Franchisor Liability to Third Parties

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Recommended Citation
John C. Monica, Franchisor Liability to Third Parties, 49 Mo. L. Rev. (1984)
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FRANCHISOR LIABILITY TO THIRD PARTIES

JOHN C. MONICA*

I. INTRODUCTION ........................................... 309
II. VICARIOUS LIABILITY .................................... 310
   A. Agency and Apparent Authority ...................... 310
   B. Using the Lanham Act to Defend Against an Assertion of Agency ................................. 317
III. DIRECT LIABILITY ....................................... 323
   A. Negligence ............................................. 323
   B. Products Liability ................................... 328
IV. CONCLUSION ............................................. 334

I. INTRODUCTION

The franchise has gained widespread acceptance as a means of distributing goods and services. It allows a developer of a product or service to operate through independent entrepreneurs, thereby reducing capital investment. The purchaser of a franchise benefits by sharing in the profits from the system. The close cooperation between franchisor and franchisee, necessary to make the system work smoothly, usually is reached through restraints imposed by the franchisor.

Antitrust law is perhaps most commonly associated with the franchisor-franchisee relationship. Many cases describe liability in this relationship through such concepts as tie-ins, resale price maintenance, and other vertical restraints. Injuries that third parties suffer, however, are not always caused by antitrust violations. They often arise from the commission of a tort or breach of contract by the franchisee. The injured party, searching for the deep pocket, seeks to impose liability on the franchisor using traditional agency concepts, negligence, and strict liability. This Article will explore some notable vicarious liability cases and articulate a defense based upon the Lanham Act (Act), as well as examine the emerging direct liability theories applied to franchisors.

* Mr. Monica is a partner with Shook, Hardy & Bacon, in Kansas City, Missouri, who specializes in franchise and antitrust law. Anne E. Goos, an associate at Shook, Hardy & Bacon, collaborated with Mr. Monica on this Article.

II. VICARIOUS LIABILITY

A. Agency and Apparent Authority

Plaintiffs frequently argue that the franchisee is an agent of the franchisor. This theory will be successful only if the franchisee was in fact an agent of the franchisor, and not merely an independent contractor. The plaintiff must prove that the franchisor actually controlled or had a right to control the franchisee’s conduct.

Agency is “the fiduciary relation which results from the manifestation of consent by one person that the other shall act on his behalf and subject to his control, and consent by the other to so act.” An independent contractor is “one who contracts to do something for another, but is not controlled by the other or subject to the other’s right to control” and for whose acts the other is not responsible. Control of or the right to control the means and manner of performance (as opposed to the ultimate result) distinguishes an agent from an independent contractor. Characterizing the agent as an independent contractor or disclaiming agency in a written contract is not dispositive of the question. It is the element of control in the relationship between the parties that is important.

Under the actual agency theory, a franchisor that sufficiently controls or reserves the right to control the franchisee may be vicariously liable for its franchisee’s acts. This presents franchisors with a dilemma. A certain degree of control is inherent and necessary in the relationship. The franchisor spends a considerable amount of time and money developing its product or service, which is often publicly identified with a recognized trademark or tradename. The franchisor knows that success depends upon consumer acceptance of the product and trademark. This acceptance depends on the franchisee’s operation. Thus, most franchisors have a keen interest in regulating the performance of their franchisees.

Absent an actual agency relationship, the franchisor may still be vicariously liable for the acts of its franchisee under an apparent authority theory. Plaintiffs often assert both theories, because factors that may support a finding of actual agency in a particular case, such as use of the franchisor’s logo or

2. Although an independent contractor by definition is not a servant, he may be an agent. RESTATEMENT (SECOND) OF AGENCY § 2(3) & comment b (1958). In this Article, the term “independent contractor” is given its colloquial meaning, excluding the independent contractor from the category of agent. See id. § 14N comment a.
uniformity of architecture and decor, may also be considered in finding apparent authority.\(^7\)

In most jurisdictions, apparent authority is created when the supposed principal causes a third party to reasonably believe that the supposed agent has the power to act on the principal's behalf, and the third party relies on the appearance of agency.\(^8\) The benefit of apparent authority is extended only to third parties who reasonably believe that authority exists because of appearances and who act in reliance thereon. The third party must deal in good faith with the agent on the face of the "holding out" by the supposed principal, reasonably believing that the agent has authority.

Apparent authority must arise from the acts of the alleged principal and not from acts of the agent; an agent cannot create his own authority.\(^9\) A person dealing with a supposed agent has a duty to ascertain the agent's authority, for the law does not presume that agency exists.\(^10\) Apparent authority is not established merely because a plaintiff claims that he believed authority was present or because it looked so to him and he acted on his conclusions.\(^11\)

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9. Jeff-Cole Quarries v. Bell, 454 S.W.2d 5, 13 (Mo. 1970); Dudley v. Dumont, 526 S.W.2d 839, 845 (Mo. Ct. App. 1975); Fielder v. Production Credit Ass'n, 429 S.W.2d 307, 313 (Mo. Ct. App. 1968). Apparent authority may be created when the purported principal acquiesces in acts of the purported agent indicating an agency relationship. See Drexel v. Union Prescription Centers, 582 F.2d 781, 796 (3d Cir. 1978) (question of fact whether franchisor who had unqualified right to inspect franchisee's premises had actual or constructive knowledge of franchisee's failure to hold itself out as the independent owner); RESTATEMENT (SECOND) OF AGENCY §§ 43, 49 (1958).

The franchisor should not be liable to an injured third party on an apparent authority theory in cases involving purely fortuitous torts, such as automobile accidents. The plaintiff cannot be said to have reasonably relied on any representations by the franchisor in encountering the franchisee. See Steele v. Armour & Co., 583 F.2d 393, 398 (8th Cir. 1978); McLaughlin v. Chicken Delight, Inc., 164 Conn. 317, 322, 321 A.2d 456, 460 (1973). But cf. Fernandez v. Thigpen, 278 S.C. 140, ———, 293 S.E.2d 424, 426 (1982) (franchisee's former employee killed in an accident while riding home from work with franchisee's assistant manager allowed to sue franchisor based on apparent authority).


Many courts have found the appearance or “holding out” of an agency relationship in the franchisor-franchisee context. Use of a trademark or trade name, advertising, distinctive architectural design, decor, employee uniforms, and other manifestations of uniformity lead consumers to believe that they are dealing with the franchisor. The willingness of the courts to find an agency relationship based on apparent authority underscores a danger inherent in the franchising concept. One of the greatest strengths of a franchise—public recognition of the trademark or name and the quality and uniformity associated with it—may become its greatest weakness: a manifestation of agency.

Certain factors frequently give rise to an agency relationship between the franchisor and franchisee. No one factor is controlling; the cumulative effect

1955); see also Erickson v. Civic Plaza Nat’l Bank, 422 S.W.2d 373, 380 (Mo. Ct. App. 1967) (test is whether a person of ordinary prudence is justified in presuming agent’s authority).


Service stations and automobile dealers may be unique because it is “common knowledge” that trademarks are displayed by these independent dealers. Reynolds v. Skelly Oil Co., 227 Iowa 163, 171, 287 N.W. 823, 827 (1939); Diaz v. GIMAC Marina, Inc., [1983] BUS. FRANCHISE GUIDE (CCH) ¶ 7916, at 13,433 (N.Y. Sup. Ct. Jan. 7, 1983) (no agency found where oil company did not hire, train, or compensate service station employees and station was not bound to sell company’s products); see also Drexel v. Union Prescription Centers, 582 F.2d 781, 796 n.23 (3d Cir. 1978) (advertising bearing oil company’s name does not alone raise an agency issue for the jury).

13. In Beck v. Arthur Murray, Inc., 245 Cal. App. 2d 976, 54 Cal. Rptr. 328 (1966), the court disregarded the franchisor’s reasonable effort to avoid the appearance of agency between itself and its franchisee. The franchise agreement required the franchisee to “conspicuously” display a sign that identified it as a licensee solely responsible for its own acts. Id. at 978, 54 Cal. Rptr. at 329. The court found apparent agency even though the plaintiff did not show that she believed that the franchisee was the agent of the franchisor. Agency was found because no one told the plaintiff that the franchisee owned the business nor called her attention to the disclaimer. Id. at 979, 54 Cal. Rptr. at 330; see also McDonald v. Century 21 Real Estate Corp., [1983] BUS. FRANCHISE GUIDE (CCH) ¶ 7975, at 13,629 (Wis. Ct. App. April 4, 1983) (plaintiffs reasonably relied on their “impression” that the franchisee represented the franchisor despite disclaimers in contracts and advertising).
of the factors present is considered. Some of the pertinent factors include the franchisor's right to control or control over the day-to-day details of the franchisee's business operation, including: the hiring, firing, wages, benefits, promotions, uniforms, or training of the franchisee's employees;\footnote{14} prices the franchisor will charge its customers;\footnote{16} financial methods and record-keeping or reporting requirements;\footnote{16} quantity and quality of goods on hand or form of

14. \textit{See, e.g.}, Drexel v. Union Prescription Centers, 582 F.2d 781, 787 (3d Cir. 1978) (franchise agreement required franchisee to exercise best efforts to secure union labor and utilize franchisor's uniforms); Nichols v. Arthur Murray, Inc., 248 Cal. App. 2d 610, 615, 56 Cal. Rptr. 728, 732 (1967) (agreement conferred on franchisor the right to control employment of all franchisee's employees); Singleton v. International Dairy Queen, 332 A.2d 160, 162 (Del. Super. Ct. 1975) (agreement required all franchisee's employees to wear franchisor-approved uniforms); Becker v. Aschen, 344 Mo. 1107, 1116, 131 S.W.2d 533, 538 (1939) (dealership agreement required dealer's employees to wear oil company's uniforms). \textit{But see} Ortega v. General Motors Corp., 392 So. 2d 40, 42-43 (Fla. Dist. Ct. App. 1980) (no agency found even though agreement required that franchisee's employees be trained by franchisor, but did not allow franchisor to regulate the franchisee in their hiring, firing, or supervision); Holiday Inns v. Newton, 157 Ga. App. 436, 437, 278 S.E.2d 85, 86 (1981) (no agency found where agreement did not give franchisor control over franchisee's employees or other details of the franchisee's business); Slates v. International House of Pancakes, 90 Ill. App. 3d 716, 727, 413 N.E.2d 457, 465 (1980) (no agency found where agreement allowed for training and supervision of franchisee's restaurant managers, training standards, and promotions); Coty v. United States Slicing Mach. Co., 58 Ill. App. 3d 237, 240, 373 N.E.2d 1371, 1374 (1978) (no agency found where franchisor could not hire or fire employees, could not stop work in the restaurant immediately, and could not give any orders to franchisee's employees, and where the franchisor's only remedy on the franchisee's breach of any franchise covenant was to terminate the entire franchise agreement); B.P. Oil Corp. v. Mabe, 279 Md. 632, 635, 370 A.2d 554, 557 (1977) (no agency or apparent authority found where franchisee hired, fired, and paid his own employees, and provided his own uniforms); Stanford v. Dairy Queen Prods., 623 S.W.2d 797, 802 (Tex. Civ. App. 1981) (no agency found where franchisee hired, supervised, and paid his own employees, even though franchisor provided employee training services, and required uniforms and other employment practices); Murphy v. Holiday Inns, 216 Va. 490, ———, 219 S.E.2d 874, 877 (1975) (no agency found even though agreement required franchisor training of certain franchisee staff members and prohibited employment of persons engaged in competitive businesses).

15. \textit{See, e.g.}, Nichols v. Arthur Murray, Inc., 248 Cal. 2d 610, 615, 56 Cal. Rptr. 728, 732 (1967) (agreement gave franchisor right to fix the minimum rates charged franchisee's clients); Becker v. Aschen, 344 Mo. 1107, 1116, 131 S.W.2d 533, 538 (1939) (service station franchisee required to sell products at oil company's prices); \textit{cf.} Murphy v. Holiday Inns, 216 Va. 490, ———, 219 S.E.2d 874, 878 (1975) (agreements did not vest franchisors with power to dictate the prices charged by the franchisees).

16. \textit{See, e.g.}, Drexel v. Union Prescription Centers, 582 F.2d 781, 787 (3d Cir. 1978) (agreement required franchisee to maintain inventory control data and records as specified by the franchisor, to use the franchisor's accounting system, and make monthly financial reports); Nichols v. Arthur Murray, Inc., 248 Cal. App. 610, 615, 56 Cal. Rptr. 728, 732 (1967) (franchisor had power to select the financial institution handling, financing, or discounting of all pupil installment contracts, and franchisee was required to maintain and report certain records to franchisor); Billops v. Magnes Constr. Co., 391 A.2d 196, 198 (Del. 1978) (factual issue as to whether there was an
inventory control;\textsuperscript{17} required insurance;\textsuperscript{18} maintenance standards and procedures;\textsuperscript{19} hours and days of operation;\textsuperscript{20} forms and stationery;\textsuperscript{21} suppliers;\textsuperscript{22} and

agency relationship where agreement required franchisee to maintain various detailed records to insure compliance with the franchisor's operations manual; Singleton v. International Dairy Queen, 332 A.2d 160, 162 (Del. Super. Ct. 1975) (franchisee required to maintain certain records and make monthly reports to the franchisor); Becker v. Aschen, 344 Mo. 1107, 1116, 131 S.W.2d 533, 538 (1939) (service station franchisee could extend credit only to those customers approved by franchisor); cf. B.P. Oil Corp. v. Mabe, 279 Md. 632, 635, 370 A.2d 554, 557 (1977) (no agency relationship found where franchisee was not required to make reports). \textit{But see} Ortega v. General Motors Corp., 392 So. 2d 40, 42 (Fla. Dist. Ct. App. 1980) (no agency relationship found where agreement required franchisee to follow a uniform system of accounting specified by the franchisor); Slates v. International House of Pancakes, 90 Ill. App. 3d 716, 727, 413 N.E.2d 457, 465 (1980) (no agency relationship found where agreement required franchisee to maintain certain recordkeeping and account controls); Stanford v. Dairy Queen Prods., 623 S.W.2d 797, 802 (Tex. Civ. App. 1981) (no agency found where agreement prescribed method of keeping financial records for franchisor); Murphy v. Holiday Inns, 216 Va. 490, \ldots, 219 S.E.2d 874, 877 (1975) (no agency relationship found where franchisee was required to submit quarterly reports to franchisor).

17. \textit{See, e.g.,} Drexel v. Union Prescription Centers, 582 F.2d 781, 787 (3d Cir. 1978) (franchisor designated inventory requirements, prohibited supplementation of inventory without the franchisor's written consent, and required maintenance and delivery of control data); Billops v. Magness Constr. Co., 391 A.2d 196, 198 (Del. 1978) (franchisor required minimum supplies of brand name goods); Singleton v. International Dairy Queen, 332 A.2d 160, 162 (Del. Super. Ct. 1975) (franchisor dictated items that could be sold). \textit{But see} Slates v. International House of Pancakes, 90 Ill. App. 3d 716, 727, 413 N.E.2d 457, 465 (1980) (no agency relationship found where franchisee could sell only the products approved in writing by the franchisor); Stanford v. Dairy Queen Prods., 623 S.W.2d 797, 804 (Tex. Civ. App. 1981) (no agency relationship found where agreement encouraged operator not to sell "incompatible" items, such as beer).

18. \textit{See, e.g.,} Drexel v. Union Prescription Centers, 582 F.2d 781, 787 (3d Cir. 1978) (franchisee required to purchase and maintain policies prescribed by the franchisor, naming the franchisor as an insured, and if franchisee failed to do so, the franchisor could purchase such insurance on the franchisee's behalf and at its cost); Billops v. Magness Constr. Co., 391 A.2d 196, 198 (Del. 1978) (operations manual detailed insurance requirements); cf. Slates v. International House of Pancakes, 90 Ill. App. 3d 716, 720, 413 N.E.2d 457, 461 (1980) (no agency found where each franchisee was expected to have its own insurance).

19. \textit{See, e.g.,} Drexel v. Union Prescription Centers, 582 F.2d 781, 787 (3d Cir. 1978) (franchisee required to maintain premises and the merchandise displays in certain ways); Wood v. Holiday Inns, 508 F.2d 167, 175 (5th Cir. 1975) (agreement required franchisee to build and maintain facility as specified by franchisor); Billops v. Magness Constr. Co., 391 A.2d 196, 198 (Del. 1978) (operations manual regulated engineering and maintenance); cf. Murphy v. Holiday Inns, 216 Va. 490, \ldots, 219 S.E.2d 874, 877-78 (1975) (no agency found where franchisor lacked power to control daily maintenance of franchisee's premises). \textit{But see} Stanford v. Dairy Queen Prods., 623 S.W.2d 797, 802 (Tex. Civ. App. 1981) (no agency found where franchisee was required to abide by approved sanitation and food preparation procedures).

20. \textit{See, e.g.,} Drexel v. Union Prescription Centers, 582 F.2d 781, 787 (3d Cir. 1978) (franchise agreement required franchisee to be open a minimum of 46 hours per week); cf. B.P. Oil Corp. v. Mabe, 279 Md. 632, \ldots, 370 A.2d 554, 557 (1977) (no
portions served.  

Equally important are the franchisor's right to control: the location, layout, and decor of the franchisee's premises;\footnote{inspection of the franchisee's premises or books;\footnote{a share of the franchisee's profits rather than a simple} agency found where franchisor lacked control over hours of operation). But see Ortega v. General Motors Corp., 392 So. 2d 40, 42 (Fla. Dist. Ct. App. 1980) (no agency found where agreement required franchisee to remain open for business during times according to community custom); Slates v. International House of Pancakes, 90 Ill. App. 3d 716, 727, 413 N.E.2d 457, 465 (1980) (no agency found where agreement required franchisee to observe the hours specified in franchisor's manual); Coty v. United States Slicing Mach. Co., 58 Ill. App. 3d 237, 240, 373 N.E.2d 1371, 1374 (1978) (no agency found where agreement set minimum hours and days of service).  

21. See, e.g., Drexel v. Union Prescription Centers, 582 F.2d 781, 787 (3d Cir. 1978) (franchisee required to use franchisor's standard forms).  

22. See, e.g., Singleton v. International Dairy Queen, 332 A.2d 160, 162 (Del. Sup. Ct. 1975) (franchisor had power to approve suppliers of "mixes"; franchisee required to purchase other supplies from franchisor-approved suppliers or manufacturers); cf. Stanford v. Dairy Queen Prods., 623 S.W.2d 797, 802 (Tex. Civ. App. 1981) (no agency found where franchisee could purchase its meat from any source). But see Slates v. International House of Pancakes, 90 Ill. App. 3d 716, 727, 413 N.E.2d 457, 465 (1980) (no agency relationship found where agreement required franchisee to purchase all flour and mixes only from the franchisor or from suppliers approved in writing by the franchisor, and required franchisee to comply with a manual that included requirements concerning suppliers).  


24. See, e.g., Wood v. Holiday Inns, 508 F.2d 167, 175 (5th Cir. 1975) (agreement required franchisee to build and maintain facility as specified by the franchisor); Drexel v. Union Prescription Centers, 582 F.2d 781, 787 (3d Cir. 1978) (agreement required franchisee to adhere to the franchisor's standards concerning interior and exterior colors, lighting, design, equipment, and fixtures, and to conform with standards concerning new construction and facilities); Nichols v. Arthur Murray, Inc., 248 Cal. App. 2d 610, 615, 56 Cal. Rptr. 728, 732 (1967) (agreement gave franchisor right to control location, layout, and decoration of franchisee's studio); Singleton v. International Dairy Queen, 332 A.2d 160, 161 (Del Super. Ct. 1975) (franchisee required to construct premises according to franchisor's specifications). But see Ortega v. General Motors Corp., 392 So. 2d 40, 42 (Fla. Dist. Ct. App. 1980) (no agency found where agreement required franchisee to obtain franchisor's approval of premises location and design); Stanford v. Dairy Queen Prods., 623 S.W.2d 797, 802 (Tex. Civ. App. 1981) (no agency where franchisor required blueprints for "suitable building"); Murphy v. Holiday Inns, 216 Va. 490, , 219 S.E.2d 874, 878 (1975) (no agency where agreement empowered franchisor to regulate architectural style, furnishings, and equipment).  

royalty fee;\textsuperscript{26} the franchisee’s business expenses, taxes, or claims against the franchisee;\textsuperscript{27} local and national advertising\textsuperscript{28} or requiring payments by the


26. See, e.g., Drexel v. Union Prescription Centers, 582 F.2d 781, 786 (3d Cir. 1978) (franchisor received monthly 4% royalty from franchisee’s gross receipts); Nichols v. Arthur Murray, Inc., 248 Cal. App. 2d 610, 615, 56 Cal. Rptr. 728, 732 (1967) (franchisor received weekly payments of 5% of franchisee’s gross receipts); cf. Harwell v. Sheraton Gardens Inn, [1981] BUS. FRANCHISE Guide (CCH) ¶ 7626, at 12,553 (N.D. Ga. July 29, 1977) (no agency found where franchisee was obligated to make monthly payments because the fee was not dependent on number of rooms rented or franchisee’s profit); Ortega v. General Motors Corp., 392 So. 2d 40, 42 (Fla. Dist. Ct. App. 1980) (no agency found where franchisor did not share in franchisee’s profits or losses, without any discussion of the fee arrangement between franchisee and franchisor); Murphy v. Holiday Inns, 216 Va. 490, ___, 219 S.E.2d 874, 877 (1975) (no agency found where franchisee paid a flat licensing fee and franchisor had no power to demand share of franchisee’s profits). But see Whitfield v. Century 21 Real Estate Corp., 484 F. Supp. 984, 986 (S.D. Texas 1979) (no agency found where licensor received percentage of the gross receipts of its licensee derived from percentage of the gross income received from the licensee’s franchise).

27. See, e.g., Nichols v. Arthur Murray, Inc., 248 Cal. App. 2d 610, 615, 56 Cal. Rptr. 728, 732 (1967) (franchisor had the right to make refunds); cf. Ortega v. General Motors Corp., 392 So. 2d 40, 43 (Fla. Dist. Ct. App. 1980) (no agency where agreement stated that franchisor was solely responsible for all expenditures and obligations); Slates v. International House of Pancakes, 90 Ill. App. 3d 716, 413 N.E.2d 457 (1980) (no agency where franchisee was responsible for paying claims against it, and franchisor did not defend the franchisee, give any instructions concerning claims, or require that the franchisee inform the franchisor in case of an accident or claim); B.P. Oil Corp. v. Mabe, 279 Md. 632, 370 A.2d 554 (1977) (no agency found where franchisee paid for its own products and taxes); Murphy v. Holiday Inns, 216 Va. 490, 219 S.E.2d 874 (1975) (no agency found where franchisor did not control or pay franchisee’s business expenditures).

franchisee to a national advertising fund.\textsuperscript{29} Finally, the courts look at the franchisor's right to terminate the relationship upon the franchisee's breach of any covenant in the franchisee agreement\textsuperscript{30} and the franchisor's broad discretionary power over the franchisee.\textsuperscript{31}

**B. Using The Lanham Act to Defend Against an Assertion of Agency**

Most of the cases discussing these factors do not even address the control required by the Lanham Act, let alone attempt to reconcile the requirements of the Act with traditional agency concepts. Usually franchisors do not even raise the Act as a defense. The few courts that have considered the Act in agency terms have concluded that the control exercised by the particular franchisor was necessary under the Act and therefore did not create a principal-agent relationship.\textsuperscript{32}

Apart from the inherent need to regulate to maintain consumer acceptance, the franchisor is required by statute to exercise a certain degree of control over franchisees using its trademark. The Act requires that the licensor of a registered mark (or name) exercise control over the nature and quality of

\textsuperscript{29} See, e.g., Drexel v. Union Prescription Centers, 582 F.2d 781, 787-88 (3d Cir. 1978) (franchisee required to pay for franchisor-developed promotional materials). But see Coty v. United States Slicing Mach. Co., 58 Ill. App. 3d 237, 240, 373 N.E.2d 1371, 1374 (1978) (no agency found where franchisee was required to finance and participate in advertising programs); Murphy v. Holiday Inns, 216 Va. 490, ----, 219 S.E.2d 874, 876 (1975) (no agency found where franchisee was required to pay continuing fee for national advertising).

\textsuperscript{30} See, e.g., Drexel v. Union Prescription Centers, 582 F.2d 781, 788 (3d Cir. 1978) (franchisor had power to terminate agreement if the franchisee breached any provision); Wood v. Holiday Inns, 508 F.2d 167, 175 (5th Cir. 1975) (franchisor could cancel agreement upon any substantial violation); Billups v. Magness Constr. Co., 391 A.2d 196, 198 (Del. 1978) ("right of unilateral termination for violation given the franchisor"); Singleton v. International Dairy Queen, 332 A.2d 160, 161-62 (Del. Super. Ct. 1975) (franchisor had right to cancel the agreement for "many reasons"); Becker v. Aschen, 344 Mo. 1107, 1115, 131 S.W.2d 533, 538 (1939) (oil company had power to terminate on 10 days notice). But see Harwell v. Sheraton Gardens Inn, [1981] BUS. FRANCHISE GUIDE (CCH) ¶ 7626, at 12,553 (N.D. Ga. July 29, 1977) (no agency where franchisor did not have power to affect franchisee's operation, and its only option was to terminate); Slates v. International House of Pancakes, 90 Ill. App. 3d 716, 749, 413 N.E.2d 457, 460 (1980) (no agency where there was testimony that franchisor had no grounds to enforce compliance with manuals); Coty v. United States Slicing Mach. Co., 58 Ill. App. 3d 237, 240, 373 N.E.2d 1371, 1374 (1978) (no agency where franchisor's only remedy for breach was to terminate entire agreement).

\textsuperscript{31} See, e.g., Drexel v. Union Prescription Centers, 582 F.2d 781, 788 (3d Cir. 1978) (franchisee required to conduct business in a manner reflecting favorably on the franchisor); Nichols v. Arthur Murray, Inc., 248 Cal. App. 2d 610, 615, 56 Cal. Rptr. 728, 732 (1967) (franchisee required to conduct, maintain, and manage business in accordance with franchisor's policies). See generally Borchard & Ehrlich, supra note 12, at 110-13 (various factors supporting inference of control).

\textsuperscript{32} See Oberlin v. Marlin Am. Corp., 596 F.2d 1322 (7th Cir. 1979); Murphy v. Holiday Inns, 216 Va. 490, 219 S.E.2d 874 (1975).
goods or services used under the mark.\textsuperscript{33} This duty is imposed to guarantee that the goods or services offered by the licensee are similar to goods and services sold under the mark before the licensing, and that the mark has the meaning it had before licensing.\textsuperscript{34}

Because there is a duty to maintain the integrity of the trademark, the licensor must attempt to discover any misleading or deceptive uses by monitoring the licensee's operations.\textsuperscript{35} Although the amount of supervision a licensor must exercise is not specified by the Act, a licensor is required to exercise control sufficient to ensure uniform quality of the product or service.\textsuperscript{36} If this control is not exercised, the licensor may be deemed to have abandoned the mark, and the mark's value is lost.\textsuperscript{37}

The question is how much control the licensor can exercise over the licensee without creating an agency relationship. There is authority that mere compliance with the Act by the licensor does not create a principal-agent relationship with the licensee.\textsuperscript{38} Each case must be reviewed on an individual basis to

\begin{itemize}
  \item 33. 15 U.S.C. § 1055 (1982) provides: "Where a registered mark or a mark sought to be registered is or may be used legitimately by related companies, . . . such use shall not affect the validity of such mark or of its registration, provided such mark is not used in such manner as to deceive the public." A related company is "any person who legitimately controls or is controlled by the registrant . . . in respect to the nature and quality of the goods or services in connection with which the mark is used." \textit{Id.} § 1127. \textit{See generally} Comment, \textit{Trademark Licensing: The Problem of Adequate Control}, 1968 DUKE L.J. 875, 887-900.
  
  
  \item 35. Huntington Nat'l Mattress Co. v. Celanese Corp., 201 F. Supp. 938, 945 (D. Md. 1962) (owner had affirmative duty to police activities of licensee to assure that licensee applies mark to a product of substantially similar quality).
  
  
  \item 37. A similar result may follow under the Missouri trademark statute, Mo. REV. STAT. § 417.041(4)(a) (1978), which provides for the cancellation of a trademark because of abandonment.
  
  \item 38. The Lanham Act "does not give a licensor control over the day-to-day operations of a licensee beyond that necessary to ensure uniform quality of the product or services in question . . . [nor does it] automatically saddle the licensor with the responsibilities under state law of a principal for his agent," Oberlin v. Marlin Am. Corp., 596 F.2d 1322, 1327 (7th Cir. 1979). In Stanford v. Dairy Queen Prods., 623 S.W.2d 797 (Tex. Civ. App. 1981), the court affirmed a finding that no actual agency existed, partially because the contractual requirements relative to the franchisee's operations were "rather directly" related to calculating and verifying the royalty fee owed and to maintaining the value of the trade name. The court also found that the purpose of the franchise agreement, as far as the franchisor was concerned, was to exploit ownership of the exclusive right to license others to use its trade name while preserving the value of the name in the market place. \textit{Id.} at 802-03. The Lanham Act was not mentioned.
\end{itemize}
determine whether the licensor has gone beyond the requirements of the Act in exercising control. 39

The control necessary to avoid trademark abandonment is commensurate with that required to protect the integrity of the registered mark or name and to prevent public deception. 40 The duty to supervise does not give the licensor the right to control the day-to-day details of the licensee's business beyond what is necessary to ensure uniform quality of the product or service sold under the trademark. 41 Supervision aimed at protecting the mark, however, may necessarily infringe on some day-to-day details of the franchisee's operation. This infringement alone should not subject a licensor to liability under agency principles.

The control which courts have deemed necessary to avoid abandonment of a registered mark and, thus, which should be tolerated without imposing the burden of agency on the licensor, includes the following: 42

1. Supervision over advertising, providing advertising, or specifying the advertising the licensee may utilize. 43 This supervision is readily accepted, particularly when it is confined to use of the trademark; some supervision of advertising is necessary to prevent misuse of the mark and deception of the public. The use of the trademark and the opportunity to benefit from the public's recognition of it is one of the most valuable benefits of franchising. 44 Advertising builds and maintains that public recognition. 45 Uncontrolled advertising could easily change recognition of the mark, mislead the public, and severely damage goodwill.

2. Inspection of the licensee's operations or premises. In Dawn Donut Co. v. Hart's Food Stores, 46 the court found that the Act mandated regular inspections by the licensor. 47 Periodic inspections should not alone create an agency relationship. The appearance of the premises from which the trade-

40. See Oberlin v. Marlin Am. Corp., 596 F.2d 1322, 1327 (7th Cir. 1979).
41. Id.; Kentucky Fried Chicken Corp. v. Diversified Packaging Corp., 549 F.2d 368, 387 (5th Cir. 1977).
42. There is a conflict between the list which follows and the agency factors set out in text accompanying notes 14-31 supra. This is because the Lanham Act has seldom been raised by franchisors facing vicarious liability claims and because the courts have adopted a case by case approach to considering vicarious liability.
45. 206 F. Supp. at 641.
46. 267 F.2d 358 (2d Cir. 1959).
47. "[T]he only effective way to protect the public where a trademark is used by licensees is to place on the licensor the affirmative duty of policing in a reasonable manner the activities of his licensees." Id. at 366-67.
marked product or service is delivered to the public is important to maintaining the quality of the trademark.

3. Control over supplies or suppliers. Franchisors who have sought to exercise control over the quality of their franchisee’s supplies in compliance with the Act have often faced claims that the control constitutes an illegal tying arrangement. The Act demands supervision, while the antitrust laws anchor control. The courts have resolved these conflicting policies by interpreting the antitrust laws to permit the franchisor to exercise enough control over its franchisee to protect its trademark.

In *McAlpine v. AAMCO Automatic Transmissions, Inc.*, 48 the franchisor (AAMCO) required its franchisees to purchase parts from it or from those vendors determined by AAMCO to offer parts of “equal quality.” The franchisor periodically inspected franchisees to ensure that they were using quality parts. In addressing this control over product selection, the court recognized that permitting inferior products to be presented to the public under the mark might constitute misuse. Thus, AAMCO “had the right, if not the duty, to establish a minimum ‘equal quality’ standard for the transmission parts used by its franchisees.”

In *Kentucky Fried Chicken Corp. v. Diversified Packaging Corp.*, 50 the franchisor required its franchisees to purchase from approved sources supplies, such as containers and napkins, carrying the franchisor’s trademark. Kentucky Fried Chicken set minimum standards for the supplies, and other suppliers meeting these standards could be approved. The court agreed that this requirement did not violate the antitrust laws because it was necessary to control quality 51 in a manner necessary and sufficient to meet the requirements of the Act. 52

In *Susser v. Carvel Corp.*, 53 the court held that the franchisor was entitled to designate dairies to supply the ice cream mix used by its franchisees, as well as the suppliers of closely related accessories, such as toppings, cones, and paper goods. This quality control was deemed necessary under the Act. A similar result was reached in *Dawn Donut Co. v. Hart’s Food Stores, Inc.*

The policy considerations present in the Lanham Act-agency conflict are similar to those involved in the Lanham Act-antitrust dichotomy. Therefore,

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49. 461 F. Supp. at 1239-40.
50. 549 F.2d 368 (5th Cir. 1977).
51. Id. at 380-81.
52. Id. at 387.
54. 206 F. Supp. at 641.
55. 267 F.2d 358 (2d Cir. 1959).
the approach in examining the amount of supervision which will be tolerated should be the same: the supervision required by the Act should be accepted without finding the existence of an agency relationship.66

4. Prohibition against sale or transfer of the licensee. This type of provision is customary in trademark licensing agreements and shows that the licensor is concerned with having its licenses in the hands of only those persons or firms of the highest character.67 It should not give rise to an agency relationship.68

5. Transfer of ownership of the trademark license to the licensor on default or bankruptcy of the licensee.69

6. Limitations on the type of products that may be sold or services which may be offered. A trademark licensor must guard against being forced by its franchisees to enter into or lend its name to lines of business other than that embodied by the trademark.69 If a franchisor were powerless to prevent its licensees from selling products or offering services other than those originally connected with the trademark, the public would be misled, and the licensor would not have met its duty under the Act.

7. Inspection of the licensee's books and records. In certain types of service-related franchises where there is no tangible product, such as an employment agency specializing only in certain areas of employment,61 inspection may be needed to ensure that the franchisee is limiting its business to the specialized areas represented by the trademark or name.

8. Right to demand a certified financial statement. By demanding financial statements, the licensor can ensure that the licensee is financially competent to continue providing quality goods or services under its license. The financially troubled licensee who cannot provide such goods or services will reflect adversely on the quality and integrity associated with the trademark or name. For example, one court found a franchisor negligent for failing to sufficiently supervise its franchisee's operation so as to avoid subjecting the franchisee's customers to an unreasonable risk of financial injury at the hands

56. A similar argument was ignored in Meyers v. Coca-Cola Co., [1983] Bus. FRANCHISE GUIDE (CCH) ¶ 8004, at 13,717 (Pa. Ct. C.P. Mar. 14, 1983), where the franchisor sought to avoid vicarious liability by pointing out that the quality control it exercised was mandated by state-imposed bottling standards. Deeming the vicarious liability issue as one for the jury, the court only mentioned that the franchisor raised the state-imposed standards and did not comment upon their significance. The fact that the franchisor prescribed written cleanliness standards dealing with bottling appeared to be the overriding consideration.


58. Id.


of a financially troubled franchise. 62

9. Periodic reports. Periodic reports may serve a dual purpose. First, as with the right to inspect the licensee’s books and records, such reports help the licensor determine whether the licensee is limiting its business to the specialized area represented by the trade name or mark. Second, if the royalty arrangement is a percentage fee, periodic reports may reveal how much the licensee owes the licensor for use of the trademark or name. The trademark or name is valuable property, the use of which entitles the licensor to compensation. The licensor who fails to treat the mark as a valuable property right by failing to monitor and demand just compensation may be accused of abandoning the mark. 63

10. Right to terminate the licensing agreement. This right is the logical extension of the other methods of necessary supervision discussed, particularly supervision over advertising, inspection (of premises and records), and reports. A licensor could not effectively maintain the integrity of its mark if it were powerless to terminate a licensee who is unwilling or unable to comply with the provisions of the licensing agreement, particularly those concerning the use of the trademark or name.

Using the Act as a defense to a claim of vicarious liability probably requires pleading it as an affirmative defense. 64 The problem is effectively placing the Act before the court and jury. Upon request, a court may take judicial notice of a federal statute. 65 Once a court takes judicial notice of the Act, the Act can then be embodied in the verdict directing and affirmative defense jury instructions.

This is not the way to impress a jury with facts showing that the licensor did no more than was necessary to comply with the Act. One solution may be to call as an expert witness an attorney who specializes in trademark law. It is not settled, however, to what extent an attorney may testify as an expert on the law. Expert testimony concerning what law governs the case is improper. 66 Thus, in many jurisdictions it is doubtful that an expert would be permitted to testify directly as to what the Act requires or to state an opinion as to whether the franchisor exercised more control than that required by the Act. This may not entirely preclude expert legal testimony. An expert may respond to hypo-


63. Cf. Stanford v. Dairy Queen Prods., 623 S.W.2d 797, 802 (Tex. Civ. App. 1981) (no agency found where licensing agreement operation requirements were “rather directly” related to calculating the royalty payable to the licensor or to maintaining value of licensor’s trade name—Lanham Act not discussed).


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hetorical questions concerning standards of ordinary practice in an industry with which he is familiar and their relationship to the facts of a particular case. A trademark attorney should be permitted to testify as to the steps normally taken by trademark licensees in an industry to protect trademarks, and that the steps taken by the particular defendant to protect its trademark, including the control exercised over licensees, are consistent with the normal practice in the industry.

III. DIRECT LIABILITY

A. Negligence

A few cases have analyzed the franchisor’s liability to an injured third party on negligence principles. In *Coty v. United States Slicing Machine Co.*, the plaintiff, an employee of the franchisee-restaurant owner, was injured while operating the franchisee’s meat slicing machine. The employee sued the franchisor on the theory of negligent supervision of its franchisee under Restatement (Second) of Torts section 414, which imposes a duty to use reasonable care in supervising an independent contractor (franchisee) over whom control in the performance of the work is retained. The trial court


68. In Jordan v. Robert Half Personnel Agencies, 615 S.W.2d 574 (Mo. Ct. App. 1981), the court dealt with the issue of agency in the franchisor-franchisee context. Jordan sued the local franchisee for tortious interference with contract and breach of fiduciary relationship. He sought to recover against the franchisor on theories of actual agency and apparent authority. The trial court dismissed the franchisor because Jordan failed to introduce sufficient evidence of an agency relationship. Id. at 582. The court of appeals reversed and remanded, concluding that Jordan should have been allowed to submit the agency issue to the jury. Id.

*Jordan* is not particularly instructive. The court merely found that the plaintiff had adduced sufficient evidence to warrant submitting the question of agency to the jury. It did not determine whether the elements of control made the franchisee an agent. There was little differentiation by the court between actual agency and apparent authority beyond noting that the plaintiff had advanced both theories. The court discussed only one case at any length, concentrating solely on that case’s examination of apparent authority issues. Id.; see Wood v. Holiday Inns, 508 F.2d 167 (5th Cir. 1975). Because the parties did not raise the issue, the court did not consider the Lanham Act. Thus, the opinion tends to leave the misleading impression that the types of controls exercised by the franchisor or which the franchisor had a right to exercise were, without more, sufficient to impose an agency relationship.


70. (1965). The plaintiff also proceeded against the franchisor on a theory of willful and wanton misconduct. A verdict in favor of the plaintiff against the manufacturer was affirmed. 58 Ill. App. 3d at 243, 373 N.E.2d at 1380.
granted the franchisor a directed verdict.\textsuperscript{71}

Coty contended that: the franchisor controlled the operations of its franchisee; was aware that the franchisee's minor employees were operating the slicing machine; knew of the applicable state and federal statutes prohibiting the operation of such machines by minors; and had the power under the franchise agreement to prevent such activities.\textsuperscript{72} Coty further argued that the franchisor's responsibility for its breach of duty to prevent such activities should have been submitted to the jury. The evidence indicated that the franchisor was aware of the federal standards and of the franchisee's failure to conform with them.\textsuperscript{73}

An Illinois appellate court affirmed the trial court's directed verdict on the ground that the franchisor had not retained sufficient control over the manner in which the franchisee's work was done to be liable for negligent supervision.\textsuperscript{74} The franchise agreement imposed a number of restrictions on the franchisee concerning the general operation of the restaurant, including the franchisee's covenant to comply with all applicable federal, state, county, and city laws, ordinances, and regulations.\textsuperscript{75} The court noted that these restrictions were principally geared towards protecting the . . . trademark and the good will associated with it."\textsuperscript{76} The franchisor did not, however, retain day-to-day supervisory control, could not hire, fire, or give orders to any of the franchisee's employees, and could not halt work immediately in the restaurant. The franchisor's only remedy, on breach of any of the covenants contained in the franchise agreement, was to terminate the agreement after giving ten days written notice to cure the breach and the franchisee's failure to cure.\textsuperscript{77}

The court observed that a franchisor possessing a right to supervise the "internal operations" of the franchisee's enterprise, including the right to veto unsafe procedures, may be liable for the negligent failure to do so.\textsuperscript{78} To impose liability, however, this right to veto unsafe procedures must consist of more than the "general right to order the work stopped or resumed, to inspect its progress or to receive reports, to make suggestions or recommendations which need not necessarily be followed, or to prescribe alternatives and devia-

\begin{itemize}
  \item \textsuperscript{71} \textit{Id.}
  \item \textsuperscript{72} This presumably minimizes the risk of injury to third parties. \textit{Id.} at 239, 373 N.E.2d at 1374.
  \item \textsuperscript{73} \textit{Id.} at 240, 373 N.E.2d at 1374.
  \item \textsuperscript{74} \textit{Id.} at 241, 373 N.E.2d at 1375. Such supervisory control could not extend to "operative details," which would have subjected the franchisor to liability on agency grounds.
  \item \textsuperscript{75} Noting that the cases concerning franchisor liability for the franchisee's acts analyze the issue on agency principles, the court turned to cases involving the liability of employers for the acts of independent contractors for negligent supervision. \textit{Id.} at 240, 373 N.E.2d at 1374-75.
  \item \textsuperscript{76} \textit{Id.} at 240, 373 N.E.2d at 1374.
  \item \textsuperscript{77} \textit{Id.} at 239, 373 N.E.2d at 1374.
  \item \textsuperscript{78} \textit{Id.} at 242, 373 N.E.2d at 1375.
\end{itemize}
tions. . . ."79 The franchisor's right to demand compliance with the applicable statutes and to terminate the franchise agreement upon the franchisee's failure to comply was deemed insufficient to impose liability under either negligence or agency principles.80

In Wise v. Kentucky Fried Chicken Corp.,81 an employee of the franchisee was burned by cooking oil from a defective pressure fryer. Vicarious liability was not asserted. The plaintiff sought to hold the franchisor liable for negligence under Restatement section 414. In denying the defendant's motion for summary judgment, the court distinguished Coty on the basis that the instrumentality in Wise was purchased with at least the approval if not the direction of the franchisor.82 The fact that the franchisor had developed a "sophisticated system for selecting, approving, testing, recommending and maintaining quality control" over equipment used by the franchisee was considered significant.83 The franchisor was also obligated under the franchise agreement to inform its franchisees concerning methods of quality control. Moreover, all franchisees were required to operate in conformity with a confidential operating manual promulgated by the franchisor.84 These circumstances gave rise to questions of material fact as to the degree of control retained by the franchisor over the franchisee's operation as a whole and over the franchisee's purchase of cooking equipment in particular.

The court in Wise further held that under general principles of tort law, Kentucky Fried Chicken might also be liable to the franchisee's employee as one who voluntarily undertook to act without a duty to do so, and acted in a negligent manner.85 The franchisor required its franchisees to purchase only certain brands of cooking equipment, the brand that caused injury was one recommended by the franchisor, the franchisor reserved the right to review the quality of equipment, and the franchisor had been notified by the manufacturer of the fryer that it contained a defect and took no steps to inform either the franchisee or its employees of the defect. The court felt that, if proven, these facts would support a finding that the franchisor had, "at a minimum," a duty to warn. Presumably the court was referring to a duty to warn the franchisee, although the opinion is not clear on this point.86

Coty and Wise are difficult to reconcile. In both cases, the franchisor did not exercise control over the day-to-day business activities of the franchisee. It

79. Id. at 241, 373 N.E.2d at 1375. Such rights do not, however, provide the franchisor with effective power over the day-to-day operations of the franchisee.
80. Id. at 242, 373 N.E.2d at 1376. These rights did not provide the franchisor with the power necessary to minimize the risk of injury, and thus no duty was owed to the plaintiff.
82. Id. at 995.
83. Id.
84. Id.
85. Id. at 995-96.
86. See id. at 996.
exercised only the general supervision necessary to protect its trademark. 87

_Cullen v. BMW of North America, Inc._ 88 also analyzed franchisor liability under negligence principles. In late January, 1979, Cullen paid the full purchase price of a new BMW automobile to a BMW dealer, Bavarian Auto Sales, Inc. (Bavarian). Cullen never received the automobile or the return of his money. Bavarian’s president, Hans Eichler, absconded with Cullen’s money. Cullen sued BMW after his suit against Bavarian was stayed due to Eichler’s filing of a bankruptcy petition. Cullen’s theories of liability against BMW included negligence, agency by estoppel, civil conspiracy to commit fraud, and _prima facie_ tort. 89

The evidence revealed that BMW had known for some time that Bavarian was experiencing financial difficulties. This included knowledge that Bavarian had issued insufficient funds checks both to BMW and to customers of Bavarian. BMW also was aware of Bavarian’s inability to maintain the minimum lines of credit necessary to operate as a BMW dealer. On December 18, 1978, less than one month before Bavarian’s franchise agreement with BMW was to expire, BMW notified Bavarian that unless Bavarian corrected its continuing deficiencies within sixty days, it would serve notice to terminate the franchise. Eichler responded that he wished to continue the dealership. After the expiration of the franchise agreement on December 31, 1978, BMW allowed Bavarian to continue holding itself out as an authorized BMW dealership, including using the BMW logo and printed materials bearing BMW trademarks. On February 13, 1979, BMW met with Eichler and learned of his misuse of customer funds. BMW accepted Eichler’s voluntary resignation three days later. 90

The trial court found that BMW owed a “duty of care” to Cullen and other BMW customers to avoid subjecting them to unreasonable exposure to financial injury at the hands of its dealer. 91 Reviewing New York law, the trial court concluded that if a defendant’s relationship to the circumstances or the intervening wrongdoer is such that it has a reasonable opportunity to reduce the risk of a foreseeable injury, a duty arises to do so. 92

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87. The court in _Wise_ discounted the fact that the franchise agreement provided that the franchisee would “actively manage the day-to-day operations of the outlet,” and “at all times remain an independent contractor.” Id. at 993. The court focused on other provisions of the agreement as providing the needed control. These provisions have, however, been recognized by other courts as necessary to protect the trademark.

88. 531 F. Supp. 555 (E.D.N.Y.), _rev’d_, 691 F.2d 1097 (2d Cir. 1982).

89. The trial court granted BMW’s motion for summary judgment on the conspiracy and fraud claims, _Cullen v. BMW of N. Am., Inc._, 490 F. Supp. 249 (E.D.N.Y. 1980), and entered judgment against plaintiff on the agency theory, finding an absence of reliance by the plaintiff on the manifestations of authority. _Cullen v. BMW of N. Am._, 531 F. Supp. 555, 560 (E.D.N.Y.); _rev’d on other grounds_, 691 F.2d 1097 (2d Cir. 1982), _cert. denied_, 103 S. Ct. 1525 (1983).

90. 691 F.2d at 1100; 531 F. Supp. at 558-59.

91. 531 F. Supp. at 564.

92. _Id._ at 563.
[D]efendant [BMW] acquiesced to circumstances which it should have reasonably known presented a substantial risk of harm to plaintiff. Most importantly, defendant had both the opportunity and capability to decrease or foreclose the risk of harm. Therefore, a duty of care arose to avoid subjecting BMW customers to the unreasonable exposure to financial injury.93

This rationale appears to create a duty on the part of the franchisor based upon the franchisor-franchisee relationship, regardless of the franchisor’s direct contacts with the injured third party.

BMW was held negligent for breaching its duty to Cullen, as a customer of Bavarian, by unreasonably allowing Bavarian to continue operating as a BMW dealer after the franchise agreement had expired and after BMW had notice of Eichler’s business dealings. BMW was also negligent in failing to supervise Bavarian’s operation after the expiration of the franchise agreement.94 BMW contented that its negligence was not the proximate cause of Cullen’s injury because Eichler’s conduct constituted an intervening criminal act. The trial court held that Eichler’s acts did not break the causal chain because BMW’s conduct constituted a “substantial causative factor” and Eichler’s conduct was a foreseeable risk of BMW’s negligence.95

The Second Circuit reversed and held that even though BMW knew of Bavarian’s precarious financial condition, it was not liable because it could not have reasonably foreseen Eichler’s criminal activity.96 The court of appeals apparently agreed that under certain circumstances a franchisor can be held liable under a negligence theory for failure to supervise or terminate its franchisee. In this particular case, however, causation was lacking due to the un foreseeability of the franchisee’s criminal acts.97

Although the decisions in Coty and Cullen ultimately were favorable to the franchisor, both cases present problems which make them precarious protection for franchisors. A major problem involves their approach to the franchisor’s right to terminate upon the franchisee’s breach of the franchise agreement. In Cullen, the court seemed to view the franchisor’s right to terminate a sufficient and appropriate means of reducing the risk of harm to third parties due to malfeasance of the franchisee. The failure by the franchisor to

93. Id. BMW’s “capability to decrease or foreclose the risk of harm” was based on its right to terminate the franchise. But cf. Coty v. United States Slicing Mach. Co., 58 Ill. App. 3d 237, 242, 373 N.E.2d 1371, 1376 (1978) (general right to terminate is an ineffective tool for exercising control over the franchisee’s operation and thus is insufficient to create vicarious liability).
94. 531 F. Supp. at 564.
95. Id. at 564-66.
96. 691 F.2d at 1101.
97. Id. Although the Second Circuit seemed to recognize the possibility of a franchisor being held liable for negligently failing to terminate a dealer, a prior statement in the opinion is contrary: “We agree with BMW that it did not owe a duty to supervise the operation of Bavarian and to terminate the franchise because of its allegedly precarious financial condition.” Id. at 1098.
terminate could subject the franchisor to liability under a negligence theory. The Coty court, in contrast, considered the mere right to terminate an unvi-

able method of minimizing the risk of injury to third parties. The court indicated that, where the franchisor lacks the power to become directly involved in the risk created by the franchisee, it is inappropriate to impose a duty on the franchisor to third parties who may be injured by the franchisee.

These varying approaches leave much doubt as to the importance of the franchisor's right to terminate as a means of maintaining control over the franchisee's acts. The cautious franchisor who retains the right to terminate or supervise the franchisee's operations as permitted by the Lanham Act would be well advised to diligently exercise its rights.

If a court is intent on holding a franchisor liable, it can easily find ways to do so. For example, when considering a negligence action brought against a franchisor by an employee of a franchisee, the court in Wise did not even mention the right of termination. The court disregarded language in the franchise agreement holding the franchisee responsible for the day-to-day op-

erations of the business as an independent contractor. Instead, the court relied on language giving the franchisor the right to require the purchase of the injury producing equipment and providing the franchisee with a duty to operate in conformity with a manual. The court suggested that these provisions were sufficient to support liability under Restatement section 414 for failing to exercise control over the franchisee with reasonable care.

The vicarious liability and negligence cases are similar in many respects. In both areas, the control exercised by the franchisor is the key issue. In the vicarious liability cases, control creates an agency relationship that makes the manufacturer liable for the acts of its franchisee. The same considerations appear in the negligence cases where the manufacturer is held liable for failing to use reasonable care in exercising control over its franchisee. In the negligence cases, the issue of control is considered twice: first, when the court determines whether the franchisor has retained control over any part of the work of the franchisee sufficient to subject the franchisor to a duty of care (very close to the agency consideration); second, when the court considers whether the manufacturer has failed to reasonably exercise the control it has retained. The results are the same under vicarious liability and negligence theories: the franchisor is deemed liable for injuries to third parties.

B. Products Liability

Often the franchisor is neither the manufacturer nor seller of the product; it merely licenses its trademark to a franchisee or licensee who manufactures

98. As discussed in the text accompanying note 96 supra, the Second Circuit apparently agreed with the trial court's conclusion on this question, although the language used does not leave the matter entirely free from doubt.


100. Id. at 995-96.
or sells the product. Breach of warranty and strict liability in tort actions have traditionally been directed against "manufacturers" or "sellers" of defective products. Courts also have applied these concepts to non-manufacturers and non-sellers under various rationales. Trademark licensors' liability to third persons under product liability theories can be broken down into breach of warranty and strict liability.

1. Breach of Warranty

The seminal breach of warranty case in the trademark-licensor area is *Kosters v. Seven Up Co.*\(^{101}\) In *Kosters*, the purchaser of a carton of soft drinks sustained severe eye damage when a bottle slipped from a defective carton and exploded. The consumer sued the soft drink franchisor urging various theories of liability, including breach of implied warranty. Seven-Up, the franchisor, appealed the $150,000 jury verdict, contending that it could not be held liable under an implied warranty theory since it did not manufacture, handle, design, or require use of the carton.\(^{102}\) The Sixth Circuit concluded that Seven-Up could be held accountable since it not only sponsored, managed, and controlled the system for distributing the product, it consented to use of the defective carton.\(^{103}\) The carton was submitted by the local bottler to Seven-Up for inspection and the franchisor, knowing of its design, consented to the carton's use.\(^{104}\) The court observed that when a franchisor consents to the distribution of a defective product bearing its name, the obligation of the franchisor to compensate the injured consumer for breach of implied warranty arises from several different factors: (1) the risk created by approving the distribution of an unsafe product; (2) the franchisor's ability to prevent the loss; (3) the consumer's lack of knowledge of the danger; and (4) the consumer's reliance on the trade name which gives the intended impression that the franchisor is responsible for the product.\(^{105}\) Seven-Up's liability was premised on its control over the product and the public's assumption, induced by the franchisor's conduct, that Seven-Up did in fact control and vouch for the product.\(^{106}\)

A second breach of warranty case, *Harris v. Aluminum Co.* \(^{107}\)

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101. 595 F.2d 347 (6th Cir. 1979). Although the court spoke in terms of "breach of warranty," the case really depended upon strict liability in tort. See *id.* at 353; see also *Restatement (Second) of Torts* § 402A (1965).

102. The court of appeals framed the issue as whether "Michigan's principles of strict accountability for breach of implied warranty extended to a franchisor who retains the right of control over the product and specifically consents to its distribution in the form sold but who does not actually manufacture, sell, handle, ship, or require the use of the product." 595 F.2d at 352.

103. *Id.* at 352-53.

104. *Id.*

105. *Id.* at 353.

106. *Id.; see also* Hayward v. Holiday Inns, 459 F.Supp. 634 (E.D. Va. 1978) (patron sued motel franchisor for injuries sustained on the franchisee's premises based on agency and breach of express and implied warranties made through national advertising).
America, also involved suit brought by a consumer against a soft drink franchisor. In Harris, a twist-off cap struck the plaintiff in the eye, resulting in partial blindness. The plaintiff advanced several theories, including breach of implied warranties of fitness and merchantability, and negligence. The franchisor’s motion for summary judgment was denied on all theories. The court observed that Kosters provided authority to expand implied warranty principles to soft drink manufacturers who promote the sale of soft drink products but do not actually manufacture or sell the product. The court found it significant that the franchisor was responsible for placing the product in the stream of commerce, had the ability to prevent the damage by eliminating the defect, and that the consumer had relied on the franchisor’s actions.

2. Restatement (Second) Section 402A

Restatement (Second) of Torts section 402A applies strict liability only when the defendant is a seller or manufacturer of the injury-producing product. Various cases, however, have either ignored or rewritten the seller/manufacturer requirement. Kasel v. Remington Arms Co. is illustrative of decisions where courts have concluded that there is no basis for distinguishing between a seller or manufacturer and a trademark licensor when both have benefitted by placing a product in the “stream of commerce.” In Kasel, a consumer was injured when ammunition manufactured by Remington’s trademark-licensee exploded. The consumer instituted an action against Remington based on section 402A. Remington argued that it could not be held liable because it neither manufactured nor sold the ammunition. The court disagreed: “[A]s long as the franchisor or trademark licensor can be said to be a link in the marketing enterprise which placed a defective product within the stream of commerce,” there is no reason not to apply strict liability in tort.

The court noted that under the “stream-of-commodity” approach, no precise legal relationship is required between a member of the enterprise that caused the defective product to be placed in commerce and the injured consumer. Moreover, liability was applied without regard to the individual defendant’s control over the cause of the defect, although if such control existed, it would have been a significant factor in finding liability.

Kasel has been followed by other courts. For example, in City of Hart-
116. Id. at 211, 384 A.2d at 394; see Connelly v. Uniroyal, Inc., 75 Ill. 2d 393, 407, 389 N.E.2d 155, 163 (1979) (non-manufacturing trademark-licensor can be a "seller" under § 400 or § 402A), appeal dismissed, 444 U.S. 1060 (1980).
117. 34 Conn. Supp. at 208, 384 A.2d at 393.
118. Id.
119. Id.
120. In discussing whether the situation met § 402A's condition that the defective product "is expected to and does reach the user or consumer without substantial change in the condition in which it is sold," the court discussed at length the Lanham Act's requirement that the owner of a trademark exercised a certain degree of control over how the market is used. The court also held that the trademark licensor could be liable under § 400 as one who placed the product in commerce as his own by permitting his trademark to be affixed thereto. 34 Conn. Supp. at 215, 384 A.2d at 397.
121. RESTATEMENT (SECOND) OF TORTS § 400 (1965).
allowed garments made according to its quality standards to carry its authorized label. Unlike Kasel, the licensor had no ties with the dress manufacturer other than the license agreement. Bancroft moved for judgment notwithstanding the verdict, contending that it could not be liable under section 402A because it was not a "seller" of the defective product. Despite Bancroft's limited involvement in the manufacturing process, the court held that it was still sufficiently involved to be liable under section 400 because the authorized label represented to consumers that Bancroft's specifications had been followed.

Another case relying upon section 400 is Connelly v. Uniroyal, Inc. Connelly suffered personal injuries when a Uniroyal tire failed while he was driving his automobile. Uniroyal neither manufactured nor sold the tire, but licensed the use of its registered trade name "Uniroyal." The tire was manufactured by Englebert and sold to General Motors Corporation, which placed the tire on the automobile when it was assembled. Uniroyal had entered into an agreement to make available to its licensee, Englebert, detailed information concerning the methods, processes, and formulas used in the manufacture of tires and to also supply technical services and instruction. Englebert made quarterly payments to Uniroyal for the license and was specifically authorized to publicize the fact that it employed manufacturing and technical methods used by Uniroyal. Englebert was also required to advise Uniroyal as to the nature of the goods and manufacturing operations being associated with the Uniroyal trademark.

The court observed that the cases applying section 400 to non-manufacturers who hold themselves out as manufacturers all involve some degree of participation in the chain of distribution by the non-manufacturer. Nevertheless, the court held that participation in the distribution of the product is not an essential element for application of section 400. A trademark-licensor is an integral part of the marketing enterprise and participates in the profits reaped by placing a defective product in the stream of commerce. Thus, the same policies that justify applying section 400 to wholesalers, retailers, and lessors apply equally to a trademark-licensor.

123. Id.
124. Id. at 1106-07.
125. 75 Ill. 2d 393, 389 N.E.2d 155 (1979).
126. Id.
127. Id. at 410, 389 N.E.2d at 162.
128. Id. at 410-11, 389 N.E.2d at 162-63.
129. The court observed:
The societal purposes underlying Suvada mandate that the doctrine be applicable to one who, for a consideration, authorizes the use of his trademark, particularly when, as here, the product bears no indication that it was manufactured by any other entity. The fact that the defendant may not have been a link in the chain of distribution is wholly irrelevant for as the court, referring to a seller, contractor or supplier, said in Suvada, 'lack of privity of contract not being a defense in a tort action against the manufacturer, it is not a defense in an action against any of these parties.'
In *Hebel v. Sherman Equipment Co.*,\(^ {130} \) the plaintiff injured his foot in a conveyor that was part of a car washing system. Hebel, who was working as an attendant when he suffered the injury, sued the manufacturer, Sherman Equipment Co., under section 400. Haverberg, another defendant, had assembled the car washing equipment from various component parts, placed its name on the system, and sold it to the Glenbrook Service Station, where Hebel was working when he was injured. Although Sherman manufactured most of the component parts, it did not manufacture the conveyor drive chain, which injured the plaintiff. Sherman's name appeared on the parts it had manufactured and on brochures which had been composed and distributed by Haverberg to the purchaser.\(^ {131} \)

Sherman received summary judgment on the ground that it did not manufacture, design, or sell the conveyor.\(^ {132} \) The appellate court reversed, finding that a genuine issue of material fact existed as to whether Sherman held itself out to be the manufacturer of the conveyor drive mechanism.\(^ {133} \) The court observed that *Connelly* and *Suvada v. White Motor Co.*\(^ {134} \) mandate that the strict tort liability doctrine be applied to "one who, for a consideration, authorizes the use of his trademark, "particularly when . . . the product bears no indication that it was manufactured by any other entity."\(^ {135} \) The court, apparently relying upon Illinois common law and without reference to section 400, found that no difference exists "between the liability of a manufacturer and the liability of one who holds himself out to be the apparent manufacturer."\(^ {136} \)

The Supreme Court of Illinois reversed\(^ {137} \) and distinguished *Kosters, Connelly*, and *Kasel*.\(^ {138} \) In addressing the "apparent manufacturer" or "holding out" doctrine that had developed in Illinois, the court observed that this species of estoppel developed originally as a basis for imposing tort liability based upon "apparent manufacturers" and was subsequently subsumed by section 400.\(^ {139} \) The supreme court found the lower court's analysis faulty for concentrating upon appearances to the injured party and not to the purchaser of the product.\(^ {140} \) The court concluded that the purchaser (Glenbrook Standard Sta-
tion) would not have believed either from the appearance of the equipment bearing Sherman's name or from advertisements published by Haverberger\(^{141}\) that Sherman manufactured the injury-producing equipment.\(^{142}\)

IV. Conclusion

Franchisor liability has traditionally been based on agency theories, both actual and apparent. Control, sometimes described as control beyond that necessary to prevent abandonment of the registered mark or name under the Lanham Act, is the key to finding actual agency. Apparent agency is based on the franchisor's "holding out" of the franchisee as being part of one business entity (by means of the trademark, advertising, or architecture), and the consumer's reasonable reliance on the franchisor's representations.

If the franchisor exercises too little control, his trademark may be deemed abandoned and the franchise system will be in jeopardy. If the franchisor exercises too much control, he may become vicariously liable for the acts of his franchisee. A franchise agreement reserving to the franchisor only those controls necessary to protect the trademark, such as control over the quality and uniformity of the franchised product or service, and perhaps control over uniformity of business identity, should not create an agency relationship with the franchisee. Controls that go beyond protection of the trademark and allow the franchisor to effectively run the business may provide a basis for a principal-agent relationship. Courts seldom agree on what constitutes "excessive" control. In the few cases where the Lanham Act has been raised as a defense to a claim of actual agency, franchisors have been much more successful in avoiding vicarious liability than in those cases where the franchisor merely attempted to minimize the elements of control without raising the requirements of the Act.

Injured third persons also have attempted to hold franchisors directly liable. Under certain circumstances, a franchisor may be held to have breached a duty of care owed to the consumer (such as the duty to supervise and control the franchisee), thus making the franchisor directly liable for its own negligence. When the injury is caused by a defective product, strict liability concepts, such as breach of warranty and strict liability in tort, may apply to a non-manufacturing franchisor or trademark licensor. The emerging theories of products liability seem to share the view that when a trademark-licensor (franchisor), through its trademark, advertising, and other manifestations,
places a product in the stream of commerce and represents to consumers that
the product or service is of a certain uniformity and quality, the franchisor
should be held liable on the same basis as a manufacturer. Regardless of
whether breach of warranty, section 402A or section 400 is used, the result is
the same: the trademark-licensor is held directly responsible to a third person
for injury caused by a product manufactured and sold by its franchisee.

These theories create a rather formidable mine field through which a
franchisor-licensor must walk in maintaining the integrity of the franchise
while avoiding responsibility for the acts of its franchisees. At the very least, a
franchisor who does no more than is required by the Lanham Act in control-
ling its franchise system should be able to avoid being held liable for the acts
of its franchisees.