

January 1988

Liability of Franchisors for the Torts of Their Montana Franchisees

E. Wayne Phillips

Follow this and additional works at: <https://scholarworks.umt.edu/mlr>



Part of the [Law Commons](#)

Let us know how access to this document benefits you.

Recommended Citation

E. Wayne Phillips, *Liability of Franchisors for the Torts of Their Montana Franchisees*, 49 Mont. L. Rev. (1988).

Available at: <https://scholarworks.umt.edu/mlr/vol49/iss1/9>

This Comment is brought to you for free and open access by ScholarWorks at University of Montana. It has been accepted for inclusion in Montana Law Review by an authorized editor of ScholarWorks at University of Montana. For more information, please contact scholarworks@mso.umt.edu.

COMMENTS

LIABILITY OF FRANCHISORS FOR THE TORTS OF THEIR MONTANA FRANCHISEES

E. Wayne Phillips

I. INTRODUCTION

Courts have described franchising as a system for distributing goods or services under a brand name through outlets owned by independent businesses called franchises.¹ The franchise relationship is governed by an elaborate contract under which the franchisee conducts a business or sells a product or services in accordance with prescribed methods and procedures.² The franchise relationship provides the franchisee with advertising, promotion, training, financing, and other specialized management resources.³ The franchisor, on the other hand, obtains from the relationship a standardized, broad distribution of its goods or services, thereby increasing the franchisor's return while reducing its risks.

The system of sales under a franchising agreement became a distinct part of American business with the franchising of auto and soft drink sales in the 1890s.⁴ The development of franchise operations such as McDonalds, Kentucky Fried Chicken, Howard Johnson Motels, and others created a franchising boom in the 1950s.⁵ The phenomenal growth and success of franchises in that period resulted from several economic and social factors. The suburbanization of American cities created an opportunity for entrepreneurs to meet demands of individuals for goods and services located far from traditional business districts. Franchising provided the enterprising individual with a business structure for capitalizing on that opportunity. The joblessness created by major ec-

1. *Murphy v. Holiday Inns, Inc.*, 216 Va. 490, 494, 219 S.E.2d 874, 877 (1975) (quoting R. ROSENBERG, *PROFITS FROM FRANCHISING* 41 (1969)).

2. In its modern form, franchising probably originated when the Singer Sewing Machine Company established its elaborate sales system after the Civil War. C. VAUGHN, *FRANCHISING* 11 (1974).

3. *H & R Block, Inc. v. Lovelace*, 208 Kan. 538, 545, 493 P.2d 205, 211 (1972).

4. C. VAUGHN, *supra* note 2, at 25.

5. *Id.* at 15-17.

onomic upheavals, such as the end of the Korean War and the switch from an industrial to a service economy, spawned a pool of talented people who responded to the attractive aspects of independent ownership and minimum capital requirements of franchises. Finally, public figures began associating their names with franchise advertising, leading to greatly increased acceptance of franchise products and services by the public.⁶

This initial wave of the franchise boom peaked in 1968.⁷ However, in recent years, a new and significant upsurge in franchising has developed.⁸ Modern entrepreneurs have created franchise options such as freeze drying of pets, aptly named Preserve-A-Pet,⁹ and radon testing of homes, to mention just a few of the approximately five hundred or so new franchises created in the United States each year.¹⁰

The unique registration process for new businesses in Montana precludes the Montana Department of Commerce's Bureau of Business Regulation and the Secretary of State's Corporate Licensing Bureau from accurately determining the number of franchises created in the state. This process allows Montana franchisees to register under a fictitious name, which name need not indicate the parent franchisor.¹¹

The proliferation of franchise operations has increased the need for courts to determine whether national franchisors can be found liable for the tortious acts of their franchisees. The Montana Supreme Court, however, has yet to rule on this liability. When presented in 1987 with its first case involving the liability of a franchisor for a franchisee's tort, the court ruled only on the validity of a grant of summary judgment.¹² The issue of franchisor liability thus remains unresolved in Montana.

This comment examines the issue of franchisor liability by

6. *Id.* at 25-26.

7. *Id.* at 26.

8. Hotch & Whittenmore, *Franchising: Find That Niche*, 75 NATIONS BUSINESS 35 (Feb. 1987).

The franchising boom continues to occur despite the imposition of a franchise fee, for the rights inherent in using the franchise, which can run to \$50,000 or higher plus the requirement for payment of monthly royalties—usually 5-7% of the gross—and for monthly advertising fees. Bacas, *Leaving the Corporate Nest—The Franchise Route*, 75 NATIONS BUSINESS 14, 20 (Mar. 1987).

9. Hotch & Whittenmore, *Franchising: Find That Niche*, 75 NATIONS BUSINESS 35 (Feb. 1987).

10. *Id.* This number only estimates the size of the franchising boom because the speed of franchise growth is so rapid nobody knows the precise numbers. *Id.*

11. MONT. CODE ANN. §§ 30-13-201 to -202 (1987).

12. *Burkland v. Electronic Realty Ass'n*, ___ Mont. ___, 740 P.2d 1142 (1987).

first discussing the elements necessary to establish an agency relationship, which relationship is necessary if a franchisor is to be held liable. Analysis then turns to the threshold element necessary for an actual agency: the control exercised by the franchisor over the franchisee's day-to-day operations. The comment next proceeds to an analysis of two key elements necessary for a finding of ostensible agency, the extent to which use of logos, trademarks and advertising creates a "holding out" and the extent to which a third party has relied on the authority of the franchisee. The comment then discusses the type of acts for which a franchisor may be held liable if an agency exists. Finally, it concludes by recommending a structure for use in analysis of a tort case involving a franchise.

II. THE NECESSITY OF AN AGENCY RELATIONSHIP

A. *Liability Hinges on the Determination of an Agency Relationship*

To hold a franchisor vicariously liable for the tortious acts of a franchisee, an agency relationship must exist between the two.¹³ Montana law provides a general analysis of the nature of an agency by stating, "an agent is one who represents another, called the principal, in dealings with third persons."¹⁴ The Montana Supreme Court will not presume the existence of an agency, but rather it will require the party asserting the existence of an agency to carry the burden of proof.¹⁵ Once the third party proves the existence of an agency, the franchisor cannot insulate itself merely by asserting the existence of a franchise agreement.¹⁶

B. *Two Types of Agency Relationship*

1. *Actual Agency*

Courts can hold a franchisor liable for franchisee torts if a determination is made that an actual agency exists. An actual agency exists when the three following elements are found: manifestation of assent by the franchisor, an act by the franchisee providing some degree of benefit to the franchisor, and control by the franchisor.¹⁷

The third element, control by the franchisor over the fran-

13. *Hayman v. Ramada Inn, Inc.*, 357 S.E.2d 394, 397 (N.C. App. 1987).

14. MONT. CODE ANN. § 28-10-101 (1987).

15. *Elkins v. Husky Oil Co.*, 153 Mont. 157, 166, 455 P.2d 329, 332-33 (1969) (citing *Hamilton v. Lion Head Ski Lift, Inc.*, 139 Mont. 335, 363 P.2d 716 (1961)).

16. *Murphy*, 216 Va. at 494, 219 S.E.2d at 877.

17. RESTATEMENT (SECOND) OF AGENCY § 1 (1958).

chisee's day-to-day operations, is the key, often-disputed, element to establishing an actual agency.¹⁸ Thus, an assessment of whether the controls exercised by a franchisor over a franchisee are sufficient to give rise to an actual agency relationship is a threshold question when determining whether a franchisor can be held liable for the torts of its franchisee.

a. Control Considered Sufficient to Establish an Agency Relationship

An analysis of what control is sufficient to establish an actual agency entails an examination of the degree of the franchisor's control, as specified in the contract, over the franchisee and of the degree of control actually exercised over the franchisee.¹⁹ In looking at the control specified in the franchise contract, a number of jurisdictions have found that "[i]f, in practical effect, one of the parties has the right to exercise complete control over the [day-to-day] operation by the other an agency relationship exists."²⁰

The Montana Supreme Court examined the degree of control actually exercised in the non-franchise case of *Elkins v. Husky Oil Co.*²¹ In *Elkins*, an accidental fire at a Husky station caused a customer's death. The court endorsed the plaintiff's view that control would only be sufficient if the principal controlled the compensa-

18. RESTATEMENT (SECOND) OF AGENCY § 1 (1958). See, e.g., *Salisbury v. Chapman Realty*, 124 Ill. App. 3d 1057, 465 N.E.2d 127 (1984). *Elkins*, 153 Mont. at 157, 455 P.2d at 329; *Coe v. Esau*, 377 P.2d 815 (Okla. 1963); *Murphy*, 216 Va. at 490, 219 S.E.2d at 874; *Apple v. Standard Oil*, 307 F. Supp. 107 (N.D. Cal. 1969); *Ottensmeyer v. Baskin*, 2 Haw. App. 86, 625 P.2d 1069 (1981); *Ortega v. General Motors Co.*, 392 So. 2d 40, (Fla. Dist. Ct. App. 1980); *Stanford v. Dairy Queen Prod.*, 623 S.W.2d 797 (Tex. Civ. App. 1981); *Singleton v. Int'l Dairy Queen, Inc.*, 332 A.2d 160 (Del. 1975); *Duluth Herald and News Tribune v. Plymouth Optical Co.*, 286 Minn. 495, 176 N.W.2d 552 (1970); *Beck v. Arthur Murray, Inc.*, 245 Cal. App. 2d 976, 54 Cal. Rptr. 328 (1966); *Nichols v. Arthur Murray, Inc.*, 248 Cal. App. 2d 610, 56 Cal. Rptr. 728 (1967).

19. *Ottensmeyer*, 2 Haw. App. at 89, 625 P.2d at 1071.

Where a sufficient degree of control and direction is manifested by the parent franchisor, an agency relationship may be created. Whether the relationship between a franchisor and a franchisee is that of principal and agent, at least insofar as this relationship affects a stranger to the franchise agreement, is dependent upon the intention of the parties as determined from the written agreement and the accompanying circumstances. The declaration of the parties in the agreement respecting the nature of the relationship created thereby are not controlling, however, and, as with contracts generally, the writings must be considered as a whole. *Salisbury v. Chapman Realty*, 124 Ill. App. 3d 1057, 1061, 465 N.E.2d 127, 131 (1984) (quoting 62 AM. JUR. 2D *Private Franchise Contracts* § 15 (1972)). See also *Singleton*, 332 A.2d 160.

20. *Nichols*, 248 Cal. App. 2d at 610, 56 Cal. Rptr. at 731.

21. 153 Mont. 157, 455 P.2d 329.

tion of employees and hours of operation.²² Because such controls were not exercised, the court found that an agency relationship was not created. Other courts have found that if the franchisor exercises control over compensation and hours of operation such controls will be sufficient to give rise to an actual agency relationship.²³

In the Florida case of *Ortega v. General Motors Corp.*,²⁴ the plaintiff sought to hold GMC vicariously liable for injuries resulting when a truck sold by a franchise dealer rolled over. The court held that GMC was not liable because the company did not exercise the controls "of greatest importance"²⁵—namely, control over hiring, firing and supervision.²⁶ The *Ortega* court also stated that an important criteria to be considered when determining the sufficiency of control is "[i]ndependent ownership of a substantial enterprise."²⁷

In the Delaware case of *Singleton v. International Dairy Queen, Inc.*,²⁸ a young girl injured herself when she fell through the glass door of a Dairy Queen franchise. The court held that the controls exercised and manifested by the franchisor were such that "the very lifeblood of the [franchisee was] in the hands of the franchisor."²⁹ The controls cited by the court included mandating the size, shape and appearance of a franchisee's establishment, imposing the nationally known sign as the only sign for the premises, requiring all containers to show the name of the parent company, dictating portion control, the size and shape of containers, the uniforms of employees, subjecting the franchisee to the obligation to obey subsequent rules and regulations, reserving the right to inspect the premises, naming the suppliers used, and even dictating what else might be sold on the premises.³⁰ The court found that these actions constituted control sufficient to give rise to an actual agency, further adding that there could be no greater control than that over portion control and the unilateral franchise termination control held by the franchisor.³¹

22. *Id.* at 163, 455 P.2d at 331-32.

23. *Salisbury*, 124 Ill. App. 3d at 1061, 465 N.E.2d at 131.

24. 392 So. 2d 40.

25. *Id.* at 42.

26. *Id.* at 43.

27. *Id.*

28. 332 A.2d at 161.

29. *Id.* at 163.

30. *Id.* at 162-63.

31. *Id.* at 163.

b. *Control Considered Insufficient to Establish an Agency Relationship*

Courts have generally held that the degree of control exercised is insufficient to establish an actual agency if the franchisor fails to tell the franchisee *how* the day-to-day franchise business is to be conducted.³² For example, in *Coe v. Esau*³³ the court held that a principal's control was insufficient to give rise to an actual agency because the station owner handled the goods of other suppliers, controlled the hiring and firing, determined his own business hours and methods, and developed independent merchandising policy restrictions.

In *Stanford v. Dairy Queen Products*,³⁴ consumption of an allegedly unwholesome cheeseburger resulting in illness and aggravation of a pre-existing heart condition prompted a suit alleging franchisor liability. In this case, the franchisor exercised control over: food-preparation procedures, periodic inspections, uniforms, financial record keeping, advertising expenditures, membership in a trade association, blue print approval for the building, operating procedures and advertising, and employment and supervisory practices. The court thus held that the franchisor was not liable because these controls were insufficient to establish an agency.³⁵

In *Drexel v. Union Prescription Centers*,³⁶ a federal district court in Pennsylvania had to rule on whether a franchisor would be liable for injuries resulting when its drugstore franchisee improperly filled a prescription. The court held that the franchisor lacked sufficient control over the franchisee, even though the franchise was registered in the franchisor's name, bags, prescription labels, cash register receipts only had the franchisor's name inscribed on them, and advertising and phone book listings were in the franchisor's name.³⁷

c. *The Effect of the Lanham Act on the Factor of Control*

The federal Lanham Act³⁸ mandates that a franchisor, as a trademark owner, must exercise control over its franchisee in order to preserve the trademark rights granted by the law and to protect

32. *Greening v. Gazette Printing*, 108 Mont. 158, 172, 88 P.2d 862, 867 (1939).

33. 377 P.2d 815, 818-19 (Okla. 1963).

34. 623 S.W.2d at 799.

35. *Id.* at 802-03.

36. 428 F. Supp. 663 (D.C. Pa. 1977).

37. *Id.* at 677.

38. 15 U.S.C. §§ 1051 to 1127 (1964).

the public against deceptive practices in use of the trademark.³⁹ Thus, courts often hear arguments that the controls exercised by a franchisor arise principally from its requirement to protect its trademark, tradename and good will and should not give rise to an agency relationship.⁴⁰ This control results from the economic fact that a franchisor's trademark often represents its principal asset.⁴¹ Whether this control "is sufficient to establish an agency relationship depends, in each case, upon the nature and extent of the power defined in the franchise contract."⁴²

The Lanham Act may pose a catch-22 for franchisors. Failure to exercise the necessary control would result in abandonment of the trademark. On the other hand, the controls necessary to prevent abandonment of the trademark are also the kind of controls a court could find sufficient to establish an agency relationship. Those who argue that trademark controls should be held sufficient to establish an agency assert that third parties patronizing the franchisee, because of the quality of goods or services that they have associated with the trademark, should have a right to recourse against the owner/franchisor of the trademark.⁴³

No court has yet ruled on the issue of whether such federally mandated trademark regulations could constitute controls sufficient to give rise to an agency relationship. But the holding by the court in the Wisconsin case of *Star Line Trucking v. Department*

39. 15 U.S.C. § 1127 (1964) states:

The term "trade-mark" includes any word, name, symbol or device or any combination thereof adopted and used by a manufacturer or merchant to identify his goods and distinguish them from those manufactured or sold by others A mark shall be deemed to be "abandoned" . . . [w]hen any course of conduct of the registrant, including acts of omission as well as commission, causes the mark to lose its significance as an indication of origin.

The statute has been interpreted as follows:

If the owner of a trademark wants to license the use thereof to another and still retain as his own the enjoyment of the rights stemming therefrom, he must do so in such a way that he maintains sufficient control over the nature and quality of the finished product, over the activities of the licensee, as will enable the licensor to sustain his original position of guarantor to the public that the goods now bearing the trademark are of the same nature and quality as were the goods bearing the trademark before the licensing, or, that the mark now has the same meaning as far as the public is concerned as it did before the licensing.

Morse-Starrett Prod. Co. v. Steccone, 86 F. Supp. 796, 805 (N.D. Cal. 1949).

40. *Nichols*, 248 Cal. App. 2d at 610, 56 Cal. Rptr. at 731.

41. *Murphy*, 216 Va. at 494-95, 219 S.E.2d at 877.

42. *Id.*

43. Comment, *Liability of a Franchisor for the Acts of the Franchisee*, 41 S. CAL. L. REV. 143, 148 n.24 (1968) (citing Lahart, *Control—the Sine Qua Non of a Valid Trademark License*, 50 TRADEMARK REP. 103, 134 (1960)). If the customer has reasonably relied on the controls inherent in the trademark, then ostensible agency may be found. *Id.*

of *Industry*,⁴⁴ an unemployment compensation case, gives valuable insight into how a Montana court might rule on this issue. In *Star Line*, the plaintiff asserted its truck owner-operators were not employees of the trucking firm, and the firm was therefore not liable for unemployment compensation, because the Interstate Commerce Commission and Wisconsin Administrative Code⁴⁵ had mandated the firm's specific controls over the truck owner-operator.⁴⁶

The Wisconsin Supreme Court noted that the contractual exercise of control over an independent contractor could be sufficient to give rise to an agency relationship. Furthermore, it recognized that the Interstate Commerce Commission requirement "arguably constitutes contractual control."⁴⁷ The court, however, held that such federally and state required controls, promulgated to promote public safety and ensure financial responsibility, could not be used to establish control sufficient to give rise to an employer-employee relationship.⁴⁸

The situation in *Star Line*, although it arose from an unemployment compensation case, is analogous to that arising because of the Lanham Act's trademark control requirements. The broader principle of the *Star Line* holding, that the controls federally mandated for protection of the public shall not be held to give rise to an agency relationship, is similarly analogous. When presented with a tort claim asserted against a franchisor under an agency theory of liability, courts should thus hold that controls mandated to protect the product and public under the federal Lanham Act will not be sufficient to give rise to an agency relationship. However, if the controls go beyond those required to protect the trademark, tradename and good will, and also cover day-to-day details of operations, a Montana court should hold that such excess controls are sufficient to give rise to an agency.⁴⁹

2. *Ostensible Agency*⁵⁰

Even if no actual agency relationship exists, a franchisor may

44. 109 Wis. 2d 266, 325 N.W.2d 872 (1982).

45. *Id.* at 276, 325 N.W.2d at 877.

46. *Id.* at 276, 325 N.W.2d at 877 (citing *Stafford Trucking, Inc. v. Dep't of Indus., Labor & Human Relations*, 102 Wis. 2d 256, 306 N.W.2d 79 (Ct. App. 1981)).

47. *Id.*

48. *Id.*

49. *Nichols*, 248 Cal. App. 2d at 611, 56 Cal. Rptr. at 731-34.

50. A plethora of different terms are used in case law to refer to the concept of ostensible agency. It is sometimes called "apparent" agency, or agency by estoppel. *Mabe v. B.P. Oil*, 31 Md. App. 221, 240, 356 A.2d 304, 315 (1976) (Melvin J., dissenting), *rev'd on appeal*, 279 Md. 632, 370 A.2d 554 (1977); *see also* *Gizzi v. Texaco*, 437 F.2d 308, 309 (3d Cir. 1971).

be held vicariously liable if the existence of an ostensible agency is established.⁵¹ An ostensible agency occurs when two circumstances are met. First, the franchisor must represent to a third person or "hold out" that the franchisee is acting on the franchisor's behalf.⁵² A "holding out" occurs when the franchisor "clothes" the franchisee with authority.⁵³ Signs of advertising typically indicate such a representation.⁵⁴ Second, the third person must rely on that representation or "holding out."⁵⁵ This reliance must result in a change of position,⁵⁶ and must be reasonable under the circumstances.⁵⁷

Stated another way, ostensible agency arises when the principle either intentionally or through want of ordinary care causes the third person to believe the agent represents the principal.⁵⁸ This want of ordinary care has been defined by the Montana Supreme Court as "the failure to do what a reasonable and prudent person would ordinarily have done under the circumstances of the situation, or doing what such person under the existing circumstances would not have done."⁵⁹

a. *Establishing a "Holding Out" through the Use of Logos and Trademarks*

(1) *Shared Identity, Logos, and Trademarks*

In *Elkins*, the Montana Supreme Court considered the issue of whether the principal's use of trademarks and logos alone is sufficient to create a "holding out" and thereby give rise to an ostensible agency. The plaintiff asserted that the Husky signs used at the gas station and the language on the back of the credit card held by the plaintiff stating, "[t]his card will also be honored at service stations of the following companies: . . . Husky Oil Co.,"⁶⁰ were sufficient to create a "holding out" which was then reasonably relied on

Montana's statutes use the term "ostensible" agency.

51. MONT. CODE ANN. § 28-10-103 (1987).

52. *Cf. Elkins*, 153 Mont. at 168, 455 P.2d at 333 (citing *Hart v. Jahn*, 59 Mont. 173, 196 P. 153 (1921)) (which case involved an employer-employee relationship).

53. *Cf. Hartt*, 59 Mont. at 181, 196 P. at 156 (which case involved a real estate contract).

54. RESTATEMENT (SECOND) OF AGENCY, §§ 27, 8 comment b (1958).

55. RESTATEMENT (SECOND) OF AGENCY, § 267 (1958).

56. *Calkins v. Oxbow Ranch, Inc.*, 159 Mont. 120, 126, 495 P.2d 1124, 1127 (1972).

57. RESTATEMENT (SECOND) OF AGENCY, § 267 (1958); *Gizzi*, 437 F.2d at 309.

58. MONT. CODE ANN. § 28-10-103 (1987).

59. *Ahlquist v. Mulvaney Realty Co.*, 116 Mont. 6, 23, 152 P.2d 137, 145 (1944) (quoting *Zanos v. Great Northern R.R. Co.*, 60 Mont. 17, 21-22, 198 P. 138, 140 (1921)) (which case involved the negligence of a common carrier).

60. *Elkins*, 153 Mont. at 167, 455 P.2d at 333.

by the plaintiff. The court agreed with the *Coe* court that goods marketed under a trademark name are not enough to create a holding out sufficient to establish an ostensible agency relationship.⁶¹

In the Montana case of *Burkland v. Electronic Realty Associates, Inc.*,⁶² the Burklands alleged that the franchisor, Electronic Realty Associates, Inc. (ERA), should be held liable for injuries caused by the negligence, fraud and breach of the implied warranty covering a home sold to them by the franchisee ERA Hannah Real Estate (ERA Hannah). More specifically, plaintiffs suffered from ill health caused by the home's water system and from the breakdown of the home's heating system.⁶³

The Burklands asserted that the requirements of the franchise agreement,⁶⁴ which included the requirement that ERA Hannah prominently display the ERA national logo on all advertising and materials, constituted a "holding out" sufficient to establish an ostensible agency relationship between ERA and ERA Hannah.⁶⁵ The Burklands claimed that the requirement that ERA Hannah use the ERA trademark and logo, contribute to a national ERA advertising fund, and participate in local advertising and marketing created a "shared identity" sufficient to qualify as a "holding out" under section 28-10-103 of the Montana Code Annotated.⁶⁶ Further, the Burklands contended they had relied on the national reputation of ERA in purchasing the home. Thus, the plaintiffs claimed that an ostensible agency existed between ERA and ERA Hannah and that ERA could be held liable for its franchisee's actions.

Defendant ERA, however, argued that ERA Hannah was independently owned and operated and that they exercised no control over the management and operations of ERA Hannah. Furthermore, ERA asserted that ERA Hannah was required to use "Hannah" in all advertising, and that they merely charged fixed fees for use of the ERA trademark and national marketing services.⁶⁷

The district court granted ERA's motion for summary judgment, holding that the Burklands failed to offer sufficient evidence

61. *Id.* at 166, 455 P.2d at 331-32; *Coe*, 377 P.2d at 818.

62. ___ Mont. ___, 740 P.2d 1142 (1987).

63. *Id.*

64. *Burkland v. Mullen*, No. 84-2467, slip op. 1, 5 (Dist. Ct. Mont. Aug. 28, 1986), *rev'd sub nom. Burkland v. Electronic Realty Ass'n*, ___ Mont. ___, 740 P.2d 1142 (1987).

65. *Electronic Realty Ass'n*, ___ Mont. at ___, 740 P.2d at 1144.

66. *Mullen*, No. 84-2467, slip op. at 5.

67. *Electronic Realty Ass'n*, ___ Mont. at ___, 740 P.2d at 1143.

to establish an agency relationship. The Montana Supreme Court reversed the district court and remanded the case for a proper determination of whether the plaintiffs reasonably relied on the trademark, reputation and advertising of ERA.⁶⁸

A split opinion exists in other jurisdictions as to what constitutes a holding out sufficient to give rise to ostensible agency.⁶⁹ In *City of Delta Junction v. Mack Trucks, Inc.*,⁷⁰ city officials purchased a customized fire truck from Alaska Mack, Inc., a dealer engaged in selling Mack, Inc. trucks. Because the weight of a full water tank proved too substantial for the truck's chassis design, the fire truck turned out to be unsuitable for its intended purposes and Mack, Inc. was brought in as a defendant on a theory of apparent agency.⁷¹ The Alaska court found that Alaska Mack's telephone listing under the heading "Mack Trucks," the advertising with the Mack logo, and the failure to post signs indicating Alaska Mack was independently owned and operated constituted a "holding out."⁷²

In *Wood v. Holiday Inns, Inc.*,⁷³ an Holiday Inn employee seized a guest's Gulf Oil Company credit card, used to charge lodging at the inn, after being instructed to do so by Gulf's credit card operations because of the guest's allegedly poor credit. The plaintiff claimed the circumstances surrounding the erroneous seizure of his credit card caused him to suffer a heart attack. Plaintiff thus sued Gulf, the Holiday Inn franchisee and the franchisor Holiday Inns. The *Wood* court reasoned that the existence of trademarks was critical to a determination of whether a "holding out" existed:

[t]he Phenix City facility was required to use the same service marks and trademarks, and exterior and interior decor as the Holiday Inns owned by the parent company. A jury could therefore reasonably conclude that the license agreement required the . . . facility to be of such an appearance that travelers would believe it was owned by Holiday Inns, Inc.⁷⁴

The *Ortega* court addressed the issue of whether GMC held

68. *Id.* at ____, 740 P.2d at 1145.

69. Compare *Apple*, 307 F. Supp. at 115 (which held that the facts of the case were insufficient to give rise to an ostensible agency) and *Ortega*, 392 So. 2d at 44 (which held that the facts of the case were insufficient to give rise to an ostensible agency) with *City of Delta Junction*, 670 P.2d 1131 (Alaska 1983) (which held that the facts in the case were sufficient to give rise to an ostensible agency).

70. 670 P.2d at 1131.

71. *Id.* at 1129.

72. *Id.* at 1131.

73. 508 F.2d 167, 169-70 (5th Cir. 1975).

74. *Id.* at 176.

out a local GMC truck dealer as its agent by allowing the dealer to use the manufacturer's signs and logos.⁷⁵ This court, contrary to the holding in *City of Delta Junction*, held that the franchisee's display of GMC signs and trademarks was insufficient to create a "holding out" and thus to give rise to an ostensible agency relationship.⁷⁶

b. *Common Knowledge Doctrine*

The common knowledge doctrine states that "it is . . . a matter of common knowledge and practice that distinctive colors and trademark signs are displayed at gasoline stations by independent dealers of petroleum product suppliers . . . [and that] [t]hese signs and emblems represent no more than notice to the motorist that a given company's products are being marketed at the station."⁷⁷ The franchisor will use this doctrine to avoid a finding of agency in cases where signs and logos are claimed to create a holding out such that ostensible agency is established.⁷⁸

Franchisors can apply the doctrine by proving that the public has common knowledge concerning the independent status of a business. For example, this was applied in *Burkland* when the plaintiff claimed the defendant presented no evidence that the public had common knowledge about real estate franchises sufficient to prevent the finding of an ostensible agency.⁷⁹

c. *Reliance*

A third party has the burden of proving a reasonable reliance on a franchisor's reputation, logos and advertising in order to establish the franchisor's liability predicated on a theory of ostensible agency. "[I]t must not only be shown that the plaintiff's belief and reliance were reasonable, but that they were caused by affirmative acts or by negligence on the part of the principal"⁸⁰

In *Burkland*, the Montana Supreme Court noted that the Burklands had "relied on the national TV advertising they had seen of ERA [and on] the reputation of ERA, Inc., and they believed they

75. *Ortega*, 392 So. 2d at 44.

76. *Id.* See also *Apple*, 307 F. Supp. at 115.

77. *Elkins*, 153 Mont. at 165, 455 P.2d at 332 (quoting *Coe*, 377 P.2d at 818); see also *Reynolds v. Skelly Oil Co.*, 227 Iowa 163, 170, 287 N.W. 823, 827 (1939); *Ortega*, 392 So. 2d at 43-44.

78. *Coe*, 377 P.2d at 818.

79. Appellant's opening brief at 7, *Burkland v. Electronic Realty Ass'n*, ___ Mont. ___, 740 P.2d 1142 (1987).

80. Annot., *Vicarious Liability of Private Franchisor*, 81 A.L.R.3d § 5[a], at 781 (1977); see also *Beck*, 245 Cal. App. 2d at 976, 54 Cal. Rptr. at 330.

were dealing with ERA at the time of purchasing the home.”⁸¹ The court thus ruled that the district court’s grant of summary judgment was erroneous, for a key material fact remained as to whether a disclaimer made such reliance on ERA unreasonable.⁸²

The *Burkland* court appeared to rely exclusively on *City of Delta Junction* to hold that reliance on trademarks and reputation was sufficient to raise a jury question as to whether such reliance could establish an ostensible agency relationship.⁸³ As with the Burklands, *City of Delta Junction* officials believed they were dealing with the franchisor when they purchased the modified Mack truck and relied on the franchisor’s reputation.⁸⁴ Although the *Burkland* court only ruled on the issue before it, whether the facts raised issues of fact such that a grant of summary judgment was improper, the court’s reliance on *City of Delta Junction* indicates that it approved the Alaska court’s determination that reliance on trademarks is reasonable.⁸⁵

d. Disclaimers

Disclaimers are often used to prevent a franchisor from being held liable for tortious acts of the franchisee under an ostensible agency theory. Often, franchisors will require that the franchisee exhibit a disclaimer sign stating the local business is independently owned and operated.⁸⁶ However, one of the clear conclusions of the case law is that the franchisor, to make an effective disclaimer, must require more than the display of a vague and ambiguous sign of independent ownership and operation.⁸⁷

Attempts to use disclaimer signs have not received favorable treatment by the courts.⁸⁸ For instance, the *Murphy* court held that “[w]hen an agreement, considered as a whole, establishes an agency relationship, the parties cannot effectively disclaim it by formal ‘consent . . . the relationship of the parties does not depend upon what the parties themselves call it, but rather in law

81. *Electronic Realty Ass’n*, ___ Mont. at ___, 740 P.2d at 1145.

82. *Id.*

83. *Id.* at ___, 740 P.2d at 1144-45.

84. *City of Delta Junction*, 670 P.2d at 1131.

85. *Electronic Realty Ass’n*, ___ Mont. at ___, 740 P.2d at 1144-45.

86. *Salisbury v. Chapman Realty*, 124 Ill. App. 3d 1057, 1062, 465 N.E.2d 127, 131 (1984).

87. *Beck*, 245 Cal. App. 2d at 980, 54 Cal. Rptr. at 331.

88. See *Murphy*, 216 Va. at 494, 219 S.E.2d at 876; *Beck*, 245 Cal. App. 2d at 979, 54 Cal. Rptr. at 330; *Ottensmeyer*, 2 Haw. App. at 89, 625 P.2d at 1071; *Salisbury*, 124 Ill. App. 3d at 1062, 465 N.E.2d at 131.

what it actually is.'"⁸⁹

3. Analysis of the "Holding Out" Factor

A court's finding that a franchisor's use of logos and trademarks is a sufficient "holding out" to create agency may be anachronistic. Clearly the use of logos and trademarks in advertising is so completely ubiquitous in the modern era that any liability based merely on reliance on them or the reputation engendered therefrom requires more substantial underpinning. In addition, the ruling by the Wisconsin court in *Star Line* indicates that compliance with federal requirements concerning control sufficient to maintain a trademark will not support a finding of agency.

Perhaps the most significant standard in evaluating whether a "holding out" exists is the reasonableness of the third party's reliance.⁹⁰ This standard provides an exception from liability for franchisors who require a posting of large, clearly visible signs on the franchisee's business premises—signs which clearly state that the franchise is independently owned and operated.⁹¹ In addition, this standard requires claimants to demonstrate that they would have chosen an alternative good or service or that they would have done something differently but for their reliance on those specific franchisor attributes manifested by the franchisee.⁹²

III. APPLICATION OF AGENCY TO A FRANCHISOR'S LIABILITY FOR THE ACTS OF A FRANCHISEE

The specific type of agency relationship must be determined once an agency has been established in order to pinpoint the types of tortious acts for which a franchisor may be held liable. A franchisee can be one of two types of agent—an independent contractor agent or an employee-agent. As the Montana Supreme Court stated in *Elkins*, "it cannot be disputed that the main distinction between . . . [an] employee and an independent contractor lies in

89. *Murphy*, 216 Va. at 492, 219 S.E.2d at 876 (quoting from *Chandler v. Kelly*, 149 Va. 221, 231, 141 S.E. 389, 391-92 (1928)). In *Kuchta v. Allied Builders Corp.*, 21 Cal. App. 3d 541, 98 Cal. Rptr. 588 (1971), the California court has stated that "declarations of the parties in the agreement respecting the nature of the relationship are not controlling." *Id.* at 548, 98 Cal. Rptr. at 591. The *Burkland* case addressed the use of disclaimers, particularly as the Burklands stated in their affidavit that "they did not notice the 'independently owned and operated' disclaimer in ERA Hannah's listing of the Mullen home nor was it explained to them." *Electronic Realty Ass'n*, ___ Mont. at ___, 740 P.2d at 1143.

90. *Electronic Realty Ass'n*, ___ Mont. at ___, 740 P.2d at 1144.

91. See generally *Beck*, 245 Cal. App. 2d 976, 54 Cal. Rptr. 328.

92. *Hayman*, 357 S.E.2d at 398.

the right of control over the performance of the work.”⁹³

An independent contractor agent is one who is told what to do but not how to do it, for the independent contractor represents “the will of his employer only as to the result of his work, and not as to the means by which it is accomplished.”⁹⁴ Conversely, an employee is one told both what to do and *how* to do it.⁹⁵

The test for distinguishing between the two types of agent—those being told what to do versus those being told what to do and how to do it—is whether or not the franchisor has control over the operational affairs of the franchisee.⁹⁶ The Restatement (Second) of Agency provides further clarification of this concept by stating:

It is only when to the relation of principal and agent there is added that right to control physical details as to the manner of performance which is characteristic of the relation of . . . [employer and employee] that the person in whose service the act is done becomes subject to liability for the physical conduct of the actor.”⁹⁷

93. *Elkins*, 153 Mont. 159, 163, 455 P.2d 329, 331 (1969).

94. *Greening*, 108 Mont. 158, 168, 88 P.2d 862, 865 (1939).

95. *Id.* at 168, 88 P.2d at 865.

96. The court in *Standard Chemical Mfg. v. Employment Sec. Div.*, 185 Mont. 241, 605 P.2d 610 (1980) stated:

The first test is the so-called “ABC” test and is established by statute: “Service performed by an individual for wages is considered to be employment subject to this chapter unless and until it is shown to the satisfaction of the division that: (a) such individual has been and will continue to be free from control or direction over the performance of such services, both under his contract and in fact; (b) such service is either outside the usual course of the business for which such service is performed or that such service is performed outside of all the places of business of the enterprise for which such service is performed; and (c) such individual is customarily engaged in an independently established trade, occupation, profession, or business.” § 39-51-203(4), M.C.A. (1985).

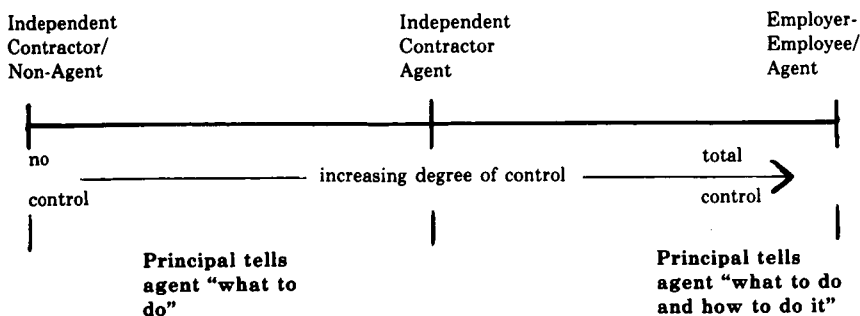
[This 1985 edition, has since been amended by MONT. CODE ANN. § 39-51-203(4) (1987)].

The second test, as expressed in *Shope v. City of Billings*, 85 Mont. 302, 306, 278 P. 826, 827 (1929) states that: “An independent contractor is one who renders service in the course of an occupation, and represents the will of his employer only as the result of his work, and not as to the means whereby it is accomplished, and is usually not paid by the job.”

Id. at 244-45, 605 P.2d at 612-13 (this case involved an employer-employee relationship).

97. RESTATEMENT (SECOND) OF AGENCY, § 250 comment a (1958).

A graphic representation of this concept is shown below.⁹⁸



Each type of agency has a particular liability attaching to it. In brief, those types of agency and their consequent liability are as follows:

(a) Where the franchisor has a duty and breaches that duty (e.g. duty to supervise, duty to employ proper persons), that franchisor is always liable for the contract or tortious actions of its franchisee regardless of whether the franchisee is found to be an independent contractor or an employee.⁹⁹

(b) Where a franchisee commits fraud, the franchisor may be held liable whether or not an independent contractor or employee agency is established.¹⁰⁰

(c) Where the franchisor has not breached a duty, in order to be held liable for the negligent or tortious action of its franchisee a franchisor must be found to be an employer.¹⁰¹

The issue of whether a franchisor can be held to be an employer or whether a franchisee can be held to be an employee or independent contractor has not been determined. However, one court has found that a limited employer/employee relation can be found in the franchise context on very minimal grounds. In *Wood*,¹⁰² the court found, citing section 220 of the Restatement (Second) of Agency, the jury could reasonably conclude a limited

98. Lecture by Steven C. Bahls, assistant professor of law, University of Montana School of Law (Oct. 8, 1987).

99. Cf. RESTATEMENT (SECOND) OF AGENCY §§ 212-215 (1958) (which states rules generally applicable to principals and agents).

100. Cf. RESTATEMENT (SECOND) OF AGENCY § 261 (1958) (which states rules generally applicable to principals and agents).

101. Cf. RESTATEMENT (SECOND) OF AGENCY § 219-229 (1958) (which states rules generally applicable to principals and agents); see also *Kornec v. Mike Horse Mining & Milling Co.*, 120 Mont. 1, 180 P.2d 252 (1947).

102. *Wood*, 508 F.2d at 173.

employer/employee relationship existed between Gulf Oil Co. and the Holiday Inn franchisee for the purpose of accepting Gulf's credit card as payment.¹⁰³ The decision was based on the degree of control exercised by Gulf over the service of extending credit or revoking credit cards.¹⁰⁴ By establishing an employer/employee relationship between two separate business organizations, Wood potentially sets the stage for a court to find such a relationship exists between a franchisor and franchisee thereby making the franchisor liable for all acts of the franchisee.

IV. SUMMARY

When analyzing whether a franchisor should be liable for the torts of its franchisee, it is essential that an agency relationship be established by first proving an actual agency. This should be done by evaluating the degree of control the franchisor exercises over the day-to-day operations of the franchisee. If "the spirit and essence of the contract, considered as a whole . . . [reserves] in the [franchisor] the power to impose his will upon the [franchisee] in accomplishing the purposes and objectives of the contract,"¹⁰⁵ then control would be sufficient to give rise to actual agency. Should the degree of control be insufficient or ambiguous so that actual agency is in question, then look to ostensible agency. To establish an ostensible agency there must be proof that the franchisor "held out" the franchisee as its agent and that the third person reasonably relied on that holding out to his or her harm.

The common law, as the cases cited in this comment illustrate, has developed differing results with similar facts as to whether an agency relationship exists between a franchisor and its franchisee. An alternative means of analysis of agency relationship is provided in sections 212-215 and 250 of the Restatement (Second) of Agency. The Restatement asks whether the franchisor intended the conduct of its franchisee, authorized the result, had a particularized duty to have the franchisee's act performed with care, acted recklessly in giving instructions or in hiring or supervision, or unintentionally authorized the conduct of the franchisee leading to the tort. The Restatement may be preferred because it provides a more definitive statement of agency for purposes of determining the liability of a franchisor for the torts of its franchisee.

103. *Id.* at 173-74.

104. *Id.* at 173-74.

105. *Stanford*, 623 S.W.2d at 803.