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## California District Court Decision May Provide Blueprint For Franchisees' Vicarious Liability Claims Against Franchisors

Late last summer, the California Supreme Court refused to find Domino's Pizza vicariously liable for the alleged wrongdoing of its franchisee's employee. The closely divided 4-to-3 decision in *Patterson v. Domino's* reflected the Court's attempt to reconcile the franchise business model with the traditional legal doctrines of agency and vicarious liability.[1]

Recognizing the universal benefit of systemwide consistency, the Court applied the "means and manner" control test to Domino's franchise system to determine whether Domino's possessed the general right to control the relevant day-to-day activities of the franchisee's employees.

The Court's application of the "means and manner" control test focused primarily on Domino's comprehensive operations manual and other materials to evaluate the control, if any, Domino's reserved over the "hiring, direction, supervision, discipline, discharge, and relevant day-to-day aspects of the workplace behavior of the franchisee's employees."[2] Following a comprehensive review of these items, the Court ultimately found that no employment or agency relationship existed between Domino's and its franchisee's employee.

Since *Patterson*, no court applying the "means and manner" control test has found an agency relationship to exist. *See Vann v. Massage Envy Franchising LLC*, 2015 U.S. Dist. LEXIS 1002, *20 (S.D. Cal. Jan. 5, 2015)(franchisor's system-wide polices identified in its operations manual assisted in brand uniformity and did not show that the franchisor was a joint employer with its franchisees); *De La Sol v. Xerox Corp*., 2014 Cal. App. Unpub. LEXIS 6155, 15 (Cal. App. 2014)(contractual requirement that an authorized sales agent use Xerox parts in the service of Xerox machines does not amount to substantial control by Xerox for purposes of vicarious liability); *Brunner v. Liautaud*, 2015 U.S. Dist. LEXIS 46018, *16 (N.D. Ill. Apr. 8, 2015) (franchisor's "hands on approach emphasizing uniformity and compliance does not support a determination that [the franchisor] is a joint-employer" with its franchisee);

*see also*, *Ambrose v. Avis Rent a Car Sys*., 2014 U.S. Dist. LEXIS 170406, *13-14 (C.D. Cal. 2014)(court refused to adopt the means and manner control test for quasi-franchise business model).

These post-*Patterson* rulings suggest that the application of the "means and manner" control test has made it nearly impossible for plaintiffs to successfully assert vicarious liability against franchisors. However, the U.S. District Court for the Southern District of California's recent denial of a motion to dismiss in the case of *Keller v. Narconon Fresh Start*, 2015 U.S. Dist. LEXIS 53596 (S.D. Cal. Apr. 22, 2015), identifies a blueprint that plaintiffs may be able to follow in an attempt to further their agency claims.

In September 2014, plaintiff Christopher Keller and his parents, Curtis and Linda Keller, filed suit for breach of contract and fraud against Narconon Fresh Start ("Fresh Start"), Association for Better Living and Education International ("ABLE"), Narconon International ("NI"), and Narconon Western United States ("NWUS").[3] The claims arise out of Christopher's experience in a drug rehabilitation program owned and operated by Fresh Start.

According to the complaint, a representative of Fresh Start made several false statements to the plaintiffs concerning the effectiveness of the drug rehabilitation program and the supervision that would be provided to Christopher while he attended the program. Relying upon these alleged representations, the plaintiffs paid a $33,000 program fee and enrolled Christopher in the program.

Christopher ended up leaving the program early because, among other things, he did not feel safe and he believed that the staff was unfit to treat him.

While each defendants' role in the facts giving rise to the plaintiffs' claims is not entirely clear, it appears that Fresh Start is a *licensee* of the Narconon trademark and system, ABLE is the *owner* of the Narconon trademark and system, and both NI and NWUS are *licensees* of ABLE, and *sub-licensors* of the Narconon trademark and system to rehabilitation centers "like" Fresh Start.[4]

More importantly, the plaintiffs alleged that NI, NWUS, and ABLE (collectively, the "Licensors") were vicariously liable for the injuries caused by Fresh Start because they "govern and control nearly every aspect of Fresh Start's business activities."[5]

Similar to the Supreme Court's decision in the *Patterson* case, the plaintiffs' allegations focus on the controls granted to the Licensors through various operations manuals governing Fresh Start's use of the Narconon marks and system.[6]

Cherry picking from these operations manuals, the plaintiffs were able to compile a list of significant controls allegedly exerted by the Licensors over the day-to-day operations of Fresh Start's business, including the following: (1) Fresh Start cannot demote, transfer, or dismiss a permanent staff member without approval from NI; (2) the Licensors have the ultimate authority over the hiring of Fresh Start's staff members; (3) in the event Fresh Start determines that a staff member is not qualified for the job, that staff member "may petition the Senior Director of Administration at NI to remain on staff"; (4) Fresh Start staff members may file a 'Job Endangerment Chit' with NI if they believe Fresh Start has given orders or denied materials that make work difficult; (5) Fresh Start employees are required to report misconduct to

NI, which is then investigated by both NI and NWUS; and (6) NI requires Fresh Start to send detailed weekly reports containing statistics of more than 40 metrics, which both NI and NWUS review.[7]

In addition to the controls identified in the operations manuals, the plaintiffs also alleged that the Licensors were all intimately involved in Fresh Start's operations in the following ways: (1) they required Fresh Start to seek their approval before circulating promotional materials and starting new websites; (2) they assisted Fresh Start in creating advertising materials and dictated the materials' content; (3) they conducted "tech inspections" at Fresh Start to determine whether Fresh Start was delivering the Narconon program correctly; (4) they worked with Fresh Start on legal issues, including patient requests for refunds and complaints to the Better Business Bureau; and (5) they exercised final authority over Fresh Start relating to hiring and firing, delivery of services, finances, advertising, training, and general operations.[8]

The Licensors moved to dismiss the complaint, arguing that the plaintiffs' experience was with Fresh Start – a single licensee – and that the allegations in the complaint are insufficient to establish an agency relationship under the precedent identified in *Patterson*.

After acknowledging that it had to accept the plaintiffs' allegations as true for purposes of the motion to dismiss, the district court quickly found that the plaintiffs had alleged facts sufficient to show that the Licensors "control the 'means and manner' of Fresh Start's operations" for purposes of an agency relationship between Fresh Start and the Licensors.[9]

Unlike the other post-*Patterson* cases identified above, the *Keller* lawsuit was initiated in its entirety after the *Patterson* ruling was announced by the California Supreme Court. This presumably provided the *Keller* attorneys with an opportunity to mold their complaint to avoid the same control deficiencies identified in *Patterson*.

By thoroughly dissecting the operations manuals and then pleading each semblance of control reserved by the Licensors over Fresh Start in these documents, the *Keller* plaintiffs were able to overcome the *Patterson* plaintiff's shortcomings and allege facts sufficient to support an agency relationship.

In light of *Keller*, franchisees should be encouraged to dissect all of the franchise system materials in search of any language that identifies control by the franchisor. Presenting this language to the court in a vacuum may be enough to overcome the *Patterson* decision.

Alternatively, franchisors must be even more vigilant in ensuring that their policies and procedures are limited to the protection of their brand and goodwill. Any suggestion that the franchisor is exceeding this limited control could provide fuel for future claims of vicarious liability.

* * *

This case report was prepared by Kevin A. Adams (kadams@mulcahyllp.com) of the Irvine law firm of Mulcahy LLP. Mulcahy LLP is a boutique litigation firm that provides legal services to franchisors, manufacturers and other companies in the areas

of franchise, trademark, trade secret, unfair competition, and distribution laws.

[1] *Patterson v. Domino's Pizza, LLC*, 60 Cal. 4th 474 (Cal. 2014).

[2] *Id.* at 497-498.

[3] The common "Narconon" name is reflective of a longstanding and famous drug rehabilitation and education program that uses the "secular technology" of L. Ron Hubbard to educate and treat addicts. (Defs.' Memo of P's & A's ISO Mtn to Dismiss, p. 2.) Of course, Mr. Hubbard is also known for founding the Scientology religion.

[4] Defs.' Memo. ISO Mtn to Dismiss, p. 3.

[5] Compl. ¶ 71.

[6] Pltfs.' Opp. To Mtn to Dismiss, p. 4 (the manuals are entitled "Running an Effective Narconon Center" and "Opening a Successful Narconon Center").

[7] Compl. ¶¶ 73-79.

[8] *Id.* at ¶¶ 79-88.

[9] *Keller v. Narconon Fresh Start*, at *10.

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