Mobile Apps Within a Franchise System: The Vicarious Liability Risk

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Like many businesses, franchise systems can benefit from staying current on technological advances. Technology serves multiple purposes for businesses: reduce costs, promote efficiency, improve customer service, and generate excitement about the business and its products. Applications for smart phones (mobile apps) are one such technological advancement that can offer increased efficiencies, reduced costs, and greater customer loyalty. Given these potential benefits, franchisors need to consider whether a mobile app is a good fit for their system.

In addition to the general benefits, mobile apps can create various opportunities and advantages that are unique to the franchise business model. For example, franchisors can promote system uniformity by employing a single app throughout a system. Nevertheless, mobile apps also bring risks with them that are unique to the franchise business model. One such risk is an increased exposure to vicarious liability for acts of a franchisee. This article explores this particular risk and offers suggestions for how to avoid or minimize it.

Franchisors work hard (or should work hard) to avoid being held vicariously liable for the actions of their franchisees.[1] A court can potentially hold a franchisor liable for the acts of its franchisee under either a theory of actual agency or a theory of apparent agency.[2] *Ahl v. Martin*, a case involving the sale of alcohol and a car accident, provides an example of actual agency.[3] The plaintiffs in *Ahl* alleged that the driver of the car had been intoxicated at the time of the accident and that an employee of a franchised convenience store sold alcohol to the driver.[4] The complaint named the

1. *See* Heather Carson Perkins et al., *Franchisor Liability for Acts of the Franchisee*, 29 FRANCHISE L.J. 174, 174 (2010) (discussing the trap of vicarious liability in the franchise business model).
2. *Id.*; Hoytt v. Docktor Pet Ctr., Inc., No. 85 C 6850, 1986 WL 11619, at *2–3 (N.D. Ill. Oct. 10, 1986).
3. 440 N.Y.S.2d 748, 749 (N.Y. App. Div. 1981).
4. *Id.*

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franchisor entities as defendants on the grounds that the franchisee employee who sold the alcohol to the driver was an agent of the franchisor entities.[5] In response, the franchisor entities moved for summary judgment, arguing in part that the seller of the alcohol was an independent contractor rather than an agent.[6] The appellate court affirmed the lower court's denial of summary judgment on the grounds that there were issues of fact regarding whether the alleged seller of the alcohol was the franchisor's agent. These issues of fact included "conflicting inferences regarding the degree of control and the right to control by the moving defendants over the operation of the store at which the driver allegedly purchased alcoholic beverage."[7]

An example of apparent agency is provided by the Fourth Circuit decision *Crinkley v. Holiday Inns*.[8] In *Crinkley*, the plaintiffs alleged that, shortly after checking into their motel room, they were beaten and robbed by a group of bandits during a time when such robberies were common in the area.[9] The appellate court upheld the jury verdict of $500,000 entered against the defendants, including the franchisor, determining that the evidence of apparent agency was sufficient to support the jury's verdict regarding vicarious liability.[10] To support its ruling, the court relied on the consistent use of marks and unified advertising among both corporate and franchised hotels within the system.[11] The court also emphasized that the only notice to patrons regarding the franchised nature of the hotel in question was a sign in the hotel restaurant, which it did not find to be sufficient notice.[12]

Thus, the risk of vicarious liability for franchisors, whether based on a theory of actual agency or apparent agency, is real. Utilization of mobile apps within a franchise system can increase these risks. As a result, franchisors must consider the risks and benefits that accompany a mobile app when determining whether to implement one.

I. Actual Agency—Two Tests to Consider

Courts evaluating the actual agency of a franchisor traditionally base their evaluation on the degree of day-to-day control that the franchisor exercises over the franchisee's operations.[13] Some courts describe the necessary level

5. *Id.*
6. *Id.*
7. *Id.*
8. 844 F.2d 156 (4th Cir. 1988).
9. *Id.* at 158–59.
10. *Id.* at 167.
11. *Id.* at 166–67.
12. *Id.*
13. Ortega v. Gen. Motors Corp., 392 So. 2d 40, 42 (Fla. Dist. Ct. App. 1980) ("Of greatest importance are those rights and duties of the parties which bear most directly and significantly on the right to control the day-to-day operation of [the franchisee's] business."); *see also* Ahl v. Martin, 440 N.Y.S.2d 748, 749 (N.Y. App. Div. 1981) (stressing that the franchisors' control of

of control of the franchisee by the franchisor as control of the "manner and means" or "complete or substantial control."[14]

Recent case law shows that courts are moving away from this traditional day-to-day-operations analysis in favor of a "control-over-the-instrumentality" test.[15] This latter test declines to impose vicarious liability on the franchisor unless the franchisor had control over the instrumentality that caused the injury.[16] This latter test is helpful for franchisors because it decreases their exposure to vicarious liability.[17] Despite the growing acceptance of this test,[18] franchisors need to be ready to argue against the imposition of vicarious liability based on both the traditional day-to-day-operations test and the newer instrumentality test.

A. *Day-to-Day Operational Test*

1. Vicarious Liability Analysis

Apps offer various levels of functionality. Some apps let users view information regarding a franchisee, such as store location, hours, or menu items. Some apps take this a step further, offering users the ability to save their favorite items. Other apps offer even more functionality, allowing users to place and pay for orders. These app features can help customers access franchisees' products and encourage customers to return to a store within the system—with obvious benefits for the system. However, there are vicarious liability issues that franchisors must bear in mind.

Generally, the greater the functionality offered by an app, the greater the likelihood that a court will find the franchisor is exerting greater control over the day-to-day operations of the franchisee via the app, thereby creating a greater risk that it may be held vicariously liable for a franchisee's conduct. An app that offers higher levels of functionality, such as ordering capability, is more likely to create a vicarious liability risk. Apps that provide only static information, such as menu items or nutritional information, will most often be run by the franchisor and create few new burdens for the franchisees. Thus, these sorts of apps pose less risk of creating vicarious liability for the franchisor.

A system-wide app that allows users to place orders at nearby restaurants provides an example. This functionality imposes new obligations on individual franchisees, including fielding orders via the mobile app, preparing those orders, and frequently delivering those orders. With this advancement, the franchisor can require the franchisees to buy new, sophisticated equipment

or right to control the franchisee's operation of its business determined whether an agency relationship existed between the franchisor and franchisee).

14. Cislaw v. Southland Corp., 6 Cal. Rptr. 2d 386, 388 (Cal. Ct. App. 1992).

15. Perkins, *supra* note 1, at 175.

16. *Id.*

17. *Id.*

18. Some jurisdictions have declined to adopt this test. *See*, *e.g.*, Rainey v. Langen, 998 A.2d 342, 348–49 (Me. 2010).

that receives and monitors the mobile orders. The franchisor can also require that the franchisees process these mobile orders in a particular fashion, creating the potential for greater day-to-day control by the franchisor and thus a higher risk of vicarious liability.

Nevertheless, it is also true that orders sent via app are similar to orders sent via website or even orders made over the telephone. All these various types of orders provide the franchisor with an opportunity to exert greater control over the franchisee by requiring the franchisee to purchase certain equipment (i.e., a computer or a telephone) and process the orders in a particular manner. App ordering and telephone ordering give rise to different levels of complexity. App ordering requires more sophisticated equipment and a more highly developed procedural operation. A person answering a telephone or even two or three telephones can only take so many orders while a business fielding orders via a mobile app can potentially receive hundreds of orders in a single minute. Therefore, taking orders via app requires that the franchisee be prepared with a highly structured system—one that is likely to be designed by the franchisor. Thus, despite the similarities between app orders and telephone orders, app orders, due to the sophisticated system they require, have an increased potential to create greater control over the franchisee by the franchisor.

A second difference between the level of control created by app ordering arises from the fact that it is yet another ordering option for customers, functioning alongside several already existing options such as telephone, in-person, or web-based ordering. In other words, the challenge with app ordering does not arise from the nature of the app itself but rather the fact that app ordering is the latest ordering option. With all the previously mentioned ordering options in place, app ordering is just another manner by which franchisors can control a franchisee's day-to-day operations. Prior to the advent of Internet and mobile technologies, a franchisee only had to follow a franchisor's telephone and in-person ordering guidelines and processes. Now, a franchisee must follow the franchisor's processes and guidelines for web-based ordering and mobile app ordering as well. This means that the franchisee is following a greater number of processes and guidelines promulgated by the franchisor. All this can lead to greater day-to-day control and a greater risk of vicarious liability for the franchisor.[19]

2. The Fix–Lessening Vicarious Liability Risks Under the Day-to-Day Test

Although apps rely on relatively new technology, the problems they create regarding vicarious liability risks are age-old. The franchisor that utilizes an app needs to balance its need for uniformity throughout its system against the increased risk of vicarious liability caused by exercising greater control.

19. The same analysis applies in varying degrees to any other high-functionality app feature such as paying for services or scheduling an appointment.

Striking this balance can be difficult but it is possible as long as the franchisor stays mindful.

One approach to striking this balance is for a franchisor to focus on the broad overview, i.e., the 15,000-foot view. A franchisor should exercise a 15,000-foot level of control over its franchisees. A useful way for franchisors to exercise such control is to remind the franchisees that the franchisor has developed a franchise system, and that it is the system (not the franchisee) that the franchisor controls. The system provides the general manner of operation for each franchisee within the system. For example, in a franchise system that sells tennis shoes, the system is comprised of contacts with shoe manufacturers, store design and layout, trademarks, employee training, and maybe even the type of music that plays in the franchised stores. The system does not include which particular employee operates the cash register and which particular employee sells kids shoes—decisions that are left to the franchisee.

The 15,000-foot view can apply to mobile app ordering within a franchise system. Picture a franchised donut shop that accepts orders via a mobile app developed by the franchisor. The donut shop franchisor can control the app itself and design and implement the system or process that necessarily must accompany the app. This means the franchisor can and should develop the procedures that individual donut shops will use to receive, monitor, and process orders. In particular, the franchisor should require specific app-compatible equipment to ensure that the system runs smoothly. Additionally, the franchisor should develop and implement a system whereby franchisees receive orders via app, process orders fielded from the app, and complete or deliver these same orders. Delving into an additional level of detail, the hypothetical donut franchisor could even train its franchisees to use a certain number of franchisee employees to receive donut orders, a certain number to fry the donuts, and a certain number to package and deliver the donuts. What the franchisor cannot do is direct the franchisee as to who should fry the donuts and who should deliver them. Such an approach is not control over the system but may be considered control over day-to-day operations and could lead to vicarious liability.

B. *Control-over-the-Instrumentality Test*

1. Vicarious Liability Analysis

The analysis under the control-over-the-instrumentality test is more straightforward. Use of mobile apps within a franchise system will give rise to vicarious liability for the franchisor only if (1) the franchisor controlled the mobile app, and (2) the app was the instrumentality that caused the injury. Such liability is most likely to arise in situations where franchisees deliver services or products different from those advertised in the app.

The first prong will almost always be satisfied because franchisors typically control the mobile app. This is a result of the need for uniformity within a franchise system and the logistical burdens, difficulties, and expense that accompany operation of a mobile app.

Under the second prong, the app must cause the injury in order for the app to give rise to vicarious liability. The manners in which an app can cause injury under this instrumentality test are limited. The content on an app should be non-offensive and accurate business-related content approved by the franchisor. One notable exception could arise if a franchisee does not provide service in accordance with the level of service described on the app. For example, say a Chinese food restaurant app tells customers that all deliveries will be made within thirty minutes of placing an order. A customer could claim that the app injured her by providing misleading or false information because her delivery was made one hour after she placed her order. Similarly, say a carpet cleaning franchise develops an app that the franchisor controls. Say that the app describes the services offered by franchisees and allows customers to make appointments. A customer could claim that the app injured her by providing misleading or false information if the franchisee used a more abrasive cleaning solution instead of the advertised all-natural cleaning solution, causing the customer to have an adverse reaction.

Therefore, the possibility exists for mobile apps to expose franchisors to vicarious liability even under the control-over-the-instrumentality test, especially if a franchisee delivers service that varies from the level of service described in the franchise system's app.

2. The Fix—How to Curb Vicarious Liability Risks under this Control-Over-the-Instrumentality Test

The fix is simple to articulate but potentially difficult to enforce. Franchisors will continue to control the apps themselves because they need such control to preserve uniformity, oversee costs, and resolve operational issues. Therefore, franchisors will not be able to avoid vicarious liability under the control-over-the-instrumentality test by arguing that they did not control the instrumentality. Instead, franchisors need to be sure that their apps do not cause injury by ensuring that franchisees offer the goods or services described on the app so that customers cannot claim that the app provided them with false or misleading information. This should not create a new burden for franchisors because they should already be enforcing uniformity throughout the system and ensuring that franchisees are offering the products and services that the other franchisees are offering. Thus, apps have not fundamentally changed how franchisors need to operate; they have just put a twist on their existing duties.

II. Apparent Agency–Appearances Matter

In addition to actual agency, it is possible for a franchisor to be held vicariously liable for the acts of its franchisees if a court determines that the franchisee is the apparent agent of the franchisor.[20] For apparent agency to arise in the context of a franchisor-franchisee relationship: (1) the franchisor must hold out the franchisee as its agent; (2) a third party must rely on this representation by the franchisor; and (3) this reliance by the third party must be in good faith or reasonable.[21]

Under the first element, a court may determine that a franchisor has held the franchisee out as its agent either expressly or implicitly.[22] Often in the situation where a plaintiff is trying to hold a franchisor responsible for the conduct of a franchisee, the plaintiff relies on the shared name and trademarks of the franchisor and franchisee to argue that the franchisor impliedly held out the franchisee as its agent.[23]

Second, the plaintiff must show that it relied on this representation.[24] Plaintiffs fail to establish this element when the franchisor can show that the plaintiff did not in fact choose the franchisee's business due to the franchisee's alleged agency relationship with the franchisor.[25]

Third, plaintiffs must show that they reasonably relied on the expressed or implied agency relationship between the franchisor and franchisee.[26] Here, the question is whether a reasonable person would have relied as the plaintiff relied on the apparent agency relationship between franchisor and franchisee.[27]

A. *Vicarious Liability Analysis of Apps Under an Apparent Agency Theory*

Apps can give rise to increased risks of vicarious liability through an apparent agency theory. First, they have the potential to create confusion among consumers regarding whether a franchisee is an agent of the franchisor. A consumer could argue that through its app, the franchisor represented that its franchisees were its agents. Consumers could bolster their arguments by pointing to the shared trademarks and names contained within the app, as well as the fact that the franchisor's app links to and provides information for a franchisee's location. In short, apps can create a greater risk that a franchisor is impliedly holding out its franchisees as its agents.

Second, if consumers use a franchise system's mobile app, it would likely not be difficult for them to argue that they relied on the apparent agency relationship between the franchisor and franchisee when deciding to purchase products or services from the franchisee. This is because if they are using the

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20. Broock v. Nutri/System, Inc., 654 F. Supp. 7, 10–11 (S.D. Ohio 1986).
21. *Id.*; Perkins, *supra* note 1, at 176; *see also* 3 Am. Jur. 2d *Agency* § 71 (2014).
22. Pinon v. Int'l Harvester Co., 390 So. 2d 154, 154 (Fla. Dist. Ct. App. 1980).
23. *See* Perkins, *supra* note 1, at 176.
24. *Broock*, 654 F. Supp. at 10–11.
25. *See* Case v. Holiday Inns, Inc., No. 87-3164, 1988 WL 70401, at *1–2 (4th Cir. July 5, 1988) (finding no apparent agency because the plaintiff could not have relied on the franchisee's apparent association with the franchisor when making hotel reservations because the plaintiff's employer, not the plaintiff, made the reservations).
26. *Broock*, 654 F. Supp. at 10–11.
27. *See* 62B Am. Jur. 2d *Private Franchise Contracts* § 300 (2014).

app, then they are aware of the agency relationship that they claim existed between the franchisor and franchisee. From there, it is only a small step for them to argue that they relied on this purported relationship when choosing to purchase the franchisee's products or services.

Third, consumers must establish that their reliance was reasonable in order to hold the franchisor vicariously liable for the franchisee's conduct under an apparent agency theory. If a franchisor fails to provide notice on its app that each store is a franchised business, not a corporate store or an agent of the franchisor, it is more likely that consumers can establish that their reliance on the purported agency relationship was reasonable. In other words, if a consumer can use a mobile app without viewing any message that makes clear that the franchised stores are independent businesses, there is a greater risk that the consumer's reliance will be deemed to be reasonable.

B. *The Fix—How to Curb Vicarious Liability Risks under an Apparent Agency Theory*

The most efficient way for franchisors to avoid being held vicariously liable under an apparent agency theory is to ensure that a consumer's reliance on any agency relationship is unreasonable. This is true because the value of the system centers on its trademarks; it would be of no benefit for the franchisor or franchisees for the app to be devoid of marks. Thus, there is going to be the possibility of an implied agency association between the franchisor and the franchisee. Franchisors can combat this by expressly providing notice to any consumer who uses the app that the franchisor is separate from the franchisees, each of which owns her own independent store. Franchisors can provide this notice in the terms of use for the app. Additionally, as an extra level of protection, franchisors could design their apps to force customers to re-acknowledge this franchisor-franchisee relationship each time a purchase is made from a franchisee. Using the donut shop example from earlier, the system's app could display a message that re-announces this franchisor-franchisee relationship and denounces any agency relationship each time a customer places an order at the nearby donut shop franchise. Such a feature would go a long way to ensure that customers' reliance on any implied agency relationship is unreasonable and thereby undercut their ability to hold the franchisor vicariously liable for the acts of the franchisee based on an apparent agency theory.

III. Conclusion

Apps can benefit franchise systems just as they can benefit most businesses. Apps can be fun, interactive, and a great way to promote customer loyalty but these potential benefits do not come without risks. A franchisor that releases an app for use throughout the system must be aware of the risks that accompany mobile apps. In the context of the franchise business model, one of these risks is increased risk of vicarious liability for the acts of franchisees. Such vicarious liability can be established under either a theory of actual agency or a theory of apparent agency. A prudent franchisor will account for both possible theories and develop its app in a way that will limit its exposure to this vicarious liability risk.