sup>5</sup> The opposite is true for independent agents; principals are generally not liable for the torts independent agents commit

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<sup>1</sup> See Fridman, *The Law of Torts in Canada* (3rd ed., 2010), at pp. 254-255.

<sup>2</sup> Vicarious liability is generally a matter of state law, such that each of the 50 states is free to develop its own standard for such claims. Although vicarious liability claims against franchisors are often brought in federal (national) courts, those courts will apply the state law that governs.

<sup>3</sup> *Vaughn v First Transit, Inc.*, 346 Ore. 128, 135 (2009) (internal quotation marks and citation omitted). Stated another way, if the franchisee is subject to the franchisor's control and the franchisee acts on the franchisor's behalf, an agency relationship exists. See *Viado v Domino's Pizza, LLC*, 230 Ore. App. 531, 540 (2009)

<sup>4</sup> *Viado*, 230 Ore. App. at 535.

<sup>5</sup> *Id.*

unless the principal intended the harm or authorized the specific act that caused the harm.<sup>6</sup> Accordingly, to determine whether a franchisor is vicariously liable for the acts of its franchisee or its franchisee's employee, a court must answer three questions: (1) is there an agency relationship between the franchisor and franchisee; (2) if yes, is it an employee or independent agency; and (3) if an independent agency, did the franchisor control or direct the instrumentality of the injured party's harm?<sup>7</sup>

(ii) ***The Majority Approach***

The majority approach to franchisor vicarious liability adopts the basic agency standard explained above, assumes that an independent agency relationship exists between the parties and focuses on the final question of whether the franchisor had sufficient control over the proximate cause of harm to make it vicariously liable. Where, as is often the case, the cause of the harm is a franchisee's employee's negligence, most courts recognize that franchisors cannot control such actions and therefore are not vicariously liable.

An early example of this is *Kerl v. Dennis Rasmussen, Inc.*, where the Wisconsin Supreme Court rejected a vicarious liability claim against a franchisor based on a franchisee's employee shooting two people during working hours.<sup>8</sup> In doing so, the *Kerl* Court held that:

If the operational standards included in the typical franchise agreement for the protection of the franchisor's trademark were broadly construed as capable of meeting the "control or right to control" test that is generally used to determine respondeat superior liability, then franchisors would almost always be exposed to vicarious liability for the torts of their franchisees. We see no justification for such a broad rule of franchisor vicarious liability.<sup>9</sup>

Relying on *Kerl*, the Kentucky Supreme Court reached the same conclusion in *Papa John's Int'l, Inc. v. McCoy*.<sup>10</sup> At issue in *McCoy* was whether the franchisor could be liable for a franchisee's employee's alleged malicious prosecution and defamation.<sup>11</sup> Recognizing that franchising relationships are "unique," the *McCoy* Court adopted the "emerging judicial consensus to apply a franchisor vicarious liability test that considers the franchisor's control or right of control over the instrumentality that is alleged to have caused the harm."<sup>12</sup> Applying this test, the *McCoy* Court rejected the vicarious liability claim because the franchisor had no right to control the intentional acts of the franchisee's employee.<sup>13</sup>

In *Pizza K, Inc. v. Santagata*, the Georgia Court of Appeals reversed a trial court's decision holding a franchisor vicariously liable for the damages a franchisee's employee caused in an automobile

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<sup>6</sup> *Id.*

<sup>7</sup> *Id.* at 540.

<sup>8</sup> 682 N.W.2d 328 (2004).

<sup>9</sup> *Id.* at 331.

<sup>10</sup> 244 S.W.3d 44 (2008).

<sup>11</sup> *Id.* at 46.

<sup>12</sup> *Id.* at 54 (collecting cases).

<sup>13</sup> *Id.* at 56.

accident.<sup>14</sup> In reaching its decision, the court recognized that “[t]he franchise agreement in this case obviously contains specific and even strict requirements concerning operation of the franchise” and permitted termination of the franchise in certain circumstances.<sup>15</sup> The franchise agreement did not, however, give the franchisor “supervisory control over individuals hired by [franchisee] to serve as delivery drivers.”<sup>16</sup> Absent such control, there was no basis for vicarious liability as a matter of law. Similarly, in *Nickola v. 7-Eleven, Inc.*, the court affirmed dismissal of a vicarious liability claim based on a franchisee’s employee throwing coffee at a customer.<sup>17</sup> “It is well established that in a determination of whether a franchisor may be held vicariously liable for the acts of its interstate franchisee, the most significant factor to consider is the degree of control the franchisor maintains over the daily operations of the franchisee, specifically, the manner of performing the very work, in the course of which the injury-causing incident occurred.”<sup>18</sup> Although 7-Eleven was contractually responsible for providing franchisees with security training, because it did not hire the employee, control the franchisee’s hiring practices or have the right to “direct and control the manner of performing the work in the course of which plaintiff was injured,” 7-Eleven could not, as a matter of law, be vicariously liable.<sup>19</sup>

In those instances where a franchisor has established a specific standard or prescribed use of a product that causes harm, courts have not hesitated to impose vicarious liability under the majority approach. For example, in *Soto v. Superior Telecom, Inc.*, plaintiffs brought a class action claim against 7-Eleven for allegedly selling prepaid telephone cards in a materially misleading way.<sup>20</sup> The court denied 7-Eleven’s motion to dismiss because plaintiffs sufficiently alleged that 7-Eleven had specific control over the sale of phone cards by: (1) requiring franchisees to offer certain calling card brands for sale; (2) negotiating purchase terms for the cards at issue; and (3) sharing profits with franchisees from the sale of the cards. Similarly, in *Toppel v. Marriott Int’l, Inc.*, the court denied the franchisor’s motion to dismiss claims brought against it by a hotel guest who fell down a set of stairs.<sup>21</sup> Relying on a renovation contract between the franchisee and franchisor that specifically required carpet on and around the stairs to be replaced and for lighting in the area to be upgraded, the court held that such specific control over the alleged “instrumentality of harm” was sufficient to allow a jury to decide the vicarious liability issue.<sup>22</sup>

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<sup>14</sup> 547 S.E.2d 405 (2001).

<sup>15</sup> *Id.* at 406.

<sup>16</sup> *Id.* at 407.

<sup>17</sup> C.A. No. 03-13494, 2006 N.Y. Misc. LEXIS 4126 (N.Y. Sup. Ct. Oct. 2, 2006).

<sup>18</sup> *Id.* at \*6 (collecting cases).

<sup>19</sup> *Id.* at \*7-8. In *Smith-Hoy v AMC Property Evaluations, Inc.*, the Appellate Division of the New York Supreme Court went one step further to question whether any type of agency relationship existed and rejected a vicarious liability claim based on a franchisee’s employee’s negligent work. 52 A.D.3d 809 (2008). “Absent proof of a principal/agency relationship or proof that a franchisor exercised a high degree of control over its franchisee, there is no basis for holding a franchisor responsible for its franchisee’s misconduct.” *Id.* at 811 (rejecting “mere” franchise relationship as establishing sufficient control to create an agency relationship).

<sup>20</sup> 2010 U.S. Dist. LEXIS 54327 (S.D. Cal. Jun 2, 2010).

<sup>21</sup> 2008 U.S. Dist. LEXIS 56226 (S.D.N.Y. Jul. 22, 2008).

<sup>22</sup> *Id.* at \*27-32.

(iii) *The Minority Approach*

Recently, some plaintiffs have focused their vicarious liability efforts on establishing an employer-employee agency between franchisor and franchisee to avoid having to show actual control over the proximate cause of harm. One of the more noteworthy of these cases is *Awuah v. Coverall N. Am., Inc.*<sup>23</sup> Although not a vicarious liability claim, *Awuah* applied Massachusetts' wage payment statute to hold that an employment relationship exists between a commercial cleaning franchisor and its franchisees. The decision is based on the conclusion that the franchisor and franchisee are both in the commercial cleaning business and therefore the franchisees' business is not "outside the usual course of the [franchisor's] business."<sup>24</sup> In perhaps its most celebrated rejection of franchising as a business separate and distinct from that of franchisees, the *Awuah* Court stated that "[d]escribing franchising as a business in itself, as Coverall seeks to do, sounds vaguely like a description for a modified Ponzi scheme - a company that does not earn money from the sale of goods and services, but from taking in more money from unwitting franchisees to make payments to previous franchisees."<sup>25</sup> Should the decision ultimately stand, it may provide a basis for significantly expanding the scope of franchisors' potential vicarious liability by obviating the need to show control over the specific cause of a third party's damages.

Another example of a franchisor initially failing to disprove an employment relationship with its franchisee is *Myers v. Garfield & Johnson Enters., Inc.*<sup>26</sup> In *Myers*, a franchisee's employee brought a claim for sexual harassment against the franchisee and franchisor, claiming both were her "employer." In support of her claim the employee alleged that the franchisor provided her job training, issued a written code of conduct that prohibited harassment and discrimination in the workplace and oversaw and approved all work product that she prepared. There was, however, no allegation of any harassment by the franchisor, the franchise agreement specified that the relationship was that of independent contractors and the employee never complained to anyone at the franchisor about the alleged harassment.

Refusing to dismiss the claim, the *Myers* Court held that the franchisor was potentially liable under three distinct theories: (1) directly as a "joint employer" with its franchisee; (2) vicariously as its franchisee's actual principal under an agency relationship; and (3) vicariously as plaintiff's "ostensible or apparent employer." Based on plaintiff's allegations that the franchisor promulgated work rules by issuing a sexual harassment policy, engaged in day-to-day supervision by reviewing and approving each tax return plaintiff prepared and assumed some control over employee records by providing a computer-based employee records system, the court held that plaintiff alleged sufficient facts to establish a potential joint employer relationship. While these facts clearly relate to the specific claims brought by the employee, they may exist in several franchise systems and be sufficient to establish an employment relationship that is then used to impose vicarious liability for harm from having no relation to the specific franchisor controls. We may in fact note from the summary chart that an employment relationship is considered quite consistently to be a legal issue generating vicarious liability. This may occur when the franchisor is held to be the effective employer of the franchisee or when the franchisor and the franchisee

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<sup>23</sup> 707 F. Supp. 2d 80 (D. Mass. 2010).

<sup>24</sup> *Id.* at 82-83 (citing Mass. Gen. Laws c. 149, § 148B). While applied only to the parties in the case, this logic would potentially hold that all franchisors are in the same business as their franchisees. Indeed, it suggests no principled basis to distinguish McDonald's and its franchisees from being in the same business as each other, i.e., the sale of hamburgers.

<sup>25</sup> *Id.* at 84.

<sup>26</sup> 679 F. Supp. 2d 598 (E.D. Pa. 2010).

may be considered as joint employers of the franchisee's employees due to the fact that they jointly manage the employees of the franchisee.<sup>27</sup>

## 2.3 The Situation in Other Common Law Countries: (Australia and Canada)

### Australia

It is a general principle of law in Australia, as it is in many jurisdictions, that when a party suffers damage by the wrongful act of another, a third party may be responsible when the party carrying out the wrongful activity acted as the employee or agent of the third party.<sup>28</sup>

As a general proposition, in Australia a principal is usually responsible for all acts within its agent's actual or apparent authority. In deciding whether an act was in the scope of an agent's authority, the retention of control can be an essential element.

#### (i) *Employment*<sup>29</sup>

Australian law continues to recognise a distinction between employees and independent contractors, although the distinction is being eroded under a number of statutes.<sup>30</sup> In Australia, whether or not a person is an employee is largely an issue for the common law. Traditionally, the test used was that of the nature and degree of control exerted by the "master" over the "servant". More recently, Australian courts have adopted a multi-factor test to determine whether a person is an employee or an independent contractor. This test, enunciated by Australia's highest appellate court in *Stevens v Brodribb Sawmilling Co*,<sup>31</sup> involves looking at the totality of the relationship between the parties. No single issue will determine the outcome and the label applied to the relationship by the parties will be given little weight. However, the traditional element of the right to control not just what work is done, but the manner in which it is done, is likely to be given more weight than other facts, in many cases. The importance of such control lies not so much in its actual exercise, as in the right to exercise it.

Of particular importance in the context of franchising, Australian common law only recognises individuals as employees. Neither a body corporate nor a partnership will be recognised as an employee. As a result of this, in practice, it is only that class of smaller franchise operated by a sole proprietor that may be classified as an employee in Australia.

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<sup>27</sup> See the Italian case mentioned under note 54, *Tribunale di Milano*, dated 25 June 2005, published in *Rivista giuridica del lavoro e previdenza*, 2006, 97, ss. However, in regard to Canada, see note 89 where the Tribunal in *Maycock v. Canadian Tire* specifically rejected the allegation that the franchisor was an employer of the franchisee's employees in the context of a human rights complaint. That can be compared to the Canadian case of *Armstrong v. Mac's Milk* (see Note 45) where there was an express admission of employment and, indeed, the facts appear to indicate that the party whose conduct was responsible for the accident had been retained directly by the franchisor.

<sup>28</sup> An early common law authority on this is the English case of *Hewitt v Bonvin* [1940] 1 KB 188 (CA) per MacKinnon LJ at 191.

<sup>29</sup> For more information on this subject, see "Can Franchisees be treated as employees?", 22nd Annual IBA/IPA Joint Seminar 10 May 2006.

<sup>30</sup> Such as under the pay-roll tax and workers' compensation statutes in certain Australian states.

<sup>31</sup> (1986) 160 CLR 16.

No case in Australia has held that a business format franchisee is an employee. However, there is, theoretically, no barrier to such a finding, where the franchisee is an individual. A number of cases have considered independent contractors with franchise-like features in an employment or "deemed employment" context. Some of these have involved insurance and encyclopaedia salesmen, multi-level marketing systems and, more recently, courier companies.

In 2001, Australia's highest appellate court re-examined this traditional multifactor test. The majority judgment of the High Court in *Hollis v Vabu Pty Ltd*<sup>32</sup> did not overturn the multi-factor test, but left open the prospect of in future applying the "economic reality" test set out in the United States Supreme Court decision of *U.S. v Silk*.<sup>33</sup> In the "economic reality" test, instead of considering the extent to which an employer may be said to have the right to control an employee, the court considers the extent to which a worker may genuinely be said to be in business on their own. Where someone is labelled an independent contractor, the court will look at whether in the course of bargaining between the two parties there has been a genuine "trade-off" of advantages (through running a genuine enterprise such as a franchise) for benefits (the protections and entitlements of an employee under legislation).

The "economic reality" test is arguably a more suitable test against which to measure a franchising relationship. The multi-factor test is necessarily subjective and difficult to predict as the number of factors, or combinations of factors that will result in a worker being characterised as an employee, will vary from case to case. Whether the "economic reality" test will be adopted in Australia and, if so, how it might impact franchising, is, for now, unclear.

(ii) **Agency**

Under Australian law, an agency relationship will not be established unless each of the following elements is present:

- the *consent* of both the principal and the agent, whether express or implied to the agency relationship; and
- *authority* given to the agent by the principal to act on the principal's behalf.

Control over the agent's actions appears to be far less relevant in Australia (and in the UK) and far less likely to, of itself, create an agency relationship than it is in the USA.

Vicarious liability based on agency has been considered outside employment relationships in Australia. The leading case on this is *Colonial Mutual Life Assurance Society Ltd v Producers and Citizens Co-operative Assurance Co of Australia Ltd.*,<sup>34</sup> in which an independent contractor was not merely a contractor or representative, but was acting as the company's agent. The contractor stood in the place of the principal, acting in the principal's rights, not in an independent capacity. The relevant conduct was engaged in in the course of, and for the purpose of executing, that agency, rather than to further the contractor's own business.

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<sup>32</sup> (2001) 181 ALR 263.

<sup>33</sup> 331 US 704 (1946).

<sup>34</sup> (1931) 46 CLR 41.

However, attempts to establish vicarious liability through independent contractor relationships when an agency does not exist have not found favour with Australia's High Court. In *Sweeney v Boylan Nominees Pty Ltd*<sup>35</sup> the majority of the court affirmed *Scott v Davis*,<sup>36</sup> stating that:

[28] In *Scott*, the majority of the court rejected the contention that the owner of an aircraft was vicariously liable for the negligence of the pilot of that aircraft if the pilot operated the aircraft with the owner's consent and for a purpose in which the owner had some concern. The argument that "a new species of actor, one who is not an employee, nor an independent contractor, but an 'agent' in a non-technical sense", should be identified as relevant to determining vicarious liability, was rejected.

(iii) ***A possible new category: representative agent?***

A minority view in *Sweeney v Boylan* was that vicarious liability could be found where an independent contractor was a "representative" but was not an agent in the technical sense, because the "representative" performed the party's functions and advanced its economic interests, effectively as part of its enterprise. It felt that if a contractor is armed with the authority to act as the principal's representative, the principal should be liable for its representative's wrongs to others acting within the scope of that authority. This was especially the case due to the "complete integration" of the 'representative' into the principal's enterprise for the relevant purpose, in that case.

The minority view, which is not yet the prevailing view, advocated a re-evaluation of the scope and application of vicarious liability in Australia.<sup>37</sup> If the minority view were to prevail, the risk to franchisors of vicarious liability for the acts of their franchisees in Australia would increase significantly.

(iv) ***Statute***

In some limited cases, local statutes may impose direct liability on a franchisor for the acts of its franchisees.

One example of this in Australia is liability imposed on franchisors of real estate agencies in the state of Victoria. In that State, local legislation makes both the franchisee real estate agent and its franchisor jointly and severally liable for any defalcation by the franchisee, for any liability incurred by the franchisee as a result of negligence of its employees or agents or in the performance of the duties of an estate agent and for any costs or fines arising out of the defalcation or negligence.<sup>38</sup>

(v) ***Participation in relevant conduct***

Australian franchisors may find themselves jointly and severally liable in damages for the acts of their franchisees, if a franchisee engages in conduct that breaches the anti-trust or consumer protection provisions in the *Competition and Consumer Act 2010*, or Australia's federal franchising law, that is a

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<sup>35</sup> At 28.

<sup>36</sup> (2000) 204 CLR 333.

<sup>37</sup> *Id.* at 69.

<sup>38</sup> Section 43, Estate Agents Act 1980 (Vic).

regulation made under the Act.<sup>39</sup> Any person who aids, abets, counsels, procures, induces or is otherwise in any way, directly or indirectly, knowingly concerned in or a party to any such contravention is equally liable in damages for the breach.<sup>40</sup> This means that a franchisor that chooses to ignore a breach by a franchisee of any such law may find itself jointly liable for its default.

## **Canada**

Under Canadian law, the circumstances under which vicarious liability will be imposed on a franchisor for the conduct of a franchisee probably are quite narrow, so that vicarious liability will arise in only limited circumstances.

### **(i) *Employment***

In the employment context, the "course of employment test", also known as the "Salmond test", adopted from English common law, has traditionally been the starting point in Canada. It contains a formulation which is derived from an implied connection between the activities which comprise the employer's enterprise and the "modes" by which such activities may be carried on by the employee. It holds that a master is not responsible for a wrongful act done by his servant unless it is done in the course of his employment. It is deemed to be so done if it is either (1) a wrongful act authorized by the master, or (2) a wrongful and unauthorized mode of doing some act authorized by the master.<sup>41</sup>

- **The Control Test**

Various approaches have been taken in an attempt to define the essentials of the employer/employee relationship. The traditional test that has been utilized to distinguish a servant from an independent contractor, or what has been said to amount to the same thing, between a contract of service and a contract for services, is the so-called "control test". In its most basic form, it posits that an individual will be considered to have been hired as an employee where the employer not only tells the person what to do, but how to do it.<sup>42</sup> This test is deceptively simple and is said to be the product of an age and economic conditions in which the employer was able to instruct the employee in the techniques of performing the work because the employer's knowledge and experience were at least the equal of the employee.<sup>43</sup> It has been shown to be of limited usefulness in modern society.

- **The Entrepreneur Test**

Control over the manner and means by which a worker is to perform his allotted tasks may be the relevant consideration in many cases, but does not comprehend all of those circumstances in which it will be determined that an employer/employee relationship exists. The courts have been willing to apply a broad range of factors with respect to this issue. In a leading case, *Montreal v. Montreal Locomotive Works Ltd.* et al.,<sup>44</sup> Lord Wright enunciated what has been described as the "entrepreneur test" which

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<sup>39</sup> Trade Practices (Industry Codes – Franchising) Regulations 1998.

<sup>40</sup> At section 236.

<sup>41</sup> See: Salmond & Heuston on the Law of Torts (21st ed., 1996), at p. 443.

<sup>42</sup> *Yewens v Noakes* (1880), 6 QBD 530 (CA), at 532-533.

<sup>43</sup> See: Fleming, *The Law of Torts* (9th ed., 1998), at p. 414.

<sup>44</sup> [1947] 1 DLR 161 (PC).

suggests that, besides control, other factors may demarcate the difference between employees and independent contractors. In that regard, it is necessary to consider all aspects of the relationship, with the focus being on a determination of whose business it is.

- **The Organization Test**

It has also been recognized that, given the increasingly technical complexity of modern industry and commerce, and the greater likelihood that an employee will be sought out because it is he or she who has the expertise, the control test can be problematic. Thus, while it remains a starting point, and is sufficient to dispose of many cases, it has been supplemented or supplanted as required. In some instances, an "organization test" has been applied which distinguishes between a contract "for services" and a contract "of service". Under a contract of service, a man is employed as a part of the business, and his work is done as an integral part of the business; whereas, under a contract for services, his work, although done for the business, is not integrated into it but is only accessory to it.<sup>45</sup>

(ii) **Agency**

There is often confusion in discussing vicarious liability for agents as the terms "servant" and "agent" are often used indiscriminately as though the legal principles governing the two are identical. Indeed, the terms "agent" and "independent contractor" are also sometimes used interchangeably. An agent can be described as a person authorized to do something on behalf of another.<sup>46</sup> Vicarious liability is therefore probably an inaccurate description of the principal's liability for an agent, as the principal's liability is personal in the sense that the agent acts in a representative capacity for him.<sup>47</sup> The distinction between an employee and an agent in Canada is that an agent does not act under the principal's control and supervision. But an agent is also different from an independent contractor because an agent must act subject to the principal's instructions and is not completely independent of his control. In general, a principal is only liable for torts committed by its agent acting within the scope of the agency even where the principal prohibits such acts. There is no liability for acts outside the scope of an agency, although a principal may be personally liable if the acts were expressly authorized or subsequently ratified or adopted by it.<sup>48</sup>

(iii) **Independent Contractors**

The previous discussion as to when it will be found that an employer/employee relationship exists describes circumstances in which it will be held that the relationship is that of employer/independent contractor. Such a relationship, subject to certain limited exceptions, typically does not give rise to a claim for vicarious liability in Canada. As was explained in *671122 Ontario Ltd. v. Sagaz Industries*

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<sup>45</sup> See *Armstrong v Mac's Milk Ltd. et al.* (1975), 7 OR (2d) 478. The case is of particular interest to the topic herein as it involved an accident which occurred at a franchised convenience store. Interestingly, the parties conceded that the owner of the store was an employee of the franchisor. A customer was injured when he slipped and fell on a patch of ice outside the store, which condition was created when an individual hired to erect decals and display window signs emptied his tray of water onto the store driveway on a cold January day. The individual was held to be a servant of the franchisor at the time, as he had been trained by the company and was under its control as to where and how the work should be done. The franchisor was therefore held liable for the plaintiff's injuries. The organization test was expressly adopted by the Supreme Court of Canada in *Co-operators Insurance Association v Kearney*, [1965] SCR 106, at 112.

<sup>46</sup> See: Atiyah, *Vicarious Liability in the Law of Torts* (1967), at p. 102.

<sup>47</sup> See: Fleming, *supra.*, at p. 414.

<sup>48</sup> See: Rainaldi (ed.), Remedies in Tort (Looseleaf), Vol. 4, at paras. 88-91.

*Canada Inc.*,<sup>49</sup> the main policy concerns justifying vicarious liability are to provide a just and practical remedy for the plaintiff's loss and to encourage the deterrence of future harm. Vicarious liability is therefore fair in principle because the hazards of the business should be borne by the business itself. Consequently, it has not been considered just to impose liability on an employer for the acts of an independent contractor because he/she is someone who is in business on his/her own account. In addition, the employer does not have the same control over an independent contractor so as to be able to reduce accidents and intentional wrongs by efficient organization and supervision.

## **2.4 The Situation in Some Civil Law Countries (Italy, Spain, France, and Germany)**

### **(i) Italy.**

The Law n. 129/2004 (“Italian Law on Franchising”) and its implementing regulation<sup>50</sup> do not contain any specific provision on franchisor’s vicarious liability as they introduced substantially a disclosure based regulation; they place on both parties the burden of complying with certain pre-contractual disclosure obligations. Furthermore, under a general rule set out by the Italian civil code, a contract may be binding and effective only between the parties entering into it. Therefore, a franchisor may only be liable to a third party under certain circumstances for liability in tort.

Having said that, Italian case law and legal scholars have identified two possible legal bases in order to hold liable a franchisor for the conduct of its franchisees or the franchisee’s employees. In the first scenario, a third party may bring a legal action against a franchisor for franchisee’s acts if ostensibly the franchisor and the franchisee seem to be one single entity and the third party is convinced in good faith and on the basis of reasonable grounds that it is entering into an agreement with an agent of the franchisor. In other words, the franchisor’s liability is solely based on external and apparent elements and on the fact that third parties relied on them, where no assessment of the control, intended as the effective management by a franchisor of the franchised business, is taken into account.

On the contrary, in the second scenario, if a franchisor has the right and power to control and direct a franchisee, then it may be held liable for the franchisee’s acts or omissions. Consequently, an analysis has to be conducted on the degree of control held by the franchisor over the franchisee and on the abusive use of such control by the franchisor. The following paragraphs will address the details of these two scenarios.

- **The “apparent agency” doctrine**

As a general rule, a third party must be protected if there are objective grounds inducing it to believe that an “apparent” legal relationship corresponds to a real one. In light of this principle, Italian courts have found that in a franchise context, a franchisor may be vicariously liable for the tortious conduct of its franchisee that was found to be its apparent agent. To avoid the risk, the franchisor and the franchisee must make it clear to third parties that they are independent and autonomous entities and that the franchisee is not an agent of the franchisor. When the franchisor puts in place or contributes to put in place a scenario where a third party is in good faith convinced to deal with an agent of the franchisor in

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<sup>49</sup> [2001] SCR 983. The case involved a claim by a car seat cover supplier against a competitor and a marketing company retained by the competitor, arising from the fact that the person responsible for purchasing at a large dealership based retail chain (Canadian Tire) had been bribed by the marketing company to switch to the competitor. The court held that the competitor was not vicariously liable for the conduct of the marketing company as there was no employer-employee relationship. The marketing company was an independent contractor as it was in business on its own account.

<sup>50</sup> Ministerial Decree dated 2 September 2005, n. 204.

lieu of a franchisee, then the franchisor may be held vicariously liable for the franchisee's acts or omissions. For instance, consumers may be convinced that they are dealing with a franchisor's agent due to the fact that the franchisee uses the trade mark and trade names of the franchisor exclusively, and the precise form of the sample contract adopted by the franchisor.

The apparent agent doctrine was first applied by Italian case law in the decision *Grimaldi S.p.A. v Magatelli Effci S.a.s.*<sup>51</sup> where the franchisor of a network of real estate agencies was held liable for the acts of one of its franchisees. The Court of Milan ruled that the franchisor was responsible to reimburse a deposit paid by a customer of one of its franchisees as advance payment for the purchase of an apartment that never occurred and set out the following principles. In order to build a case of vicarious liability, the "apparent" agency relationship must be (1) based on objective grounds (eg. advertising and contractual documents showing only one company name), (2) generated due to franchisor instructions and contractual prescriptions, such as the requirement to use only its brand, name and contractual forms. Finally, the third party will have to have relied in good faith and without fault on the fact that the franchisor and the franchisee are the same entity, as the franchisee is an agent of the franchisor.

According to the Court of Appeal of Naples in the *Sarpi Franchising Group S.p.a.* case,<sup>52</sup> liability under the "apparent agent" doctrine may also be found because the third party, although being aware of dealing with a franchisee, relied on the fact that the franchisee belonged to a well-reputed franchise network and therefore had the same commercial standing and integrity as the franchisor. The case involved again a network of real estate agencies and a franchisor held liable to one of its franchisee's customers for the reimbursement of a deposit. The franchisor was found jointly liable with the franchisee based on the allegations that it failed to carefully select its franchisee<sup>53</sup> and omitted to put in place appropriate monitoring and control systems on the franchisee's activity. This liability may be found despite the absence of any provision of the Italian Law on Franchising requiring the franchisor to control and monitor the franchisee.

In other words, one may conclude that a franchisor has the active duty to protect its uniform image also through strict contract provisions and periodic controls on franchisees and their activity, in the absence of which the franchisor runs the risk of being jointly liable with a franchisee for the damages suffered by third parties for tortious conduct of its franchisees.

- **Liability of franchisor as "controlling company" or as a company exercising direction and coordination activity**

A franchise relationship may also generate vicarious liability claims if the franchisor is in practice the one controlling and managing the franchisee's business. This may occur when the franchisor has, in respect of the franchisee's personnel, the right to hire and fire, set hours of work and rates of pay and the right to give directions on the work performed. Regardless of the fact that the legal basis for a franchise relationship is the economic and legal independence between the two parties, in the above circumstances franchisor and franchisee entities may be re-classified, for the purposes of the labor laws, as one employer. The franchise agreement may in fact be considered as an abusive instrument to jointly manage

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<sup>51</sup> Pretura Milano dated 21 July 1992, published in *Contratti*, 1993, pag. 173 n. DE NOVA, Franchising ed Apparenza.

<sup>52</sup> Corte di Appello di Napoli, dated 3 March 2005, published in *I Contratti*, n. 12, 2005, pag. 1138 ss, n. A. VENEZIA.

<sup>53</sup> In the decision at stake franchisee was insolvent and declared bankrupt ( Corte d'Appello di Napoli, dated 3 March 2005, published in 2005, *I Contratti*, 1133.

the two businesses and not an instrument to put in place a genuine franchise relationship. Therefore, a franchisor may face claims from franchisee's employees for violation of the labor laws and regulation.<sup>54</sup>

Furthermore, a franchisor's liability may stem from the liability regime applying to the corporate group. A recent decision<sup>55</sup> has established that a franchise agreement may in principle be the tool for the exercise of direction and coordination activity on a franchisee. Consequently, a franchisor and its franchisees may be considered as a group of companies. If a franchisor by exercising direction and coordination activity in relation to a franchisee violates the correct corporate and entrepreneurial management principles in order to pursue its own entrepreneurial interest, it shall be directly liable (1) towards the shareholders of the franchisee for damages caused to the profitability and the value of the participation in the franchisee and (2) towards the creditors of the franchisee for the damage caused to the integrity of the corporate capital. In the view of a recent decision of the Pescara court, indicia of the contractual power of direction and coordination activity (which power could be then exercised abusively by a franchisor to give rise to its liability toward third parties) are the following: (1) mandatorily fixing resale prices, (2) imposing quantity, colors and products to be sold by the franchise units, (3) imposing the opening of new units, (4) charging to the franchisee certain costs such as the costs for personnel training, purchasing catalogues, repairing defective products and for the architectural projects of the points of sale. Not surprisingly, in the case at stake, the court did not find such indicia in the franchise agreement; therefore the franchise agreement did not grant to the franchisor a contractual power which could be considered as a power of direction and coordination on the franchisee, nor that the franchisor had abused of this power. The franchise agreement in fact, did not grant the franchisor with the powers to impose on the franchisee certain behaviors (such as fix resale prices, charge costs for personnel training or impose the purchase of advertising brochures) which, further to the abuse of the franchisor, had allegedly caused the economic collapse of the franchisee. In addition, the court held that there was no evidence of a *de facto* (e.g., not based on the franchise agreement) abuse of the franchisor on franchisee.

(ii) *Spain*

A few laws have been enacted in Spain for franchising but there is no specific law covering the topic of vicarious liability. However, case law has been developing in this area. A crucial element to determining franchisor liability vis-à-vis a third party is the nature of the independent contractor relationship between the franchisor and the franchisee. The key consideration is, according to several court decisions, whether or not the franchisee possesses the fundamental elements of independence, management autonomy and activity and profitability control.<sup>56</sup> A direct relationship between a franchisor and a franchisee's employees has been alleged in many occasions by the latter to support a derived liability of the franchisor for the obligations contained in the employment agreements.

In a number of labor cases where franchisees' former employees claimed unpaid salaries, it was also argued, like in Italy, that franchisors and franchisees belonged to the same group of companies and this established a direct relationship between them, thus creating a direct liability of franchisor. However, in the labor cases, the court denied the existence of a "group of companies" due to the lack of a series of elements showing a common organization (e.g. unitary functioning of the work organization; integration of workforce, management, assets).

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<sup>54</sup> Tribunale di Milano, dated 25 June 2005, published in *Rivista giuridica del lavoro e previdenza*, 2006, 97, ss

<sup>55</sup> Tribunale di Pescara dated 2 February 2009, published in *Foro Italiano* 2009, I, 2829.

<sup>56</sup> Evolution of Franchise law in Spain by Albero Echarri and César Vazquez, in *International Journal of Franchising Law*, Volume 2, 2004, Issue 4

In respect of the franchisor's liability towards consumers, we note an interesting case decided by the court of appeal of Segovia where the franchisee advertised its activity as part of a joint service company with the franchisor. The advertising was approved by the franchisor (which consequently received the benefit of capturing clients). The court therefore deemed that the franchisor had to be held liable to consumers consistently with the advertising made by the franchisee and approved by the franchisor.<sup>57</sup>

(iii) **France**

In France, franchising is regulated by the so-called "Doubin Law"<sup>58</sup> which sets out essentially disclosure obligations for the franchisor and contains no provisions on the franchisor's vicarious liability. Also, the general principles of French law, based on the French civil code, establish that a contract may establish liabilities only between the contracting parties and not towards third parties.

However, this principle has been reversed by a decision of the French Supreme court,<sup>59</sup> which ended a long-lasting debate within case law and legal scholars, establishing that "a third party to a contract may have an action founded in tort, for the breach of a contract, provided that the contractual breach caused damage to the third party." In other words, the defaulting party to a contract may be sued not only for breach of contract by the non-defaulting party, but also by the third parties damaged by the breach. The new principle has also been mentioned in the preliminary works of the French Senate regarding the reform of civil liability presently under discussion in France.

One can easily think of the consequences of the new principle in terms of the franchisor's vicarious liability. A franchisor not fulfilling its contractual obligations towards a franchisee which consequently is no longer able to pay the suppliers, may face an action brought by the same suppliers for the damages they suffered.

Another area for vicarious liability is franchisor's liability in connection with financing or providing financial assistance to franchisees. Whenever a franchisor finances an existing franchisee, or sets up or takes part in the shareholding or asset acquisition of a franchisee or a franchise project, its liability may be at stake if the project or transaction ends up with the franchisee in a distressed situation.<sup>60</sup> In the event that a franchisee ends up in liquidation, for instance, the franchisor may be held responsible to fund repayment of the franchisee's debts. This liability may be charged to a franchisor interfering in the management of the franchisee's business beyond the normal contractual obligations and contributing to the franchisee's insolvency.

A franchisor may also be held liable for certain employment obligations *vis-à-vis* the franchisee's employees, if the franchisor and franchisee may be seen as companies belonging to the same group.<sup>61</sup>

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<sup>57</sup> Audiencia Provincial de Segovia, 2006 Responsabilidad del franquiciador fresón, 2008 online in [www.infofranquicias.com/.../Responsabilidad-del-franquiciador-frente-a-terceros.aspx](http://www.infofranquicias.com/.../Responsabilidad-del-franquiciador-frente-a-terceros.aspx).

<sup>58</sup> Loi Doubin of 31 December 1989, with its operating decree dated 4 April 1991.

<sup>59</sup> Cass. Ass. Plenière, Arret n 541 dated 6 October 2006.

<sup>60</sup> Navigating rough financial seas in international franchising, in International Journal of Franchising Law, Volume 7,- Issue 3/4-2009.

<sup>61</sup> Cour d'Appel de Metz, dated 8 December 2008, which established that the existence of a "group" has to be ascertained also in the event of a franchise contract, and that it is within the group that in case of dismissal, the employer has to check if there is any possibility to find a different place of work for the dismissed employee.

Like in Italy and the majority of the examined jurisdictions, a franchisor's vicarious liability may arise when the franchisee specifically acts as agent of its franchisor (e.g. when the franchisee is appointed to deal with national clients on behalf of the franchisor or represents that it is entitled to bind its franchisor or when customers could reasonably believe that the franchisee is an agent of its franchisor or that the franchised operation is a branch of the franchisor).

(iv) **Germany**

In Germany, vicarious liability for acts of franchisees is established by the law.<sup>62</sup> If a third party assumes a that franchisee is acting on behalf of a franchisor and (1) the franchisor is aware of and accepts this, or (2) the franchisor does not know this but should have known, the franchisee is considered to be an agent of the franchisor. Similarly, in case of misleading business conduct, a franchisee could be considered to be an authorized agent of the franchisor. Finally, a franchisor's liability may arise for disguised employment as was noted can be the case in Spain and Italy.

### **3. Possible Vicarious Liability Scenarios**

Comparing the risks that a franchisor will face from vicarious liability in a multi-jurisdictional context is not straightforward. One of the reasons for this is that the contexts in which decided cases have arisen differ markedly from jurisdiction to jurisdiction.

#### **3.1 Cases in the United States**

(i) **Employment/Harassment**

Two recent harassment cases demonstrate possible legal bases upon which franchisors can be held to "employ" their franchisees' employees in the United States and therefore liable for harassment damages. In *Myers v. Garfield & Johnson Enterprises, Inc.*,<sup>63</sup> a franchisee's employee alleged that she was sexually harassed by the franchise's owners and managers and sought to hold the franchisor liable under federal and state anti-discrimination laws. In support of her claim, the employee alleged that the franchisor provided her job training, issued a written code of conduct that prohibited harassment and discrimination in the workplace and oversaw and approved all work product that she prepared. There was, however, no allegation of any harassment by the franchisor and the employee never complained to anyone at the franchisor about the alleged harassment.<sup>64</sup>

The franchisor immediately moved to dismiss the claims against it, arguing that it did not "employ" plaintiff and therefore could not be liable as an "employer." Plaintiff responded by arguing that the franchisor was potentially liable under three distinct theories: (1) directly as a "joint employer" with its franchisee; (2) vicariously as its franchisee's actual principal under an agency relationship; and (3) vicariously as plaintiff's "ostensible or apparent employer." Based on plaintiff's allegations that the franchisor promulgated work rules by issuing a sexual harassment policy, engaged in day-to-day supervision by reviewing and approving each tax return plaintiff prepared and assumed some control over employee records by providing a computer-based employee records system, the court held that plaintiff alleged sufficient facts to establish a potential joint employer relationship.

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<sup>62</sup> §§ 164, 242 BGB.

<sup>63</sup> 679 F. Supp. 2d 598 (E.D. Pa. 2010).

<sup>64</sup> The franchise agreement specified that the relationship was that of independent contractors.

Relying on decisions from other jurisdictions, the court also rejected the argument that franchise relationships could not give rise to vicarious liability for discrimination claims. “Although the mere existence of a franchise relationship does not necessarily trigger a master-servant relationship, neither does it automatically insulate the parties from such a relationship.”<sup>65</sup> Finally, the court allowed plaintiff to proceed with her apparent agency theory. Recognizing that apparent authority must be based on statements of the principal, not the alleged agent, the court focused on plaintiff’s allegations concerning communications she received directly from the franchisor, including the training and codes of conduct.

Another recent case, *EEOC v. Papin Enterprises, Inc.*,<sup>66</sup> also addressed a franchisor’s potential liability for employment discrimination. In *Papin*, the Equal Employment Opportunity Commission (“EEOC”), which is the federal agency that enforces the federal anti-discrimination statute, brought a religious discrimination claim against a franchisor based on the no facial jewelry policy contained in the Operations Manual. During a routine quality inspection, an inspector observed an employee wearing a nose ring and asked the employee to remove it pursuant to the policy. The employee refused based on its religious importance. When the franchisee asked for a waiver of the no-facial-jewelry policy, the franchisor requested documentation supporting the religious nature of the nose ring. The employee ultimately furnished a note from her mother and herself explaining the significance of the nose ring in the Nuwaubian religion, but did not, as requested, provide a “note from a minister” or any “religious text” supporting the request.

The franchisor responded to the proffered letters by denying the waiver request unless the employee could provide “some sort of bona fide documentation regarding the nose ring and its significance to her religion within five days.”<sup>67</sup> When the employee did not provide any additional documentation within the five day period, the franchisee terminated her employment so as not to be in violation of the Operations Manual.

The franchisor moved for summary judgment on the basis that it did not employ the individual and therefore could not be liable. The EEOC responded by arguing that the franchisor was jointly liable with its franchisee because the franchisor and the franchisee were either a single employer/integrated enterprise or joint employers. Alternatively, the EEOC argued that the franchisor was directly liable because it “adversely affected” the individual’s employment by insisting upon adherence to its no-facial-jewelry policy. The court summarily rejected the EEOC’s first argument, holding that there was no evidence of integrated operations between the franchisor and its franchisee, no centralized control of labor relations and no common management, ownership or financial control.

As in *Myers*, however, the *Papin* Court refused to accept the franchisor’s second argument that it was not a joint employer with its franchisee. To support its position, the franchisor relied on its franchise agreement that specifically disclaimed any franchisor responsibility for “recruiting, hiring, terminating or supervising” the franchisee’s employees.<sup>68</sup> Refusing to rely upon the terms of the franchise agreement, the court instead focused on the facts that: (1) the franchisor, not the franchisee, retained ultimate control

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<sup>65</sup> 679 F. Supp. 2d. at 612 (quoting *Drexel v United Prescription Ctrs.*, 582 F.2d 781, 786 (3d Cir. 1978)).

<sup>66</sup> 2009 U.S. Dist. LEXIS 30391 (M.D. Fla. Apr. 7, 2009) and 2009 U.S. Dist. LEXIS 69787 (M.D. Fla. Jul. 28, 2009).

<sup>67</sup> *Id.* at \*6.

<sup>68</sup> *Id.* at \*27.

over whether to issue a waiver to the no-facial-jewelry policy; and (2) the franchisor had injected itself in the decision making process by specifying what would be acceptable to substantiate a waiver.<sup>69</sup>

The court also held that the franchisor could be directly liable to the employee under the federal anti-discrimination statute for “adversely affecting” her employment. Holding that “more is involved in the unique circumstances of this case than the mere existence of a franchise relationship,” the court refused to limit the franchisor’s potential liability to the joint employer doctrine.<sup>70</sup>

### 3.2 Canadian cases

In determining whether an individual is an employee, agent or an independent contractor, the court will attempt to ascertain the real facts of the situation and not rely on titles, labels or terminology used by the parties. Generally speaking, in light of the principles previously described, franchisees are more likely to be found to be independent contractors as opposed to agents or employees of the franchisor. That was demonstrated in *Toshi Enterprises Ltd. v. Coffee Time Donuts Inc.*,<sup>71</sup> in which the appellate court reversed a judgment below which held a franchisor liable for smoke damage caused by a fire which emanated from a franchised store and caused damage to the neighbouring premises. The appeal court held that the trial judge had erred in finding that the facts supported the conclusion that the owner of the franchise was an employee of the franchisor. Rather, the franchisee was an independent contractor.<sup>72</sup>

- **Enterprise Risk**

All of the previous analysis may have been rendered superfluous, at least in the context of intentional torts, as a result of the recent decisions of the Supreme Court of Canada in *Bazley v. Curry*<sup>73</sup> and *Jacobi v. Griffiths*.<sup>74</sup> In *Bazley v. Curry*, the employer was the Children's Foundation, a nonprofit organization which operated residential care facilities for the treatment of emotionally troubled children. As substitute parent, it practised total intervention in all of the aspects of the lives of the children for which it cared. The Foundation's employees would do everything a parent would do, from general supervision to intimate duties like bathing and tucking in at bedtime. Unbeknownst to the Foundation, an employee in one of its homes (Curry) was a pedophile. Background checks had indicated that he was a suitable employee. After investigating a complaint about Curry, and verifying that he had abused children

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<sup>69</sup> *Id.* at \*28.

<sup>70</sup> *Id.* at \*30. Ultimately, a jury rejected all claims brought against both the franchisor and the franchisee. 2009 U.S. Dist. LEXIS 69787, at \*2. The jury did so because it determined that the employee did not wear the nose ring for any sincerely held religious belief.

<sup>71</sup> (2008), 246 OAC 17 (Div Ct).

<sup>72</sup> Having said that, there still can be reluctance to strike a pleading of vicarious liability at an interlocutory stage. See for example: *Boardman v Pizza Pizza Ltd.* (2002), 30 C.P.C. (5th) 384; 2000 CarswellOnt 1465, court refusing to dismiss claim against franchisor for injurious falsehood, negligence, negligent misrepresentation, false arrest and malicious prosecution arising from plaintiff's acquittal of assault relating to altercation between plaintiff and delivery person employed by the franchisee. See also: *MacKinnon v National Money Mart Co.*, 2004 BCSC 1534 (court refusing to strike claim against franchisor based on an allegation that franchisee collected unlawful payday loan fees in accordance with directions of franchisor); Aviva Insurance Co. of Canada v *Pizza Pizza Ltd.*, [2007] ILR 1-4652 (Ont SCJ) (insurer required to defend franchisor under CGL policy on non-automobile related claims in action against it arising from motor vehicle accident alleged to have been caused by driver employed by franchisee driving too fast because of delivery policy of franchisor).

<sup>73</sup> [1999] 2 SCR 534.

<sup>74</sup> [1999] 2 SCR 570.

in one of its homes, the Foundation discharged him. Curry was subsequently convicted of 19 counts of sexual abuse, two of which related to Bazley, a resident of one of the Foundation's facilities. Bazley sued the Foundation for damages for the injuries he suffered while in its care. The parties stated a case to determine whether the Foundation was vicariously liable for Curry's tortious conduct.

In a unanimous judgment, the Supreme Court of Canada held that vicarious liability should be imposed. The majority decision of the Supreme Court considered the Salmond test to be inadequate because it focuses on the question of whether there is a sufficient connection between that which was done and that which the employer authorized to be done. Rather, the better approach is to apply a two-step procedure. First, the court should determine whether there are precedents which unambiguously determine on which side of the line between vicarious liability and no liability the case falls. If prior cases do not clearly suggest a solution, the next step is to determine whether vicarious liability should be imposed in light of the broader policy rationales behind strict liability. The court should avoid the semantic discussion of "scope of employment" and "mode of conduct" fostered by the Salmond test and, instead, should attempt to determine whether the wrongful act is sufficiently related to conduct authorized by the employer to justify the imposition of vicarious liability. Vicarious liability will be imposed under this "enterprise risk" approach where there is a significant connection between the nature of the business which the employer conducts, and therefore the activity in which the employee is engaged, which creates or enhances the risk of the wrong occurring and the wrong which does occur.<sup>75</sup>

In contrast, in *Jacobi v. Griffiths*,<sup>76</sup> a divided court held that the defendant Boys' and Girls' Club was not vicariously liable for sexual assaults committed on two children by its Program Director (Griffiths) because there was no "strong connection" between the enterprise risk and the sexual assault.

The differing results in these two cases is indicative of the fact that, although the court has postulated a new approach to the issue of vicarious liability, much still depends on the facts and, in particular, the nature and scope of both the enterprise of the employer and the position held by the employee in it.

As can be seen, the test set out in the two Supreme Court of Canada cases involved intentional torts, more particularly, sexual abuse and, therefore, it is not entirely clear whether the "enterprise risk" theory postulated in them will be applied more generally to all tort claims. It does signify a change in approach to one which is more policy oriented and which imposes an obligation on an employer to ensure that it does not introduce unnecessary risks into the work place or foster situations that can facilitate an employee engaging in wrongful acts.<sup>77</sup> However, it is submitted that, generally speaking, the franchisor-franchisee relationship is not one which can be said to create or enhance the risk that a tort will be committed by a franchisee, it is probably unlikely to have any material impact.

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<sup>75</sup> *Ibid.*, at p. 559

<sup>76</sup> In this case, the Club's "enterprise" was to offer group recreational activities for children to be enjoyed in the presence of volunteers and other members. The opportunity that the Club afforded Griffiths to abuse whatever power he may have had was slight, given his particular position. The sexual abuse only became possible when Griffiths managed to subvert the public nature of the activities. The success of his agenda of personal gratification depended on his ability to isolate the victims from the larger group, and while the progress from the Club's program to the sexual assaults was a chain of multiple links, none of them could be characterized as the inevitable or natural outgrowth of its predecessor. There was therefore not enough to postulate a series of steps each of which might not have happened "but for" the previous steps. Here, the chain of events constituted independent initiatives on the part of Griffiths for his own personal goals, and it was too remote from the Club's enterprise to justify imposing "no fault" liability on it.

<sup>77</sup> See: Klar, *Tort Law* (4th ed., 2008), at pp. 659-662.

### 3.3 Australian cases

#### (i) *Employment*

Two cases involving the "Crisis Couriers" courier business demonstrate the very fine distinctions which can arise between employees and independent contractors in Australia, that the legislative context in which the issue arises can be critically important to the finding, and that judicial sympathy for a franchisee plaintiff in a particular fact situation can influence the outcome. In a context in which judges must balance a series of competing factors and exercise their discretion on the outcome, this is unsurprising. The "Crisis Couriers" business was not a franchised, but there are many franchised courier businesses in Australia for which parallels may be drawn from these cases.

In the first Crisis Courier case, *Hollis v Vabu Pty Ltd*,<sup>78</sup> Hollis was struck and injured by a Crisis Couriers' "independent contractor" bicycle courier. Hollis commenced proceedings against Vabu, the owner of the "Crisis Couriers" business, primarily on the basis that Vabu was vicariously liable for the negligence of its bicycle couriers.

The High Court concluded that the relationship in question was one of employer and employee, particularly because: (1) the couriers were not providing skilled labour and were not in the position to generate goodwill. Therefore to conclude that the couriers were running their own enterprises was "intuitively unsound"; (2) the couriers had little or no control over the manner in which they performed their work; (3) the couriers were required to wear a uniform which presented them to the public as emanations of Vabu; (4) Vabu was aware of the dangers which its couriers presented to pedestrians, yet failed to adopt any means for personal identification of individual couriers to the public; (5) Vabu administered the couriers' finances and offered them no scope to bargain for their remuneration. In addition, their employment with Vabu left the couriers with limited scope for undertaking any business enterprise of their own; and (6) the fact that the couriers were required to supply their own transport and equipment was not determinative. The Court held that this was just as likely to be indicative of an employment relationship as not.

The High Court considered that when the relationship was viewed practically, the couriers were not running their own business, nor did they have any real independence in conducting their work. However, as each case is decided on its facts, if the couriers had significantly invested in capital equipment which required greater skill to operate it, the conclusion may have been different.

A different decision was reached by the New South Wales Court of Appeal in a previous case involving the "Crisis Couriers" business. In *Vabu Pty Ltd v Commissioner of Taxation*,<sup>79</sup> the court was required to consider whether Vabu employed motor vehicle, motor cycle and bicycle couriers, for the purposes of superannuation legislation. The Court of Appeal accepted that the cumulative effect of the work conditions gave Vabu a deal of control over the couriers but noted that a person may supervise others without becoming their employer. Several considerations supported the conclusion that the couriers were independent contractors rather than employees. One consideration was that the couriers supplied their own vehicles and had to bear the expense of providing for and maintaining those vehicles, and making (considerable) payments for repairs and insurance. The couriers were also required to provide themselves with street directories, telephone books, ropes, blankets and tarpaulins. The couriers

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<sup>78</sup> (2001) 181 ALR 263.

<sup>79</sup> (1996) 81 IR 150.

received no wage or salary, but were paid a prescribed rate for the number of successful deliveries they made. On this basis, the Court of Appeal held that they were not employees.

Unlike some other jurisdictions, Australian courts have yet to develop a doctrine of joint liability, so there is little or no prospect of a franchisor and a franchisee being found to be joint employers.

(ii) **Agency**

The issue of whether a franchisee can be the agent of a franchisor has been considered only very rarely in Australia. The most notable case involved a master franchise<sup>80</sup> of a "Lenard's Poultry Shop" in South Australia.<sup>81</sup> The master franchisee made representations to a potential franchisee about the gross sales that were achievable at the store. The franchisee brought proceedings against both the master franchisee and the master's franchisor, on the basis that the master franchisee made the representations as the franchisor's agent. The primary judge concluded that the master franchisee was "in reality" the agent of the franchisor for the purpose of providing documents to potential franchisees.

The franchisor challenged the finding of the primary judge that there was actual agency insofar as it extended to the provision of financial packages annexed to disclosure documents. It said that there was no evidence of actual authority and the franchise agreement included terms that were inconsistent with such authority. The Court referred to established case law to support the notion that actual agency requires the consent of both the principal and the agent, and that the manifestation of such consent may be express or implied. The Court stated that "regardless of the terms of the agreement between the parties, if the facts fairly disclose that one party is acting for another with that person's authority then agency is established".<sup>82</sup>

In this case, the financial packages and disclosure documents were prepared by the franchisor but the financial packages were reviewed and adapted by the master franchisee to reflect the experience of franchisees within its territory.

In the Court's view, it was not open to infer from the evidence or from the nature of the relationship between the master franchisee and the franchisor that the franchisor consented to, or authorised the master franchisee to deliver to the potential franchisee the financial packages prepared, not by the franchisor, but the master franchisee.

### **3.4 Italian Cases**

Italian courts have so far placed liability on franchisors for the actions of their franchisees in a limited number of cases.

(i) **Consumer Claims**

In the first case, *Grimaldi S.p.A. v. Magatelli-Effeci S.a.s*<sup>83</sup>, the potential buyer of an apartment paid a deposit to a franchisee of a famous network of real estate agencies called "Grimaldi". The

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<sup>80</sup> In this case, the franchisor franchised a master franchisee/sub-franchisor, which, granted a franchise to a sub-franchisee. The franchisor did not contract with the sub-franchisee.

<sup>81</sup> *The Silver Fox Company Pty Ltd v Lenard's Pty Ltd* [2004] FCA 1570 and *Poulet Frais Pty Ltd v The Silver Fox Company Pty Ltd* [2005] FCAFC 131.

<sup>82</sup> [2005] FCAFC 131 at para 124

<sup>83</sup> Pretura Milano dated 21 July 1992, published in *Contratti*, 1993, pag. 173 n. DE NOVA, *Franchising ed Apparenza*.

franchisee did not return the deposit when the owner of the apartment refused to proceed with the sale and the potential buyer sued the franchisor, which was found liable on the basis of the apparent agency doctrine. The court established that the potential buyer had relied on the fact that the franchisee was an agent of the franchisor.

Likewise, the Naples court of Appeal in 2005<sup>84</sup> found that a franchisor was jointly liable with a franchisee to return the deposit paid by a client to the franchisee, where the sale of the apartment was not finalised. The court of Appeal held that the franchisor had the duty to control the activities, the reputation and financial reliability of its franchisee as the client correctly expected the franchisee to have the same commercial reputation and integrity as the franchisor. In the case at stake, the franchisee was selected to join the franchise network although it had been declared bankrupt.

The concepts developed in the above two cases may be applied in business sectors other than real estate services, provided that similar scenarios of apparent agency relationships unfold.

The case of *Ford Italiana S.p.a. v. Campopiano*<sup>85</sup> represents a further application of the franchisor's liability under the "apparent agent" doctrine. The court held that a distribution agreement may be qualified as a franchising contract if there is a particular degree of coordination and integration between the undertaking of the dealer and the manufacturer (or vendor). The vendor was held liable for damages suffered by the dealer's customers as they relied in good faith on the fact that they were dealing with the vendor's agent.

#### (ii) *Employment*

The degree of control of a franchisor over a franchisee and its abuse were used by courts in the following cases in assessing franchisor vicarious liability. In the first case,<sup>86</sup> a dismissed employee of a franchisee (belonging to the famous "Body Shop" retail network) made a claim against its franchisor asking to be reinstated in its place of work on the basis of a provision of the law applying to employers of a certain size. The dismissed employee alleged that the size of the work unit had to be calculated on the basis of the total and combined number of franchisor and franchisee employees. This triggered certain protection for the workers against unfair dismissal which otherwise did not apply. The court found that employees of the franchisor managed the recruiting of personnel for the franchisee, gave directions on the work to be performed and set hours of work and shifts for the employees of the franchisee and in general put in place other behaviors showing that the franchisor was de facto managing the franchisee's personnel and for this reason the real employer of the dismissed employee had to be considered e the franchisor together with the franchisee.

In a recent decision,<sup>87</sup> mentioned above, a franchisee of a famous Italian brand of furniture (Divani & Divani by Natuzzi) alleged that its franchisor abused its powers of control to financially undermine a franchisee and force a sale on a fire sale basis. The court conducted an analysis of the franchise agreement to find indicia of contractual powers to manage and control the franchisee and considered whether the franchisor abused such powers. The court did not find any contractual provisions

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<sup>84</sup> *Corte di Appello di Napoli*, dated 3 March 2005, published in *I Contratti*, n. 12, 2005, pag. 1138 ss, n. A. VENEZIA.

<sup>85</sup> Tribunale di Crema, dated 23 November 1994, published in *Contratti*, 1996, 52, n. C. BERTI.

<sup>86</sup> Tribunale di Milano, dated 25 June 2005, *Bellotto v Body Shop Milano s.r.l. e Dorado s.r.l.*, n. O. Azzolini, *Riflessioni sul franchising e ambito di applicazione della tutela reale*, published in *Riv. Giur. Lav. e Prev.*, 2006.

<sup>87</sup> Tribunale di Pescara, dated 2 February 2009, published in *Foro Italiano* 2009, I, 2829.

granting the franchisor any such control or managing powers, nor did the franchisee prove a de facto managing and controlling power which the franchisor had abused.

## **4 Possible Other Bases for Franchisor Liability**

### **4.1 Misrepresentation**

In many jurisdictions, a franchisee may be liable to third parties who act in reliance on a misrepresentation made by the franchisee, be they fraudulent or negligent. In some cases, if the franchisor is aware of the misrepresentation, and takes no steps to correct it, the franchisor may itself be found to have engaged in making misrepresentations and have its own primary liability, as a result. In other jurisdictions, such as Australia, Canada and Germany, statutory liability arises for certain misleading conduct and participants in the misleading conduct can be jointly liable for the results. In such cases, a franchisor must be particularly diligent to act on and cease any misleading conduct engaged in by a franchisee that comes to its attention.

### **4.2 Statutes**

Statutes can, on occasion, directly impose joint or joint and several liability on two persons for the acts of another. A franchisor's liability for issues arising out of its franchisees' businesses can arise under a wide variety of statutes. In some cases, the liability arises as a result of public policy issues: such as the imposition in Argentina of joint liability on franchisors and franchisees for the franchisee's statutory obligations to their employees. An example of such liability is the Canadian case of *Youngblut v. Jim and Jaklen Holdings Ltd.*,<sup>88</sup> in which a franchisor was held liable under employment standards legislation when it took over the business of its franchisee which had expressed a desire to shut down. Because of its assumption of day-to-day control over the operations and employees, the franchisor was deemed to be an employer under the *Labour Standards Act* (Saskatchewan) and therefore was liable for wages owing to the employees.<sup>89</sup> Another example of liability driven by public policy is the liability of certain franchisors in Australia for financial compliance obligations of their real estate franchisees.

In some instances, legislation treats the franchisee's business as an extension of the franchisor's. Examples of this are bribery and anti corruption legislation, such as in the UK and the "extended enterprise" approach to measuring and reporting carbon emissions in Australia and in the UK.

Although it is beyond our scope of this paper to consider more general statutory liability, this can include the corporate liability of one entity for acts leading up to the insolvency of another, or the finding that an individual or business is a "shadow director" of the other. In most jurisdictions, it will also include the liability of manufacturers, trade mark owners, importers and others in the supply chain for injury or damage caused by defective goods.

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<sup>88</sup> [2003] 3 WWR 124 (Sask QB).

<sup>89</sup> Cf. *Maycock v Canadian Tire Corp.* (2004), 49 CHRR D/189 (BCHRT) (franchisor not liable in respect of complaint of discrimination when complainant denied entry to store with service dog, as franchisor did not exercise degree of control over franchisee sufficient to conclude that franchisor provided services in store and/or employed staff in store). None of the existing Canadian franchise statutes purport to impose anything in the nature of vicarious liability on a franchisor for the conduct of a franchisee. See: Arthur Wishart Act (Franchise Disclosure), 2000, SO 2000, c. 3; Franchises Act, RSA 2000, c. F.23; Franchises Act, SPEI 2005, c. 36; Franchises Act, SNB 2007 c. F235, Franchises Act, CCSM, c. F156 (not yet in force).

Vicarious liability can also be distinguished from situations where a direct contractual relationship is created with the franchisor.<sup>90</sup>

### 4.3 Other

While it does not arise frequently, there is no reason why, in appropriate circumstances, the franchisor and franchisee could not be considered to be a partnership: persons carrying on business in common with a view to profit. It will, however, in most cases be sufficient to avoid this by denying a partnership relationship in the franchise agreement and by structuring fees accordingly.

It is useful to remember that businesses can be liable, often in negligence, as joint tortfeasors where they both have a duty of care to the same person. For example, a franchisor could be itself directly liable and negligent to a customer of a franchisee, if the franchisor was found to have provided the franchisee with inadequate instruction or, in extreme cases even if the franchisor was negligent in choosing its franchisees. One example of this is the Canadian case of *Leahy v. McDonald's Restaurants of Canada Ltd.*,<sup>91</sup> in which liability was imposed on a franchisor for the injuries sustained by the plaintiff when he slipped and fell while leaving a franchised restaurant. Liability, was based on the franchisor owning the premises, not on the conduct of the franchisee.

## 5. Risk Management Techniques

This paper has so far dealt with the risks for franchisors stemming from the acts of their franchisees. This section will now analyze possible ways to reduce the risk of vicarious liability claims. That will be assisted by the attached table, which has been completed by contributors from a number of different jurisdictions. Examples of risk management techniques in different jurisdictions are listed below. The example jurisdictions listed below are not intended to be exhaustive.

The analysis of the countries discussed in this paper in detail and those listed in the table suggests that the potential and advisable risk management techniques are likely quite similar, regardless of the country and the legal theory upon which a franchisor may be found to be vicariously liable, such as; (1) including appropriate provisions in the franchise agreement, although unlikely to be definitive in most cases, is important in order to reduce the risks of vicarious liability claims; (2) it can be particularly helpful for the franchise agreement to make it clear that the franchisor and the franchisee are independent parties; (3) the franchise agreement should contain language making it clear that there is no partnership, joint venture or agency relationship between the parties; (4) it will also help if franchisees display notifications in their premises, on signage, business cards, letterhead, etc., clarifying that they, not the franchisor, run the independent businesses; (5) although probably not conclusive, it might be convenient to mention in the agreement that the franchise affiliation does not involve an employment relationship of

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<sup>90</sup> See: *Fraser v U-Need-A-Cab Ltd.* (1983), 43 OR (2d) 389, aff'd 50 OR (2d) 281 (CA) (passenger injured while alighting from taxicab dispatched by defendant, but owned and operated by someone else, had contract claim against defendant for breach of warranty arising from continuing offer through advertising to provide taxicab service to members of public and based on failure of defendant to select reasonably competent independent contractor); *Beuker v H & R Block Canada Inc.*, [2001] 10 WWR 274 (Sask QB) (franchisor of tax service business held liable for breach of contract for negligently prepared tax returns in light of advertising, documentation and representation to public giving franchisee apparent or ostensible authority to create contractual relationship between plaintiff and franchisor). See also: *Percival v Mayes*, 1986 CarswellOnt 3321 (franchisor, Toronto Homeservice Maintenance Limited, would have been held liable for breach of contract in respect of poorly performed house renovations arranged through franchisee, in light of reasonable expectation by plaintiffs, based on advertising, brochures and membership cards, that they were contracting with franchisor, but for fact that plaintiffs lost protection of guarantee given by franchisor when they broke applicable rules by retaining their own contractor).

<sup>91</sup> [1993] OJ No. 2226.

any sort; (6) including, in many countries, a statement in the agreement that the parties are independent contractors which would probably need to be reflected by the substance of the relationship in order to avoid a de facto employer-employee relationship; and (7) it is advisable that the franchise agreement clearly states that the franchisee is solely responsible for its operation and any possible claims in this respect and also contains an indemnification clause in favor of the franchisor for any loss deriving from the franchisee's acts.

Franchisors should, ideally, repeat these warnings in any publicly available document that discusses or is relevant to the franchise relationship (*e.g.*, Franchise Offering Circular).

In addition, there are risk management techniques that are relevant to the development of the franchisor/franchisee relationship. It is advisable to monitor franchisees to ensure that they put in place behaviours or actions consistent with the provisions of the agreement. For instance, a franchisor should ensure that the franchisee identifies itself vis-à-vis third parties as an independent entity and business. A franchisor should regularly audit how a franchisee represents itself to ensure that it does not mislead third parties into thinking that the franchisee has authority to act on behalf of the franchisor. Consequently, a franchisor is advised to rectify or amend incorrect or incomplete representations a franchisee makes and put a stop to a franchisee's unlawful or negligent acts, if it becomes aware of them.

The degree of control a franchisor exercises over a franchisee is also an issue to be addressed. It is a well established principle that franchisors may set and enforce clear quality standards on a franchisee to protect the brand and the network's reputation. These standards must be communicated clearly and effectively to franchisees. However, franchisors should carefully evaluate whether specific procedures necessary to reach quality standards and their enforcement on franchisees may involve the risk of vicarious liability claims based on the legal theories examined.

Lastly, a few words must be spent on the topic of insurance coverage. It is quite common for a franchise agreement to require franchisees to obtain insurance coverage for its business and to include the franchisor in the insurance policies as an additional insured. The insurance coverage should include vicarious liability claims. In addition, the franchisor itself should purchase insurance coverage including vicarious liability.

## **6. Comparative Analysis among the Examined Countries**

As the discussion above demonstrates, certain basic themes run throughout the jurisprudence of all countries, with application varying from jurisdiction to jurisdiction. This section summarizes some of the major similarities and differences first within the common law countries of Australia, Canada and the United States and then between the common law and civil law countries.

### **6.1 The U.S. vs. Canada and Australia**

All three common law jurisdictions generally approach the issue of vicariously liability in the same fashion. Concepts of employment and agency dominate the analysis. Who is an employee, however, varies. In the United States, states are almost evenly split between a statutory employment test and the common law right to control test. Under the statutory test, which itself varies both amongst and within the states that have adopted it, individuals are presumed to be an employee unless the franchisor

can satisfy all components of the statutory test to establish an independent contractor relationship.<sup>92</sup> Under the common law test, used by the remainder of the states, Australia and Canada, there is no presumption of employment or independence and the factors analyzed vary from jurisdiction to jurisdiction. For example, some U.S. jurisdictions only analyze the issue of whether the putative employer has the “right to control.” Others, including the U.S. federal government, have developed multi-factor tests to apply, weighing certain factors more heavily than others.<sup>93</sup> Despite the various factors that courts will consider, there is one factor that all jurisdictions say they consider, but to which they give little weight: how the parties themselves describe their relationship. While a franchise agreement provision describing the relationship as non-employee is certainly helpful, it is by no means dispositive. Instead, courts have made clear that how the parties actually interact will be the basis for determining whether an employment relationship exists.

Another potential difference between the common law jurisdictions is the effect of how a franchise is held, through a corporate entity or personally, on the issue of employment status. Australia only recognizes individuals as potential employees, such that requiring a franchise be held in corporate form may head off any employment-related concerns. In the U.S., however, the issue remains unresolved, with at least one court holding that an individual’s use of a corporation to run his business did not prevent his “employment” by a distributor.<sup>94</sup> The mere existence of a corporation would not stop a finding of employment in Canada, as it is but one of the factors to be considered. In Italy it would be the essence of the relationship that matters and not the legal label; consequently the criteria establishing an employment relationship may be met also in the presence of an individual who set up a corporate entity for the purposes of the franchised business.

Not surprisingly, U.S. and Australian law also differ with respect to agency. The main distinction is the effect of the principal’s control over the agent versus the authority an agent has to act on the principal’s behalf. Australian law focuses on the authority issue, while U.S. law focuses more on control. By focusing on a franchisor’s control, U.S. jurisdictions appear to assume that a franchisee is working on a franchisor’s behalf by generating revenues upon which a franchisor is paid royalties. In Australia, however, it seems that a franchisor will not be liable for the actions of a franchisee, even one whose actions it controls and who acts as its “representative”, unless the parties intended that the franchisee be authorized to act as its agent.

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<sup>92</sup> The states that utilize a statutory test are: Alaska, Arkansas, Colorado, Connecticut, Delaware, Georgia, Hawaii, Idaho, Illinois, Indiana, Louisiana, Maine, Maryland, Massachusetts, Nebraska, New Hampshire, New Jersey, New Mexico, Oregon, Pennsylvania, South Dakota, Tennessee, Utah, Vermont, Virginia, and West Virginia.

<sup>93</sup> Historically, the U.S. federal taxing authority used a 20 factor test to evaluate the “right to control.” The factors it considered were: (1) level of instruction; (2) amount of training; (3) degree of business integration; (4) extent of personal services; (5) continuity of relationship; (6) flexibility of schedule; (7) demands for full-time work; (8) need for on-site services; (9) sequence of work; (10) requirements for reports; (11) method of payment; (12) payment of business or travel expenses. (13) provision of tools and materials; (14) investment in facilities; (15) realization of profit or loss; (16) work for multiple companies; (17) control of assistants; (18) availability to public; (19) control over discharge; and (20) right of termination. Rev. Rul. 87-41, 1987-1 C.B. 296. Today, the taxing authority focuses on three primary concepts: (1) behavioral – whether the company controls or has the right to control what the worker does and how the worker does his or her job; (2) financial -- whether the business aspects of the worker’s job are controlled by the payer (these include things like how worker is paid, whether expenses are reimbursed, who provides tools/supplies, etc.); and (3) type of relationship – whether there are written contracts or employee type benefits (i.e. pension plan, insurance, vacation pay, etc.); whether the relationship will continue and whether the work performed is a key aspect of the business. IRS Pub. 1779.

<sup>94</sup> *Amero v Townsend Oil Co.*, 25 Mass. L. Rep. 115 (Mass. Super. Ct. 2008).

## **6.2 Common law vs. Civil law countries**

While one might think that civil law countries would be more proactive in addressing the unique characteristics of franchise relationships, that is not the case. Like their common law counterparts, civil law countries rely upon the application of legal principles developed outside of franchising to determine vicarious liability issues. As a result, many of the same apparent agency concepts discussed above are equally applicable to civil law jurisdictions.

One key distinction is that civil law countries focus more on the reasonable expectations of the injured party, as opposed to the franchisor's right to control or allegiance of the agent/franchisee to analyze vicarious liability claims. This suggests that disclaimers in advertisements and at locations as to the independence of franchised businesses may play a more important role in civil law countries. Also, a franchisor's success in the market without appropriate disclosure of the nature of the franchisor/franchisee relationship, appears to put it at something of a disadvantage in defeating vicarious liability claims. As the real estate cases from Italy demonstrate, the franchisor's success in establishing a brand that dominates its field appears to have blurred the distinction between itself and its franchisees in consumers' minds. As a result, the franchisor and its franchisees became one, with the franchisor held liable for its franchisees' acts.

Franchisors in civil law countries must also be certain that they are not taking too active a role in their franchisees' operations. As in common law countries, franchisors in civil law countries that have the right to hire and fire franchisees' employees, set their rates of pay and establish hours of work will likely find themselves to be "controlling companies" and liable for franchisee acts.

## **7. Conclusion**

As the world marketplace continues to shrink, further international expansion of franchise systems appears inevitable. This expansion presents a host of challenges, including different consumer demands, different marketing challenges and different legal systems. Understanding how those legal systems apportion responsibility between franchisors and franchisees for the incidents that will inevitably happen should be a key inquiry of any system considering international expansion. As this paper demonstrates, contractual agreements alone are almost always insufficient to insulate franchisors from third-party claims. Instead, franchisors must provide their franchisees with sufficient autonomy and independence to make them truly independent and responsible for their actions, while still maintaining and enforcing adequate system standards to protect the brand. How exactly to accomplish this result takes careful planning and an appreciation that one solution will not work in every jurisdiction. Hopefully, this paper has alerted readers to many of the basic tenants of vicarious liability laws applicable to franchisors throughout the world and provided a roadmap to the further study necessary for each jurisdiction.

## Franchisor liability for the acts of its Franchisees<sup>\*</sup>

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
<i>Argentina</i> <sup>1</sup>	Labour law	Labour law provisions declare that the subcontracting of the principal activity of an establishment generates joint liability. Labour courts have considered that a company by using franchisees is avoiding liability towards labour personnel involved in distributing the products of the franchisor establishment Even though franchisees act as agent, absolute control of a franchisee operation generates liability under the same control theory in Argentina as applied to the personnel of a franchisee..	There are many labour cases making franchisors jointly liable for the labour and social security debts of franchisees, as if they were the franchisor's personnel.	Deny any power to act on behalf of the franchisor. Verify franchisees' compliance with their labour obligations. If control is focused on the protection of the trademark or industrial property and not on the operation, there are cases allowing franchisors to escape liability.
		By direct action of the franchisee employee against the franchisor.	Yes, these are many.	Obtain personal covenants from the principal of the franchisee, personally assuming liability for the Labour obligations.

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<sup>\*</sup> Survey conducted in February 2011 for the 27<sup>th</sup> Annual IBA/IFA Joint Conference May 18, 2011. The survey does not cover liability a franchisor could have as the manufacturer or supplier of products to a franchisee.

<sup>1</sup> Argentina, contributed by Osvaldo Mazorati, Allende & Brea, Buenos Aires ([ojm@allendebrea.com.ar](mailto:ojm@allendebrea.com.ar)).

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
Australia <sup>2</sup>	Vicarious liability for acts of franchisee	If the franchisee acts as agent of the franchisor <u>and</u> the franchisee acts within the scope of its authority <u>and</u> the franchisor controls the manner of performance (control without actual authority as agent unlikely to be sufficient to create agency).	Not on vicarious liability. However, the Federal Court in <i>The Silver Fox Company Pty Ltd v Lenard's Pty Ltd</i> [2004] FCA 1225 decided that the master franchisee provided its disclosure document and made representations as agent of the franchisor. The decision was reversed on appeal.	Deny agency in the franchise agreement. Ensure franchisee identifies itself as an independent business (including by registering a business name).
		If the franchisee is the employee of the franchisor. This could not arise if the franchisee is a corporation or other entity.	Not on vicarious liability. There are several cases only on whether a franchisee can be an employee of the franchisor. These include <i>Hollis v Vabu Pty Ltd</i> (2001) ALR 263 and <i>Vabu Pty ltd v Commissioner of Taxation</i> (1996) 81 IR 150.	Deny employment relationship in agreement.
	Misleading or deceptive conduct	If the franchisor allows the franchisee to represent itself as being the franchisor or its agent, it could be liable for the franchisee's conduct as an accessory or as a principal. In addition, if the franchisor allows a master franchisee to make representations it knows to be misleading, the franchisor could be equally liable for the representations.	Yes	Regularly audit how the franchisee represents itself. A franchisor should correct incorrect or incomplete representations a master franchisee makes, if it becomes aware of them.
	Misrepresentation	Similar	No.	

<sup>2</sup> Australia, contributed by Penny Ward, Baker & McKenzie, Sydney ([pennyj.ward@bakermckenzie.com](mailto:pennyj.ward@bakermckenzie.com)).

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
<i>Brazil</i> <sup>3</sup>	Vicarious liability for acts of franchisee	Brazilian law recognizes franchisees as independent parties, responsible for their own actions and omissions. However, there are certain cases in which franchisors have been liable for the master franchisee/franchisee's operation of the franchised business, as described below:	The 11 <sup>th</sup> Chamber of the Rio de Janeiro State Court of Appeals (appeal no. 0068802-72.2005.8.19.0001) decided that the franchisee was an independent party and so the franchisor and franchisee were liable for their own acts.	It is advisable to clearly state in the agreement that the parties are independent contractors and that it does not create nor should it be construed to create any labor, joint venture or agency relationship between them.
		Consumers' claims: The Brazilian End Consumer Defence Code ("CDC") establishes joint and strict liability of all the parties involved directly or indirectly in the supply chain of products and services to consumers. Such liability does not depend on fault and the CDC allows the end consumer to file a claim against any of such economic agents that participated in the circulation of a product or service that has caused harm or has any defect. Therefore, under the definition of the CDC and also as owner of the relevant trademarks, franchisor may be deemed to be one of the agents in the supply chain and, thus, be held liable towards end consumers for acts of the franchisee. If the franchisor is deemed liable	There has been certain controversy in case law regarding franchisor's liability to end consumers for services rendered by franchisees. The 10 <sup>th</sup> Chamber of the Rio Grande do Sul State Court of Appeals (appeal no. 70029257045) has decided that both the franchisee and the franchisor are liable for any damages caused to the consumer. However, other recent Court decisions have decided that franchisors are not liable for harm or losses caused to consumers by the services rendered solely by franchisees (i.e. appeal no. 0045506-36.2009.8.26.0114 issued by the 36 <sup>th</sup> Chamber of the São Paulo State Court of Appeals). In some cases, the franchisor was able to demonstrate that the franchisee's conduct was not in	The agreement should establish a clause under which the franchisee or master franchisee holds the franchisor harmless from any possible claims derived from its activities in the territory, such as, but not limited to, consumers', employment and tax claims, confirming franchisor's right of recourse in case of any possible condemnation by Brazilian courts. Franchisor should be able to demonstrate that franchisee's actions are in violation of the agreement, the manuals, its instructions and/or the standards of the relevant chain, in order to minimize the chances of being held vicariously liable before end consumers. We highlight that in cases, where franchisor is a company located abroad, the chances of either

<sup>3</sup> Brazil, contributed by Luiz Henrique O. do Amaral, Dannemann Siemsen, Rio de Janeiro ([amaral@dannemann.com.br](mailto:amaral@dannemann.com.br)).

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
		and required to indemnify end consumers, article 88 of the CDC grants it recourse against the franchisee, if, the claim was due to franchisee's fault in operating the franchised business.	accordance with the franchisor's instructions in the operating manuals, soothe franchisor should also be indemnified by the franchisee for damages related to the reputation of the franchise chain.	Brazilian consumers, employees or tax authorities pursuing franchisor for any obligations and debts incurred by master franchisee/ franchisee are very reduced.
		<p>Employment claims: Brazilian labor laws establish joint liability for employment claims filed by the employees by all company members of the same economic group.</p> <p>Brazilian Franchise Law expressly states, in the definition of the franchise relationship, that the relationship between franchisors and franchisees is not one of employment.</p> <p>Based on the above and the fact that in most cases franchisees and franchisors are independent parties, the franchise relationship should not fall into the concept of "members of the same economic group" in Brazilian labor law, for the purposes of joint liability of the franchisor for the franchisee's employees.</p>	<p>Brazilian case law shows, generally appreciates that franchisors and franchisees do not fall into the concept of "members of the same economic group" in Brazilian labor law. Therefore, generally Brazilian courts do not hold franchisors liable for any franchisee's employment obligations, except in cases of fraud.</p> <p>The 3<sup>rd</sup> Panel of Labor Court (process no. RR-64700-50.2007.5.13.0002) issued has a decision confirming that article 2 of Law no. 8,955/94 (Franchising Law) does not establish liability of the franchisor for the labor debts of franchisee.</p>	
		<p>Tax duties: According to Brazilian tax law, people who have common interest on the situation consisting of the tax generating event are jointly liable for the resulting tax regardless of being the actual taxpayer.</p> <p>However, in principle, this "common interest" tax liability</p>	No.	Stipulate that the franchisee is solely responsible for its operation and any possible claim derived there from (such as, but not limited to, consumers', employment and tax claims). It is also important that franchisors exercise their rights to audit franchisees' books of accounting

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
		would most likely not be applied in a franchising context, given the independence of the business and financial affairs of franchisors and franchisees.		and financial records.

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
Canada <sup>4</sup>	Vicarious liability for acts of franchisee	If the franchisee were held to be the employee or agent of the franchisor. But this unlikely to be the case.	In <i>Toshi Enterprises Ltd. V. Coffee Time Donuts Inc.</i> (2008), 246 O.A.C. 17 (Div. Ct.) the court dismissed a claim against a franchisor in respect of smoke damage to the plaintiff's restaurant as a result of a fire which emanated from the neighbouring premises operated by the franchisee. The court held that it was clear that the owner of the franchise was an independent contractor and not an employee of the franchisor. However, in <i>Boardman v. Pizza Pizza Ltd.</i> (2002), 30 C.P.C. (5 <sup>th</sup> ) 384; 2000 Carswell Ont 1465 the court refused to strike a claim against the franchisor for injurious falsehood, negligence, negligent misrepresentation, false arrest and malicious prosecution arising from an incident in which the plaintiff was involved in an altercation with a delivery person employed by the franchisee. In declining to summarily dismiss the claims against the franchisor based on vicarious liability, the court held that the nature of relationship between the franchisor and the delivery person would be better	Ensure agreement explicitly denies and disclaims employment and agency relationship. Avoid use of franchisor's trademarks in franchisee's corporate name.

<sup>4</sup> Canada, contributed by Larry Weinberg, Cassels Brock, Toronto ([lweinberg@casselsbrock.com](mailto:lweinberg@casselsbrock.com)).

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
			determined by a trial judge.	
	Misleading or deceptive conduct.	If the franchisor has knowledge of or participates in conduct which is misleading to consumers, there could be liability. However, in the absence of such knowledge or participation, the franchisor has a due diligence defence (e.g. <i>Competition Act</i> , R.S.C. 1985, c. C-34)	No	Avoid exerting too much control over day to day operations (although retain right to mandate standards of operation).
	Agency principles	Despite provisions in the franchise agreement, the franchisor can clothe the franchise with apparent authority to contract on the franchisor's behalf.	In <i>Beuker v. H &amp; R Block Canada Inc.</i> , [2001] 10 W.W.R. 274 (Sask. Q.B.) the franchisor was held liable for a tax reassessment resulting from the negligence of its franchisee, on the basis that the franchisee had apparent authority to act on the franchisor's behalf because all correspondence and advertising referenced the franchisor, and did not distinguish it from the franchisee. See also: <i>Fraser v. U-Need-A-Cab</i> (1983), 43 O.R. (2d) 3889, aff'd 50 O.R. (2d) 281 (C.A.) (owner/broker of taxi liable for breach of warranty when passenger injured while alighting from vehicle; no vicarious liability for failure of driver to properly maintain vehicle, but breach of common law duty of common carrier to select reasonably competent independent contractor).	Provide explicit notice to the public that business operated under license by franchisee, who is an independent contractor.

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
<i>England and Wales</i> <sup>5</sup>	Vicarious Liability	If the franchisor takes too much control of the day-to-day operations of the franchisee, this could give rise to the claim that the relationship is akin to an employment or agency. Even if a court could not find such a relationship, it may be argued that the franchisee is an agent or partner by estoppel. This would arise where one party represents by words or conduct that another person is his agent or partner such that he will not be allowed to later deny such a relationship. The effect of these matters on the mind of the third party, who may think he is dealing with one entity, is crucial. Such a claim is more difficult today given that franchising has become so prevalent.	There is little English case law on these matters in a franchising context. However, in the employment case of <i>Massey v Crown Life Assurance Co</i> [1978] 1 WLR 676, at 680, Lord Denning made clear that a court will look to the substance of the relationship between the parties.	The franchise agreement should be drafted to make it clear that there is no partnership, agency, employment or joint venture relationship between the parties. However, as the court will look to the substance of the relationship, it is prudent to limit control to preserving or enhancing the goodwill in the mark. Communications of the franchisee should make it clear that it is an independent business operating under the licence of the franchisor.
	Disguised employment	If franchisor controls and manages franchisee's personnel	Yes	Avoid management of franchisee's personnel

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<sup>5</sup> England, contributed by Mark Abell, Field Fisher Waterhouse, London ([mark.abell@ffw.com](mailto:mark.abell@ffw.com)).

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
<i>France</i> <sup>6</sup>	De facto management (including de facto partnership with sharing of profits and losses)	When actions taken by the franchisee are dictated by the franchisor or when franchisor interferes in the management of the franchisee's business, either directly through decisions imposed by the franchisor or indirectly through the selection of third parties by the franchisor.	Yes, including a franchisor being made jointly liable for the bankruptcy of the franchisee.	<ol style="list-style-type: none"> <li>1. Denying partnership relationship in the franchise agreement.</li> <li>2. In the franchise agreement, ensure that the running of the franchised business and day-to-day operations are the responsibility of the franchisee.</li> <li>3. In the franchise agreement, emphasize the franchisor's role in system enforcement rather than on franchisee day to day management controls.</li> <li>4. In the franchise relationship itself, avoid overly interfering.</li> <li>5. Document any specific action the franchisor requires as specific or temporary (financial crisis, etc).</li> </ol>
	Vicarious liability for acts of franchisee.	<ol style="list-style-type: none"> <li>1. When franchisee specifically acts as agent of the franchisor (e.g. when the franchisee is appointed to service national clients on behalf of franchisor or represents that it can bind the franchisor).</li> <li>2. When customers could reasonably believe that the franchisee is an agent of the franchisor (under the theory of apparent authority) or that the</li> </ol>	Yes	Deny agency in the franchise agreement. Ensure franchisee identifies itself as an independent business by posting the "independent franchisee status" sign in the premises (legal obligation under so-called " <i>rête Neiertz</i> "), registering a separate business name including as domain name, telephone books, etc; clear indication on letterhead and

<sup>6</sup> France, contributed by Remi Delforge, Donald Manasse & Remi Delforge Avocats Associes ([delforgelaw@rivieramail.com](mailto:delforgelaw@rivieramail.com)).

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
		franchised operation is a branch of the franchisor.		business cards etc and cash register tickets should not indicate the franchisor's name. Audit how the franchisee represents itself.
		When the franchisee is deemed to be an employee of franchisor under specific criteria (including when franchisor sets prices for resale) or when franchisor exerts a power of direction and control over the franchisee, putting the latter in a situation of dependence.	Yes.	Deny employment relationship (but French courts can rename contract). By franchisor not setting prices for franchisee or reserving management controls over the franchised business (e.g. hiring of franchisee personnel, etc). Draft obligations under the franchise agreement as system enforcement measures rather than personal obligations on franchisee (e.g. opening hours, hiring and staffing criteria, etc).

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
<i>Germany</i> <sup>7</sup>	Vicarious liability for acts of franchisee (§§ 164, 242 BGB)	If a third party assumes that the franchisee is acting on behalf of the franchisor and the franchisor knows this and does not mind, or the franchisor does not know this but should have known this, The franchisee is considered to be an agent of the franchisor.	BGH JW 2008, 1214 OLG Jena OLGR Jena 1999, 357	Deny agency in the franchise agreement. Ensure franchisee identifies itself as an independent business (including by registering a business name). Ensure that the franchisee has to bear the liability in the internal relationship.
	Misleading business conduct (§§ 3, 5, 5a, 8 I, II UWG)	Similar to above. The franchisee could be considered to be an authorised agent in the sense of § 8 II UWG. Competitors and other market participants could claim misleading omissions by the franchisor.	BGH GRUR 1995, 605, 607	Similar to above.
	Disguised employment (§ 28 e SGB IV; § 831 BGB;)	The franchisor could be liable for the social insurance contributions in relation to the franchisee (§ 28 e SGB IV).	No.	Similar.
		Under certain circumstances, the franchisor could be liable under § 831 BGB, if the franchisee is considered his authorised agent in the sense of § 831 BGB.	No.	Ensure that the franchisee himself employs someone.

<sup>7</sup> Germany, contributed by Karsten Metzloff, Nörr Stiefenhofer Lutz, Berlin, Germany ([karsten.metzloff@noerr.com](mailto:karsten.metzloff@noerr.com))

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
<i>Italy</i> <sup>8</sup>	Vicarious liability for acts of franchisee is a liability in tort (based on art. 2043 of the civil code)	If franchisee acts as an agent of franchisor and the third party relies in good faith on the fact that the franchisor and the franchisee are the same entity. If the third party relies in good faith on the fact that the franchisee belongs to a well reputed franchise network and therefore has the same commercial standing and integrity of franchisor.	Yes	Ensure franchisee identifies itself with third parties as an independent entity. Monitor and control franchisee's conduct in this respect. Carefully select franchisees effecting prior due diligence.
	Disguised employment	If franchisor controls and manages franchisee's personnel	Yes	Avoid management of franchisee's personnel
	Liability regime applying to the corporate group (art. 2497 of the civil code)	Abusive control of franchisee's business	Yes, but franchisor's liability was denied	franchise agreement not to give franchisor powers to direct franchisee's business; Avoid abuse of existing powers to direct franchisee's business.

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<sup>8</sup> Italy, contributed by Francesca Romana Turitto, Roma Lepri & Partners; Rome, ([francesca.turitto@studiolegalerlp.com](mailto:francesca.turitto@studiolegalerlp.com)).

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
<i>Malaysia</i> <sup>9</sup>	Vicarious liability for acts of franchisee	Section 4 of the Malaysian Franchise Act 1998 provides that the franchisor-franchisee relationship is not to be regarded as a partnership, service contract or agency. Therefore, vicarious liability under those categories will not arise. However, if the franchisor exercises such a high degree of control over the franchisee that the franchisor and franchisee may be said to be in a “special relationship”, justifying the imposition of vicarious liability.	No cases specifically on point but the case of <i>Tan Eng Siew &amp; Anor v. Dr. Jagjit Singh Sidhu &amp; Anor</i> [2006] 5 CLJ 175 lays down the general tests to be applied when determining whether a “special relationship” exists to establish vicarious liability. The tests involve looking at how much control the franchisor has over the franchisee, whether the franchisee’s acts were integral to the business of the franchisor, as well as the circumstances of the relationship (i.e. a common sense approach is taken).	Ensure that any control which the franchisor exercises over the franchisee is no more than necessary.
		If franchisee is the employee of the franchisor. However, this is unlikely to be the case because section 4 of the FA also provides that the franchisee operates the business “separately from the franchisor”.	No cases specifically relating to franchise liability but in <i>Market Investigations Ltd v. Minister of Social Security</i> [1969] 2 QB 173, it was held that where a person performed services “as a person in business on his own account”, there is no employment relationship.	Deny employment relationship in the Franchise Agreement.
	Employment law	If the franchisee is an independent contractor of the franchisor and the act complained of is a recognised exception to the general rule that an employer is not responsible for the acts of its independent	The Federal Court in <i>Datuk Bandar Dewan Bandaraya Kuala Lumpur v Ong Kok Peng &amp; Anor</i> [1993] 3 CLJ 205 recognised 2 exceptions to the general rule: Where an employer has not exercised care in selecting a	Deny that the franchisee is an independent contractor of the franchisor in the Franchise Agreement.

<sup>9</sup> Malaysia, contributed by Brian Chia, Wong & Partners, Kuala Lumpur ([brian.chia@bakermckenzie.com](mailto:brian.chia@bakermckenzie.com)).

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
		contractors.	competent contractor. Where the duty to take care is said to be “non-delegable”. A non-delegable duty to take care means in effect that the employer would have to see to it that such duty of care is exercised and if it is not, he would be held equally liable.	
	Ostensible authority/ agency by estoppel	If the franchisor represents that the franchisee is its agent or allows the franchisee to represent itself as such, it could be liable for the franchisee’s conduct because the franchisee may be held to have ostensible authority to act on behalf of the franchisor, even though there is no actual authority given. The relationship of “ostensible authority” may be said to have created an agency by estoppel. The Federal Court cases of <i>Chew Hock San &amp; Ors. V Connaught Housing Development Sdn. Bhd.</i> And Another Case [1985] 1 CLJ 533 and <i>Chan Yin Tee v William Jacks &amp; Co (Malaya) Ltd</i> [1964] 1 LNS 18 set out the general principles to be applied.	No cases on point.	Regularly audit how the franchisee represents itself to ensure that it does not mislead third parties into thinking that the franchisee has authority to act on behalf of the franchisor. It is advisable that the franchisor make it a requirement that any documents, signs, displays etc. of the franchisee contain a notice to the effect of: “A franchise of ABC (the franchisor) owned and operated by DEF (the franchisee)”.

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
<i>Mexico</i> <sup>10</sup>	Vicarious liability for acts of franchisee	Vicarious liability is not recognised in Mexican law.	No	N/A
	Agency, Legal Representation and/or Employment	<p>If the franchisee acts as agent of the franchisor and, within the scope of its authority, performs acts in the name and on behalf of the franchisor or even in its own name but on behalf of the franchisor.</p> <p>If the franchisee is a legal representative or attorney-in-fact of the franchisor and, within the scope of its authority, performs acts in the name and on behalf of the franchisor or binds the franchisor in any manner.</p> <p>If the franchisee is an employee of the franchisor. In this case, the franchisor may be responsible for acts of the franchisee.</p>	<p>No</p> <p>Yes</p> <p>Yes</p>	<p>Include a provision in the franchise agreement stating that they are independent contractors and that the relationship between franchisor and franchisee is not and may not be construed as an agency, legal representation, mandate, employment, joint venture or partnership. Likewise, it is important to ensure that franchisee identifies itself as an independent business. Additionally, it is suggested not to grant powers of attorney to a franchisee that may empower the franchisee to bind the franchisor.</p>
	Misrepresentation	If a franchisee makes a misleading representation of which the franchisor is aware, the franchisor could be equally liable for the representation.	Yes	Franchisors should rectify or amend incorrect or incomplete representations a franchisee makes, if it becomes aware of them.

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<sup>10</sup> Mexico, contributed by Jorge Mondragon, Gonzalez Calvillo SC ([jmondragon@gcsc.com.mx](mailto:jmondragon@gcsc.com.mx)).

<b>Jurisdiction</b>	<b>Possible source of liability</b>	<b>How might it arise?</b>	<b>Are there any cases on the subject?</b>	<b>How could the risk be minimised?</b>
	Intermediary business under articles 12 and 13 of the Mexican Federal Labour Law.	If a franchisee hires personnel and uses the franchisor's materials, elements and/or resources for the ultimate benefit of franchisor, the franchisee may be considered as an intermediary and/or the franchisor may be considered as the final beneficiary of the services. In this case, the franchisor is jointly liable for the franchisee's employees.	Yes	By including a provision in the franchise agreement agreeing that, with respect to articles 12 and 13 of the Mexican Federal Labor Law, the franchisee is not an intermediary and that it has the necessary and sufficient material and human resources to perform its obligations under the franchise agreement.
	Liability for personal injury from non-compliance with laws	If a franchisee fails to comply with a law and a personal injury occurs as a result, the failure may cause a third party (franchisee's client, customer, supplier, a governmental entity, etc.) to suffer damages or losses. The third party may claim that the franchisor is responsible for the damages or losses, by allowing the franchisor to be identified with the licensed trademarks.	Yes	By including a provision in the franchise agreement that the franchisor expressly assumes no responsibility to third parties for the failure of franchisee to comply with any applicable law or the franchise agreement or for any acts of the franchisee in the operation of the franchised business.

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
<i>New Zealand</i> <sup>11</sup>	Vicarious liability for acts of franchisee	If franchisee acts as agent of franchisor <u>and</u> franchisee acts within the scope of its authority <u>and</u> franchisor controls the manner of performance (control without actual authority as agent unlikely to be sufficient to create agency). Potential liability depends on the nature and extent of franchise relationship. Liability may also arise through agency by estoppel or ostensible authority.	No cases specifically on vicarious liability in relation to franchisors' liability for franchisee's acts and/or omissions vis-à-vis third parties.	Deny agency in the franchise agreement. Ensure franchisee identifies itself as an independent business. For example, signage and stationery should emphasise the independent nature of the franchise relationship.
		If franchisee is the employee of the franchisor. Unlikely if the franchisee is a corporation or other entity.	Cases establish that employers may be vicariously liable of the acts of their employees. No recent cases considering whether franchisee is, in fact, employee. However, recent Employment Court case establishes that employees of franchisee may be able to claim they are, in fact, employees of franchisor where close connection/control exists ( <i>McDonald v Ontrack</i> [2010] NZ Employment Court 132).	Deny employment relationship in agreement. However, as wording of agreement is not sufficient to establish there is no employment relationship, also ensure relationship is at arm's length- e.g. franchisee contracts through a company, is responsible for own taxes, levies etc and provides own equipment.
		Franchisor may have liability as controller of franchisee's workplace.	Health and Safety in Employment Act 1992, s 16	Agreement to state that franchisee is responsible for controlling its own workplace and for ensuring compliance with health and safety legislation on

<sup>11</sup> New Zealand, contributed by Earl Gray, Simpson Grierson, Auckland ([earl.gray@simpsongrierson.com](mailto:earl.gray@simpsongrierson.com)).

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
				site. This must also happen in practice – e.g. franchisee to develop health and safety policies for site.
	Misleading or deceptive conduct/ misrepresentation	If the franchisor and franchisee have a relationship of agency, the franchisor could be liable for the franchisee's acts as the principal.	Fair Trading Act 1986 ss 9, 43 and 45; see also <i>Commerce Commission v Vero Insurance New Zealand Ltd</i> (2006) 11 TCLR 779 at [49-65] for a discussion on agency under the Fair Trading Act 1986.	Regularly audit how the franchisee represents itself. A franchisor should correct incorrect or incomplete representations a master franchisee makes, if it becomes aware of them.
	Misrepresentation	Similar to above.		As for above.

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
<i>Russia</i> <sup>12</sup>	Secondary (subsidiary) and/ or joint and several liability of the franchisor for the acts of the franchisee	The franchisor is subsidiarily liable for the claims brought against the franchisee with regard to quality of goods / services sold / performed / rendered under a franchise agreement. The franchisor is jointly and severally liable with the franchisee with regard to the claims brought against the franchisee as a manufacturer of the products (goods).	No.	Contractually oblige a franchisee to compensate a franchisor for all damages, costs and expenses caused by such claims.  Use special purpose vehicles or sub-licensing structures to mitigate the franchisor's exposure.

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<sup>12</sup> Russia, contributed by Margarita Divina, Baker & McKenzie, Moscow ([margarita.divina@bakermckenzie.com](mailto:margarita.divina@bakermckenzie.com)).

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
<i>South Africa</i> <sup>13</sup>	Vicarious liability	<p>If the franchisee acts as the franchisor's agent where the franchisor grants authority to the franchisee to bind it.</p> <p>If the franchisee is an employee of the franchisor it is very unlikely that a franchisee will be an employee of the franchisor. However, where control over the franchisee is excessive and is similar to the control over an employee, vicarious liability may arise.</p>	<p>Many cases exist on vicarious liability of employees. For instance, <i>Feldman v Mal 1945 AD 733 735</i>.</p>	<p>Refrain from conduct that might imply that authority to bind the franchisor has been granted. Ensure that agreements do not authorise any acts on behalf of the franchisor, unless written authority is provided. Refrain from 'blanket approval' i.e. granting authority to perform certain acts on the franchisor's behalf without requiring new written authority for every transaction.</p> <p>The agreement should not create obligations that are, in substance, similar to those of employment or agency.</p>
	Insolvent trading	<p>S424 of the South African Companies Act, 1973 provides that a person may be personally liable for the debts or other liabilities of a company, if it appears, on winding up, that the business of the company was being carried on recklessly, or with an intent to defraud creditors and such person was party to the carrying on of the business in this manner.</p> <p>This could apply in instances where the franchisor directs the business of the franchisee in a</p>	<p>None involving franchisors. However, there are cases where companies have been investigated for potential liability, e.g. <i>Simon NO v Mitsui &amp; Co Ltd</i>.</p>	<p>Provide guidelines on conducting the franchised business without becoming personally involved in the franchisee's business. Audit the franchisee's activities to ensure that conduct does not expose the franchisor to liability.</p>

<sup>13</sup> South Africa, contributed by Andre Visser, Adams & Adams ([AV@adamsadams.co.za](mailto:AV@adamsadams.co.za)).

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
		certain manner, or where the franchisor ostensibly allows the franchisee to carry on the business, in that manner.		
	Wrongful Omissions	South African law recognises liability for damages where a party fails to act where there was a "legal duty" on it to act positively. For example, where the franchisee breaches the franchise agreement continuously, for instance providing sub-standard burgers, and the franchisor allows this to continue and a person is injured by the franchisee, courts may find that there was a legal duty on the franchisor to prevent this conduct.	None involving franchises.	Enforce breaches of the franchise agreement strictly where the breach might subject the franchisor to a claim. Provide for enforcement or termination for continuous breaches or non-compliance.
	Estoppel	Estoppel applies where a misrepresentation is made and a person, relying on this misrepresentation, acts to its detriment. Instances where this could be relevant is where the franchisor negligently allows the franchisee to make a misrepresentation causing customers or third parties to act to their detriment.	Many cases exist on estoppel however not specifically for franchises. See <i>Fawden v Lelyfeld</i> and <i>NBS Bank Ltd v Cape Produce Co (Pty) Ltd and Others</i> .	Monitor how the franchisee represents itself and take remedial action if necessary.

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
<i>Spain</i> <sup>14</sup>	Vicarious liability for acts of franchisee	The franchisor can be held liable for the acts of the franchisee if: 1. the franchisee is really acting on behalf of the franchisor, and not as an independent contractor; or  2. if the franchisor and the franchisee can be considered to be a sole company.	Yes	Be clear in the franchise agreement that the franchisor and the franchisee are independent one from each other.
	Disguised employment	If the franchisor controls the franchisee's staff in a way it can be understood that the franchisee's staff is really working for the franchisor (i.e., is taking the franchisor's orders)	Yes	Be clear in the franchise agreement that the franchisor and franchisee are independent. Also, the franchisor should avoid exercising any power of decision over the franchisee's staff.

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<sup>14</sup> Spain, contributed by Alberto Echarri, Gomez-Acebo & Partners, Madrid ([aecharri@gomezacebo-pombo.com](mailto:aecharri@gomezacebo-pombo.com)).

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
<i>Turkey</i> <sup>15</sup>	Vicarious liability for acts of franchisee	If a franchisee is granted the authority to represent a franchisor and if the franchisee acts in the name of the franchisor and within the scope of its authority, the franchisor will be liable for the acts of the franchisee. This type of liability may also arise in case the franchisee acts as if it has the authority to represent the franchisor and if the franchisor remains silent and allows the franchisee to represent itself as being its agent or the franchisor consents to the acts of the franchisee.	No direct decisions regarding franchise agreements. However, there are some decisions with regard to relationships between an agent and a principal.	Include a provision in the franchise agreement which explicitly states that the agreement does not constitute an agency relationship and that the franchisee acts on its own name and behalf and as an independent entity.
	Wrongful/Tortious act	Liability arising from a wrongful/tortious act is personal. In principle, the franchisor cannot be held liable for the tortious acts of the franchisee such as deceptive or fraudulent acts of the franchisee. However, if the franchisor and the franchisee jointly commit an illicit act or the franchisor contributes to the wrongful act of the franchisee the franchisor may be held liable for the wrongful act of the franchisee.	No.	

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<sup>15</sup> Turkey, contributed by Sebnem Isik, Mehmet Gun & Partners, Istanbul ([sebnem.isik@gun.av.tr](mailto:sebnem.isik@gun.av.tr)).

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
	Employment law	<p>Turkish law recognises the franchisee as independent from the franchisor. However, even it is a slight possibility, the relationship between the parties may be interpreted as an employment relationship and the franchisee can be deemed personally dependent on the franchisor, if the franchisee is in all manners subject to the instructions of the franchisor and to the control of the franchisor. In such a case, the franchisor, as an employer, will be held liable for the acts of its employee (the franchisee).</p>	No.	<p>Include a provision in the franchise agreement which explicitly states that the agreement does not constitute an employment relationship and that the franchisee acts on its own name and behalf and as an independent individual or a legal entity.</p>

Jurisdiction	Possible source of liability	How might it arise?	Are there any cases on the subject?	How could the risk be minimised?
<i>United States</i> <sup>16</sup>	Vicarious Liability	U.S. common law generally recognizes that principals are responsible for the acts of their employee agents, but not for the acts of their independent agents. Where a franchisor has specific control over the “instrumentality of harm” that causes damage to a third party, such as a particular product or a particular technique, vicarious liability is likely, where, however, the franchisor lacks control, such as over a franchisee’s employee’s day-to-day activities, vicarious liability is unlikely.	Several that vary from state to state.	While specific recognition of the parties’ independent relationship in the franchise agreement is helpful, courts instead often focus on the actual relationship between the parties and the franchisor’s legal right to control how the franchisee runs its business. Whether exercised or not.
	Employment Law	Under certain federal and state laws, franchisors may be vicariously liable if they are a “joint employer” or “single employer” of a franchisee’s employees. Although uncommon, this happens where the franchisor imposes certain personnel policies on its franchisees and those policies are discriminatory or the franchisor has the right to review and control a franchisee’s employee’s day-to-day work.	Yes.	Allow franchisees to maintain control over employee relations and day-to-day personnel matters. Ensure that franchisees adopt their own employee policies and not those of franchisor.

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<sup>16</sup> United States, contributed by Gregg Rubenstein, Nixon Peabody, Boston ([grubenstein@nixonpeabody.com](mailto:grubenstein@nixonpeabody.com)).

<i>Vietnam</i> <sup>17</sup>	Vicarious liability for acts of franchisee	If franchisee acts as agent of franchisor.	No.	Deny agency in the franchise agreement.
	Employment law	If franchisee is the employee of the franchisor. This could not arise if the franchisee is a corporation or other entity.	No.	Deny employment relationship in the franchise agreement.
	Misleading or deceptive conduct	If the franchisor allows the franchisee to represent itself as being the franchisor or its agent, it could be liable for the franchisee's conduct.	No	Regularly audit how the franchisee represents itself. A franchisor should correct a franchisee's misleading or deceptive conduct, if it becomes aware of them.

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