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Patterson v. Domino's Pizza LLC. Clarity on Franchisor Liability, California Style

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On August 28, 2014, the California Supreme Court in *Patterson v. Domino's Pizza, LLC*, No. S204543, addressed what, before now, has been an unsettled question of California law: "Does a franchisor stand in an employment or agency relationship with the franchisee and its employees for purposes of holding it vicariously liable for workplace injuries allegedly inflicted by one employee of a franchisee while supervising another employee of the franchise."[i]

The answer, said the Court, lies "in the inherent nature of the franchise relationship itself." In light of the new business realities that have seen a growth in the franchise business, the Court refused to assign liability simply on the basis of a "comprehensive operating system" implemented by a franchisor. "The imposition and enforcement of a uniform marketing and operational plan cannot *automatically* saddle the franchisor with responsibility for employees of the franchisee who injure each other on the job." Instead, a franchisor "becomes potentially liable for actions of the franchisee's employees only if it has retained or assumed a general right to control other factors such as hiring, direction, supervision, discipline, discharge, and relevant day-to-day aspects of the workplace behavior of the franchisee's employees."

The *Patterson* decision provides much-needed clarity to both franchisees and franchisors, who may have previously made an attractive target for claims by employees of franchisees even though the franchisors did not inject themselves into the day to day employment decisions of the franchisees, and had no way of proactively protecting themselves from liability.

Background

Patterson, a former female employee of a Domino's Pizza ("Domino's") franchise store ("Franchisee"), brought an action for sexual harassment she allegedly suffered at the hands of the Franchisee's manager, Renee Miranda ("Miranda"). Patterson complained to the Franchisee, who initiated an investigation of the harassment. Patterson also complained to her father, who called Domino's customer service number to lodge a complaint on his daughter's behalf. Domino's (the franchisor) took no steps to investigate the complaint and issued no employment directives to the Franchisee. Franchisee's investigation was inconclusive, but when Miranda stopped coming to work, he "self-terminated." Patterson, likewise, resigned and brought a lawsuit under the Fair Employment and Housing Act ("FEHA").

Arguing that it was not Patterson's employer, Domino's moved for summary judgment. Domino's presented evidence that it and the Franchisee had distinct legal identities and corporate structures; that they shared no officers or directors; that Domino's had no access to Franchisee's banking accounts; and that Franchisee filed its own tax returns, obtained all necessary business licenses and operating permits, maintained property and liability insurance, made its own recruiting, interviewing, hiring, and termination decisions, trained its employees (including on sexual harassment), promulgated its own "zero tolerance" sexual harassment policy, and investigated the conduct in question. Under the terms of the franchise agreement, Domino's "disclaimed any right or duty to operate the Store or to direct [the Franchisee's] employees in their jobs" and disclaimed the presence of any principal/agent relationship between Domino's and the Franchisee. Those functions were made "[Franchisee's] sole responsibility." Addressing specifically Patterson's evidence of a comment by Claudia Lee ("Lee"), Domino's area leader, which seemingly urged Miranda's termination, Domino's presented Lee's deposition testimony that she was not involved in hiring, discipline or termination of Franchisee's employees, and the only time she would make staffing recommendations would be if she saw an employee who was "hurting Domino's brand or endangering the franchise." Domino's further presented evidence that its corporate human resources department offered no guidance to franchisees on handling personnel issues. In exchange for the right to operate a Domino's franchise, Franchisee paid Domino's a royalty fee (calculated as a percentage of weekly sales).

Patterson opposed the motion for summary judgment, arguing that an employment relationship existed between her, Miranda, and Domino's. Patterson relied on the terms of the franchise agreement, deposition testimony and a Managers' Reference Guide ("MRG"), compliance with which was required under the franchise agreement. Specific to the MRG, Patterson submitted a portion related to employment matters, which stated that employees must receive training on any programs provided or approved by Domino's, detailed uniform and grooming standards, and prohibited certain behaviors related to alcohol and tobacco use. Patterson further relied on the Franchisee's deposition, where he described that he always felt compelled to say "yes" to a Domino's representative responsible for his area (Lee), that he "assumed" that any franchisee who did not "play ball" with the area leader might be "in jeopardy," "in trouble," or "out of business," and that Lee, in discussing the harassment matter, stated to Franchisee "You've got [to] get rid of this guy."

The trial court granted Domino's motion and determined that "Domino's did not control day-to-day operations or employment practices such that [the Franchisee] was an agent of Domino's, or that Miranda was an employee of Domino's." The Court of Appeal reversed, finding that "reasonable inferences could be drawn from the franchise contract and the MRG that [the Franchisee] lacked managerial independence" and that "Domino's meddled in [the Franchisee's] employment decisions."

The Supreme Court granted Domino's petition for review, limiting the issue to "determining a franchisor's potential liability for wrongful acts committed by one employee of a franchisee while supervising another employee of the franchisee."

Holding

The Supreme Court held that: "A franchisor will be liable [for a tort committed by a franchisee's employee] if it has retained or assumed the right of general control over the relevant day-to-day operations at its franchised location [such as hiring, direction, supervision, discipline and discharge], and cannot escape liability in such a case merely because it failed or declined to establish a policy with regard to that particular conduct." The Court refused, however, to assign liability based on a "comprehensive operating system alone," ruling that it did not constitute "'control' needed to support vicarious liability claims…."

The Supreme Court limited its holding to "determining the circumstances under which an employment or agency relationship exists as a prerequisite to pursuing statutory and tort theories like those alleged against the franchisor here."

Analysis

In reaching its conclusion, the Supreme Court noted the prevalence of franchise arrangements, and undertook a detailed examination of the economic realities of a franchising model of business operations.

Safer than a sole proprietorship, a franchise arrangement allows a franchisee to acquire the "right to sell products or services under the franchisor's name and trademark. In the process, the franchisee *also* acquires a business, plan, which the franchisor has crafted for all of its stores. The business plan requires the franchisee to follow a system of standards and procedures. A long list of marketing, production, operational, and administrative areas is typically involved. The franchisor's system can take the form of printed manuals, training programs, advertising services, and managerial support, among other things." In return, this business format allows "the franchisor to raise capital and grow its business, while shifting the burden of running local stores to the franchisee. The systemwide standards and controls provide a means of protecting the trademarked brand at great distances." All of this "benefits both sides to the contract" and is designed to "build and keep customer trust by ensuring consistency and uniformity in the quality of goods and services, the dress of franchise employees, and the design of the stores themselves."

By contrast, franchisors do not necessarily retain or acquire control in the area of personnel actions.

Vicarious liability, found the Court, will lie only when the franchisor exercises "control" over the "means and manner" of the franchisee's operations – but not in general; in the (relevant here) employment arena. "The terminology varies, but [prior decisions] have focused on the franchisor's lack of control over the 'instrumentality,' the 'conduct,' or the 'specific aspect of the franchisee's business' that **caused the alleged injury**."

"[P]otential liability [under FEHA] requires that the franchisor exhibit the traditionally understood characteristics of an 'employer' or 'principal;' i.e., it has retained or assumed a general right of control over factors such as hiring, direction, supervision, discipline, discharge, and relevant day-to-day aspects of the workplace behavior of the franchisee's employment." "The contract-based operation division that otherwise exists between the franchisor and the franchisee would be violated by holding the franchisor accountable for misdeeds committed by employees who are under the direct supervision of the franchisee, and over whom the franchisor has no contractual or operational control."

The focus of the *Patterson* decision rest squarely on the type of decisions Domino's left solely to the Franchisee versus those it tightly controlled. Falling in the latter categories were decisions related to the preservation of the Domino's pizza brand: Domino's "prescribed standards and procedures involving pizza-making and delivery, general store operations, and brand image."

Domino's disclaimed – verbally in depositions and in various policies and other documents – any involvement in personnel matters. The Franchisee hired both the offender and the complainant, trained both on harassment policies, received the complaint, initiated the investigation, and would have terminated the offender had he not quit. "The uncontradicted evidence showed that the [F]ranchisee imposed discipline consistent with his own personnel policies, declined to follow the ad hoc advice of the franchisor's representative, and neither expected nor sustained any sanction for doing so."

In *Patterson*, the Court answered in the negative the question whether Domino's exercised "control" over the "means and manner" of the franchisee's operations when it came to relevant *personnel* matters. In doing so, it drew express contrast with an earlier Court of Appeal decision in *Nichols v. Arthur Murray, Inc*.[ii], where a customer sued both the franchisee and the franchisor over cancelled dance lessons. In *Nichols*, the relevant question was control related to customer lessons. The court found that control rested with the franchisor who "retained the right to control the employment of all persons working in any capacity for the franchisee; to decide matters related to studio location, decoration, and advertisement; to set minimum tuition rates and select the institution handling student financing; to make student refunds and charge those amounts to the franchisee; to settle and pay all claims against the franchisor arising out of the operation of the business; to reimburse itself for the payment of any refunds, claims, or related litigation costs from a fund consisting of weekly payments by the franchisee; to invest the proceeds from this fund and pay the franchisee only such portion of the income as the franchisor saw fit; to dictate the manner in which unused dancing lessons would be honored among franchisees; and to require the franchisee to provide records on accounting, insurance and tax matters. … Such pervasive controls made the franchisor the party responsible for the franchisee's contractual obligations towards the plaintiff."

Conclusion

Future cases will likely further examine how the types of decisions left to the franchisee rather than retained by the franchisor, as well as the degree of involvement by the franchisor, will impact liability. In the meantime, the Court provided important guidance to both the litigants and the courts that it is not the quantity of the control in general, but the control over the relevant aspects of the relationship that should be analyzed when evaluating franchisor liability. To ignore such division – and, in this case, to use control in business matters to infer control of personnel matters – would "stand the franchise relationship on its head."

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[i] Opinion authored by Justice Baxter and joined by Chief Justice Cantil-Sakauye and Justices Chin and Corrigan. The dissent was authored by Justice Werdegar and joined by Justice Liu and Court of Appeal Justice Chaney. Dissenting justices found no fault with the Court's legal analysis, but disagreed with its factual application, writing that the majority opinion allows franchisors "in effect, to opt out of the statutory duties of a California employer."
[ii] 248 Cal. App. 2d 610 (1967).