

FRANCHISOR LIABILITY FOR FRANCHISEE CONDUCT

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Franchisors and franchisees are legally and financially independent parties responsible for their own torts, contracts and other legal obligations. From the perspective of the general public however the independent contractor nature of the relationship is obscured by system standardisation and uniformity which conveys the appearance of a single entity. Although in law there is a fundamental difference between a system outlet operated by a franchisee and a system outlet operated by the franchisor through a manager, the outlets are otherwise identical and the legal subtleties are imperceptible to customers and the public generally. The legal ramifications are nevertheless significant. In general terms a franchisor is liable under the principle of vicarious liability for the torts committed by employee managers but not for the torts committed by franchisees who are independent contractors. Franchisors may also be liable under agency principles — for contracts made by those agents who have the actual or apparent authority to make contracts on behalf of the franchisor principal — which may be the case for employed outlet managers but rarely for franchisees. This article reviews the law relating to franchisor liability for franchisee conduct in Australia and concludes that legal principle and commercial practice have been largely effective in insulating franchisors from liability under vicarious liability and agency principles. Such actions are nevertheless not the exclusive sources of potential franchisor liability and franchisors and their legal advisors need to be aware of the potential consequences beyond unwelcome system publicity which might arise from franchisee conduct.

I INTRODUCTION

Standardisation and uniformity are both the characteristics and the drivers of business format franchising. The ‘essence of franchising’ is, in the words of Stephen Kos, ‘to convey the appearance of a single entity largely indistinguishable from a single owner chain comprising branches at separate locations’.¹ The formulaic ubiquity — perhaps best, albeit not approvingly, described by George Ritzer as the ‘McDonaldization of society’² — through which brand recognition

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1 Stephen Kos, *Franchisor Liability for Franchisee Misconduct* (Franchisors Association of Australasia, 1990) 1 [1.1].

2 George Ritzer, *The McDonaldization of Society* (SAGE, 7th ed, 2013).

and goodwill are harnessed, and efficiencies, knowledge, and economies of scale are leveraged, is prescribed by system specifications and business formats enshrined in an operations manual and supported by contractual provisions under which the franchisor has the power to control the franchisee and its operations.

The formulaic uniformity builds system goodwill which ultimately resides in the franchisor. Conversely, actions or inactions of system franchisees which damage or cause injury to the customers of franchisees or to other third parties are a potential source of adverse publicity or liability for the franchisor. Although the franchisor and the franchisee are legally and financially independent parties and, as a general principle, responsible only for their own torts, contracts and other legal obligations, philosophical and jurisprudential niceties are unlikely to be of much interest to a plaintiff who may seek to sue the franchisor simply because it is a bigger target with a vested interest in settling a matter to avoid unwelcome system publicity. Such actions may arise for practical reasons — the franchisee may not be a viable defendant — and in the franchising context may be supported, at least philosophically, by the proposition that the franchisor who has created and who controls the standardised uniformity should be responsible.

Kos comments that ‘in the dramatic development of franchising as an instrument of commerce, insufficient attention has been paid by franchisors to the potential of their being held liable for franchisee misconduct’.³ Although there is a rich vein of US case law on the vicarious liability of franchisors, it has not produced a consistent and internally logical paradigm.⁴ Outside of the US, there is little authority and indeed little consistency in the legal approach.⁵ Although it will be rare under Australian law for a franchisor to be held vicariously liable for the conduct of its franchisee, this area of law is both legally and conceptually complex and, in any event, liability may be imposed under other principles. This article addresses the liability of franchisors for franchisee conduct in the Australian context.

II POSSIBLE LEGAL BASES OF FRANCHISOR LIABILITY

In *Ultramares Corporation v Touche* Cardozo J referred, in the context of the liability of accountants for economic loss, to the possibility of ‘liability in an indeterminate amount for an indeterminate time to an indeterminate class’.⁶ Similar considerations accompany the issue of a franchisor’s potential

3 Kos, above n 1, 1 [1.2].

4 See generally Gregg Rubenstein et al, ‘Vicarious and Other Franchisor Liability’ (Paper presented at the IBA/IFA 27th Annual Joint Conference, Washington, DC, 18 May 2011) 2–6; Randall K Hanson, ‘The Franchising Dilemma Continues: Update on Franchisor Liability for Wrongful Acts by Local Franchisees’ (1997) 20 *Campbell Law Review* 91; William L Killion, ‘Franchisor Vicarious Liability — The Proverbial Assault on the Citadel’ (2005) 24 *Franchise Law Journal* 162; Joseph H King Jr, ‘Limiting the Vicarious Liability of Franchisors for the Torts of Their Franchisees’ (2005) 62 *Washington and Lee Law Review* 417.

5 See generally Rubenstein et al, above n 4.

6 174 NE 441, 444 (NY Ct App, 1931).

liability for franchisees' conduct. Franchising could not operate successfully if franchisors were generally to be held liable for their franchisees' conduct. The franchisor/franchisee relationship is essentially one of independent contractors, and boilerplate clauses to the effect that the agreement does not constitute a partnership, agency, joint venture, or employment relationship are standard in franchise agreements. Giles, Redfern and Terry note that although such clauses 'simply reflect the reality of the independent contractor relationship the parties intend to create',⁷ they are not conclusive and the courts will look to the substance of the relationship rather than the form. Kos nevertheless notes that among franchisors there is a belief, 'sadly without foundation', that such boilerplate provisions confer 'complete immunity against liability for franchisee misconduct'.⁸

The franchisor/franchisee relationship is both commercially and legally complex. It is, as Rubenstein et al note, 'symbiotic and interdependent', but nevertheless 'legally independent'.⁹ Franchise agreements have been described by the Privy Council as 'not ordinary commercial contracts'.¹⁰ The relationships they enshrine resemble to some extent a variety of established commercial relationships — employment, agency, partnership — but they are sui generis and, in other than exceptional cases, fall into none of these categories.¹¹ It is the exceptional cases which may provide the legal basis for franchisor liability. Franchisors may be liable for the conduct of franchisees under general principles of agency or tort law. Under agency law, franchisors may be directly liable for contracts made by franchisees who have the authority — actual or ostensible — to act as the agent for the franchisor principal.¹² Under tort law, franchisors can be held primarily or directly liable for their own actions, or vicariously through the actions or non-actions of their franchisees if they are held to be employees.

Vicarious liability imposes on one person the liability for the tort of another¹³ and arises 'by virtue of the relationship between the actual tortfeasor and the person who is made vicariously liable'.¹⁴ The most significant relationship giving rise to vicarious liability is the employer-employee relationship which, if found by a court, renders the employer vicariously liable for tortious acts or

7 Stephen Giles, Michael Redfern and Andrew Terry, LexisNexis, *Franchising Law and Practice*, vol 1 (at Service 37) [5.0030].

8 Kos, above n 1, 1 [1.2].

9 Rubenstein et al, above n 4, 1.

10 *Dymocks Franchise Systems (NSW) Pty Ltd v Todd* [2004] 1 NZLR 289, 311 [63].

11 Giles, Redfern and Terry, above n 7, [5.0030]. See also Gehan Gunasekara and Susan Watson, 'Regulating Business Format Franchising: Familiar Solutions for Novel Problems' (2006) 12 *New Zealand Business Law Quarterly* 174.

12 Queensland Law Reform Commission, *Vicarious Liability*, Discussion Paper No 48 (1995). A principal is directly liable for the torts of its agents rather than vicariously. Although the Queensland Law Reform Commission has noted that '[o]ne situation in which vicarious liability presently arises in Queensland under statute law is the case of business partners': at 7. The example used of partners being jointly and severally liable is better regarded as primary rather than vicarious liability. See also *Sweeney v Boylan Nominees Pty Ltd* (2006) 226 CLR 161, 170 [22].

13 See generally *Darling Island Stevedoring & Lighterage Co Ltd v Long* (1957) 97 CLR 36.

14 Luke McCarthy, 'Vicarious Liability in the Agency Context' (2004) 4(2) *QUT Law and Justice Journal* 1, 1 (emphasis altered).

omissions of employees within the course of their employment.¹⁵ The majority in *Sweeney v Boylan Nominees Pty Ltd* stated the basic proposition central to this body of law in these terms: ‘there is [a] distinction between employees (for whose conduct the employer will generally be vicariously liable) and independent contractors (for whose conduct the person engaging the contractor will generally not be vicariously liable)’.¹⁶ For this reason vicarious liability is unlikely to arise in the franchising context in Australia: the franchisor/franchisee relationship is one of independent contractors, not of employment. The circumstances in which vicarious liability will be imposed are nevertheless susceptible to judicial expansion and there is sustained debate as to the application of vicarious liability in the agency context. In *Colonial Mutual Life Assurance Society Ltd v Producers and Citizens Co-operative Assurance Co of Australia Ltd* (‘*CML*’), vicarious liability for a defamatory statement made by an independent contractor acting as the principal’s agent in a representative capacity to induce a third party to enter into relations with the principal rendered the principal vicariously liable.¹⁷ Some commentators suggest that vicarious liability in the agency context can be extended beyond the tort of defamation to other statements and indeed to ‘physical conduct constituting a tort committed in the course of representing the principal in transactions with third parties’.¹⁸ While this proposition was doubted by the majority in *Sweeney*, Kirby J in dissent did not regard the principle in *CML* as being so confined.¹⁹ McHugh J’s proposed ‘representative agent’ in *Hollis v Vabu Pty Ltd* would further extend the reach of vicarious liability into a new category of relationship not falling into agency or employment.²⁰ New Zealand has recently widened the reach of vicarious liability by imposing vicarious liability between independent contractors in a relationship not involving an employment or agency agreement of any kind.²¹ Other commentators have argued that there can be no vicarious liability in the context of agency relationships because the principal’s liability in such cases is *as principal* and not vicariously.²² Further confusion arises as the term ‘vicarious liability’ is often used, albeit not accurately, as a generic term to cover all situations in which, in the present context, franchisors may be liable for the conduct of franchisees.²³

15 See, eg, *New South Wales v Lepore* (2003) 212 CLR 511; *Darling Island Stevedoring & Lighterage Co Ltd v Long* (1957) 97 CLR 36.

16 (2006) 226 CLR 161, 167 [12] (‘*Sweeney*’). See also P S Atiyah, *Vicarious Liability in the Law of Torts* (Butterworths, 1967) 3.

17 (1931) 46 CLR 41, 49–50.

18 McCarthy, above n 14, 8.

19 *Sweeney* (2006) 226 CLR 161 186–7 [78]–[79].

20 (2001) 207 CLR 21, 51 [74], 57–8 [93] (‘*Hollis*’). See discussion in Part IV(D).

21 See *Nathan v Dollars & Sense Ltd* [2008] 2 NZLR 557. This novel approach by the New Zealand Supreme Court extends vicarious liability to a ‘principal who asked an agent to perform a task where there was an inherent risk for third parties’: Susan Watson and Chris Noonan, ‘The Widening Gyre of Vicarious Liability’ (2009) 17 *Torts Law Journal* 144, 159.

22 G E Dal Pont, ‘Agency: Definitional Challenges through the Law of Tort’ (2003) 11 *Tort Law Journal* 68, 90. See also McCarthy, above n 14, 10; John G Fleming, *The Law of Torts* (Lawbook, 9th ed, 1998) 413–14; R P Balkin and J L R Davis, *Law of Torts* (LexisNexis Butterworths, 4th ed, 2009) 731 [26.21].

23 In the US, employment is within overarching agency principles and thus an employment relationship would also be one of agency simultaneously: see Rubenstein et al, above n 4, 2. See also G E Dal Pont, *Law of Agency* (LexisNexis Butterworths, 2nd ed, 2008) 97 [4.13].

In addition to the possibility of being vicariously liable for the conduct of a franchisee, a franchisor may be directly or primarily liable to a franchisee's staff or customer under both the common law and legislation in a range of circumstances.²⁴ A franchisor whose selection, training, or supervision of franchisees is negligent may be primarily liable under tort law. US case law records a number of instances in which franchisors have been liable for their own negligence in failing to exercise due care in, for example, selecting franchisees,²⁵ maintaining standards,²⁶ franchise unit design,²⁷ food safety,²⁸ and security.²⁹ Statutory liability may also be imposed in a range of circumstances. Misleading or deceptive conduct in breach of the *Competition and Consumer Act 2010* (Cth) sch 2 ('*Australian Consumer Law*') gives rise to actions not only against the person whose conduct causes any loss or damage suffered as a result of the contravention but also against any person 'involved' in the contravention.³⁰ In appropriate cases franchisors may be jointly liable with franchisees for misleading conduct communicated by or engaged in by franchisees.³¹ A franchisor who is, or is deemed to be, the manufacturer of products supplied by franchisees may be liable under pt 3.5 — 'Liability of Manufacturers for Goods with Safety Defects' — of the *Australian Consumer Law*. Occupational Health and Safety (OH&S) laws are another potential source of direct franchisor liability. OH&S laws have extended liability for workplace safety beyond a franchisee that occupies premises to persons, including franchisors, who manage or control the workplace. A tragic example is provided by *WorkCover Authority of New South Wales v McDonald's Australia Ltd*.³² Charges under the *Occupational Health and Safety Act 1983* (NSW) were brought against McDonald's and a franchisee in respect of the death of a 19 year old casual employee who was electrocuted when touching the inner core of a power cable while cleaning a piece of kitchen equipment.³³ Both franchisor and franchisee were convicted on the basis that they had, as required by the now-repealed s 17(1), 'to any extent, control of' the premises. The liability

24 Section 43 of the *Estate Agents Act 1980* (Vic) expressly provides for franchising arrangements. If an estate agent 'carries on business pursuant to a franchising agreement ... each party to the agreement is jointly and severally liable for any defalcation by the estate agent' and for any liability incurred as a result of the estate agent's (or its employee's) negligence: at s 43(3).

25 See Michael R Flynn, 'The Law of Franchisor Vicarious Liability: A Critique' (1993) *Columbia Business Law Review* 89, 97.

26 See, eg, *Read v Scott Fetzer Co*, 990 SW 3d 732 (Tex, 1998).

27 See, eg, *Morse v McDonald's Corporation* (Conn Super Ct, No CV000379426S, 6 November 2001).

28 See, eg, *Hyde v Schlotzsky's Inc*, 561 SE 2d 876 (Ga Ct App, 2002).

29 See, eg, *Wunder v Mobil Oil Corporation* (Conn Super Ct, No X04CV000120525S, 24 October 2002).

30 *Australian Consumer Law* ss 18, 236. See also s 2 (definition of 'involved'). Most accessorial liability is in respect of a person who 'has been in any way, directly or indirectly, knowingly concerned in, or party to, the contravention': at s 2 (definition of 'involved' para (c)).

31 Accessorial liability arising from a person being 'knowingly concerned in, or party to, the contravention' in accordance with s 2 of the *Australian Consumer Law* is not imposed unless the person is aware or should have been aware of the relevant facts giving rise to the contravention, even though he or she may not be aware that they give rise to such a contravention: *Yorke v Lucas* (1985) 158 CLR 661, 670, concerning s 75B of the *Trade Practices Act 1974* (Cth), which provided the same definition of 'involved' as in the *Australian Consumer Law*.

32 (2000) 95 IR 383.

33 *Ibid* 385.

of franchisors in relation to workplace safety is even greater under the national Work Health and Safety (WHS) laws which are replacing the OH&S laws.³⁴ Under the harmonised WHS laws the primary duty of care is not reliant on the existence of control: the obligation for work place safety is placed on '[a] person conducting a business or undertaking' to 'ensure, so far as is reasonably practicable, the health and safety of' workers.³⁵ The Explanatory Memorandum explains that '[t]he phrase "business or undertaking" is intended to be read broadly and covers business or undertakings conducted by persons including employers, principal contractors, head contractors and, franchisors', as well as the Crown.³⁶

III VICARIOUS LIABILITY BASIS FOR FRANCHISOR LIABILITY

Two theories lie behind the rationale of vicarious liability. The first theory is traditionally known as the 'servant tort' theory. According to this doctrine, vicarious liability is 'a form of liability imposed on one party for the tortious conduct of another'.³⁷ Under this theory the master is financially liable for the tortious act of the servant but there is no assumption of any personal fault on the master.³⁸ The second theory is the 'master tort' theory, which stipulates that the master acted through the servant in committing the tort. The focus is on the act of the servant to which the master is liable and as a result, the master is considered to have committed the tort him/herself. Arguably the maxim *respondeat superior* ('let the master answer') could be seen as reflecting the traditional servant tort theory, whereas the maxim *qui facit per alium facit per se* ('one who acts through another is deemed to act through himself') could be seen to underline the master tort theory. The master tort theory may explain the emergence of vicarious liability in agency contexts, and present a possibility that, in exceptional situations, criminal liability could be attributed to the master.³⁹ Although it is recognised by most commentators that the more acceptable theory would be the servant tort theory as it would explain the majority of cases,⁴⁰ there is little benefit in examining the 'true' basis of vicarious liability, as in this context most

34 *Work Health and Safety Act 2011* (Cth); *Work Health and Safety Act 2011* (ACT); *Work Health and Safety Act 2011* (NSW); *Work Health and Safety (National Uniform Legislation) Act 2011* (NT); *Work Health and Safety Act 2011* (Qld).

35 *Work Health and Safety Act 2011* (Cth) s 19.

36 Explanatory Memorandum, *Work Health and Safety Bill 2011* (Cth) 9 [19].

37 Atiyah, above n 16, 6. See also *Darling Island Stevedoring & Lighterage Co Ltd v Long* (1957) 97 CLR 36, 57, where the servant tort theory was applied.

38 *Staveley Iron & Chemical Co Ltd v Jones* [1956] AC 627, 643, 646–7.

39 See generally Joe Catanzariti, 'Employers' Vicarious Liability for Employee Criminal Activity' (2007) 45(7) *Law Society Journal* 48; Ian Freckelton, 'Vicarious Liability and Criminal Prosecutions for Regulatory Offences' (2006) 14 *Journal of Law and Medicine* 24; Gregory J Ellis and Beth Anne Alcantar, 'Franchisor Liability for the Criminal Acts of Others' (1998) 18 *Franchise Law Journal* 11; Marilyn Pittard, 'Employers' Liability for Criminal Acts of an Employee' (2007) 13(7) *Employment Law Bulletin* 77. Criminal liability in this form is extremely rare and can only be found in exceptional cases: see, eg, *Luff v Oakley* (1986) 65 ACTR 19.

40 See, eg, Atiyah, above n 16, 3.

judges are influenced more by practical considerations than doctrinal theories.⁴¹ Indeed, the Australian High Court in *Hollis* has recently commented that ‘the modern doctrine [of vicarious liability] ... was adopted not by way of an exercise in analytical jurisprudence but as a matter of policy’.⁴²

Irrespective of its historical and policy antecedents the scope for vicarious liability in the franchisor/franchisee context is very limited in Australia because of the required employment nexus.⁴³ Despite embryonic developments in the application of vicarious liability in the agency context,⁴⁴ the doctrine of vicarious liability is limited by its application only to employer-employee relationships. It does not apply to independent contractor relationships.⁴⁵ The vicarious liability plaintiff has a heavy hurdle to overcome in satisfying a court that a franchising relationship is an employment relationship. Where the franchisee is incorporated this hurdle is, in practice if not in law, insurmountable.⁴⁶ In contrast, vicarious liability plaintiffs in the US have an easier road to successful litigation under the *Restatement (Second) of Agency* ‘extent of control’ test which, as applied in the franchising context, imposes vicarious liability on a franchisor if it controls or has the right to control the day-to-day operations of the franchisee.⁴⁷ This has led to franchisors regularly being held vicariously liable for the conduct of their franchisees.⁴⁸ There is nevertheless increasing support for a more precisely focused test with some courts arguing that:

the marketing, quality, and operational standards commonly found in franchising agreements are insufficient to establish the close supervisory control or right of control necessary to ... demonstrate the existence of

41 *Ibid* 6–7. See also *New South Wales v Ibbett* (2006) 229 CLR 638, 650–2 [41]–[48].

42 (2001) 207 CLR 21, 37 [34] (Gleeson CJ, Gaudron, Gummow, Kirby and Hayne JJ). See also *Darling Island Stevedoring & Lighterage Co Ltd v Long* (1957) 97 CLR 36, 56–7 (Fullagar J). For a discussion on the purpose and justifications of vicarious liability, see T Baty, *Vicarious Liability: A Short History of the Liability of Employers, Principals, Partners, Associations and Trade-Union Members, with a Chapter on the Laws of Scotland and Foreign States* (Clarendon Press, 1916) ch 1; Atiyah, above n 16, ch 2; *Bazley v Curry* [1999] 2 SCR 534; *London Drugs Ltd v Kuehne International Ltd* [1992] 3 SCR 299.

43 *Sweeney* (2006) 226 CLR 161.

44 See *CML* (1931) 46 CLR 41. See also *Hern v Nichols* (1709) 1 Salk 289; 90 ER 1154, which, almost three centuries earlier, held that the principal was vicariously liable for the agent’s conduct.

45 Principals may be vicariously liable under the context of non-delegable duties (although this may better be regarded as primary liability rather than vicarious liability): Balkin and Davis, above n 22, 733–9 [26.26]–[26.34]. Owners or bailees of chattels may in exceptional circumstances be vicariously liable for the negligence of another ‘person who has the temporary management of the chattel, even when that other person is not an employee of the owner or bailee’: *Scott v Davis* (2000) 204 CLR 333, 339 [6]. See also *Soblusky v Egan* (1960) 103 CLR 215; *CML* (1931) 46 CLR 41.

46 See Andrew Stewart, ‘Redefining Employment? Meeting the Challenge of Contract and Agency Labour’ (2002) 15 *Australian Journal of Labour Law* 235, 256.

47 American Law Institute, *Restatement (Second) of Agency* (1958) § 220 provides that the imposition of vicarious liability depends on the ‘extent of control which, by the agreement, the master may exercise control over the details of the work’. See generally Kevin M Shelley and Susan H Morton, ‘“Control” in Franchising and the Common Law’ (2000) 19 *Franchise Law Journal* 119. See also Killion, above n 4; Rubenstein et al, above n 4. See also below Part IV.

48 See, eg, *Parker v Domino’s Pizza Inc*, 629 So 2d 1026 (Fla Ct App, 1993); *Miller v McDonald’s Corporation*, 945 P 2d 1107 (Or Ct App, 1997); *Miller v D F Zee’s Inc*, 31 F Supp 2d 792 (D Or, 1998); *Wu v Dunkin Donuts Inc*, 105 F Supp 2d 83 (ED NY, 2000); *VanDeMark v McDonalds Corporation*, 904 A 2d 627 (NH, 2006); *Madison v Hollywood Subs Inc*, 997 So 2d 1270 (Fla Ct App, 2009).

a master/servant relationship for all purposes or as a general matter. We hold, therefore, that a franchisor may be held vicariously liable for the tortious conduct of its franchisee only if the franchisor has control or a right of control over the daily operation of the specific aspect of the franchisee's business that is alleged to have caused the harm.⁴⁹

A Employee or Independent Contractor

In *New South Wales v Lepore*, Gleeson CJ succinctly stated the proposition that '[a]n employer is vicariously liable for a tort committed by an employee in the course of his or her employment'.⁵⁰ The distinction between an independent contractor engaged under a contract for services and an employee employed under a contract of service is nevertheless difficult, confusing and uncertain. There is no single definitive test to determine and identify an employee as distinct from an independent contractor. The *control* test,⁵¹ after a long period of use in Australia, has lost favour as the determinative sole test and the courts have embraced a more holistic approach looking at the *totality* of the relationship.⁵² In *Stevens v Brodribb Sawmilling Co Pty Ltd*, Mason J stated that

the existence of control, whilst significant, is not the sole criterion by which to gauge whether a relationship is one of employment. The approach of this court has been to regard it merely as one of a number of indicia which must be considered in the determination of that question ...⁵³

His Honour then found that

the common law has been sufficiently flexible to adapt to changing social conditions by shifting the emphasis in the control test from the actual exercise of control to the right to exercise it, 'so far as there is scope for it', even if it be 'only in incidental or collateral matters' ... Furthermore, control is not now regarded as the only relevant factor. Rather it is the totality of the relationship between the parties which must be considered.⁵⁴

49 *Kerl v Dennis Rasmussen*, 682 NW 2d 331, 331–2 (Wis, 2004). See generally above n 47.

50 (2003) 212 CLR 511, 535 [40] ('*Lepore*').

51 The Privy Council has noted that '[t]he older test was simple. It all turned on the right to control the manner of doing the work': *Australian Mutual Provident Society v Chaplin* (1978) 18 ALR 385, 387, quoting *R v Allan; Ex parte Australian Mutual Provident Society* (1977) 16 SASR 237, 247 (Bray CJ). In brief, the control test emphasises the employer's actual direction and control of, or its right to direct and control, the method as well as the result of the work that needs to be done. On the other hand, employers of independent contractors can only give directions as to the results of the work. In other words, an employee agrees to serve and an independent contractor agrees to produce finished goods or supply a specific service. See also Simon Deakin and Gillian S Morris, *Labour Law* (Hart Publishing, 4th ed, 2005) 150–1.

52 Due to changes in society, and changes to how business is conducted generally, courts have moved to be more flexible by introducing and applying other tests. This was recognised by the majority in *Hollis* (2001) 207 CLR 21, 40 [43]. Indeed in *Vabu Pty Ltd v Federal Commissioner of Taxation* (1996) 33 ATR 537, 538, Meagher JA stated that '[t]he old test of "control" is now superseded by something more flexible'.

53 (1986) 160 CLR 16, 24 (citations omitted) ('*Stevens*').

54 *Ibid* 28–9 (citations omitted).

The High Court in *Hollis* and *Sweeney* approved the use of the multi-factor test.⁵⁵ In *Stevens*, Wilson and Dawson JJ outlined the following approach to determine whether a person is an employee:

The other indicia of the nature of the relationship have been variously stated and have been added to from time to time. Those suggesting a contract of service rather than a contract for services include the right to have a particular person do the work, the right to suspend or dismiss the person engaged, the right to the exclusive services of the person engaged and the right to dictate the place of work, hours of work and the like. Those which indicate a contract for services include work involving a profession, trade or distinct calling on the part of the person engaged, the provision by him of his own place of work or of his own equipment, the creation by him of goodwill or saleable assets in the course of his work, the payment by him from his remuneration of business expenses of any significant proportion and the payment to him of remuneration without deduction for income tax. None of these leads to any necessary inference, however, and the actual terms and terminology of the contract will always be of considerable importance.⁵⁶

Nevertheless, because of the flexibility and breadth of the multi-factor test, courts may give different weight to each consideration and reach different decisions on similar facts.⁵⁷ For example, in *Hollis* the High Court held that bicycle couriers who were owner-drivers were also employees for vicarious liability purposes. In an earlier decision, the NSW Court of Appeal found that the same company's bicycle and vehicle couriers were not employees for taxation purposes.⁵⁸ The different decisions may reflect the different purposes for which they were made but, as Burnett observes, such flexibility creates a great deal of uncertainty as to what amounts to an 'employee'.⁵⁹ Brooks suggests that the issue of whether a

55 See *Hollis* (2001) 207 CLR 21, 33 [24], 41 [45] (Gleeson CJ, Gaudron, Gummow, Kirby and Hayne JJ); *Sweeney* (2006) 226 CLR 161, 172–4 [30]–[34] (Gleeson CJ, Gummow, Hayne, Heydon and Crennan JJ), 184 [68] (Kirby J).

56 *Stevens* (1986) 160 CLR 16, 36–7 [11].

57 Stewart argues that the decision in *Hollis* 'suggests a willingness to promote the significance of certain indicia (notably association with the hirer through "badges of origin" such as company uniforms, at least in the context of vicarious liability), and to downplay others (in particular any requirement on the worker to supply their own tools and equipment, unless the capital outlay is substantial and significant skill and training is required to operate them)': Stewart, above n 46, 250. See also *Aufgang v Kozminksy Nominees Pty Ltd* [2008] VSC 27 (14 February 2008) [38].

58 See *Vabu Pty Ltd v Federal Commissioner of Taxation* (1996) 33 ATR 537. In that case, bicycle and vehicle couriers working for Vabu were held to be independent contractors for the purpose of the superannuation guarantee legislation as they provided their own tools of transport to deliver articles. This was held despite the fact Vabu controlled the hours worked by the couriers, their appearance, behaviour while on the job, and their pay.

59 Jonathan Burnett, 'Avoiding Difficult Questions: Vicarious Liability and Independent Contractors in *Sweeney v Boylan Nominees*' (2007) 29 *Sydney Law Review* 163, 174.

person is an employee or independent contractor in fact ‘often, if not always ... depends on why the question is being asked’.⁶⁰

B Joint Employment

An alternative approach is the joint employer doctrine. It may be held that the franchisor is a joint employer with the franchisee of the franchisee’s staff. In this case the franchisor would be vicariously liable for the conduct of the franchisee employee. A joint employment arrangement may occur when ‘one party has day-to-day control and the other party authority in relation to such matters as hire and fire, discipline and payment’.⁶¹ Critics of this concept cite the difficulties of dividing responsibilities and issues of loyalty and good faith between two independent masters.⁶² Proponents of the concept argue that this would resolve many of the difficulties involving injuries at the workplace.⁶³ Although the joint employment doctrine has been accepted in the US,⁶⁴ its judicial status in Australia is unclear. In *Fair Work Ombudsman v Eastern Colour Pty Ltd*, Collier J commented that ‘[t]he question whether joint employment is a valid concept in this country has not been the subject of decisive consideration by an Australian court’.⁶⁵ Her Honour did not make a formal ruling on the issue but commented that ‘[t]here is, in my view, scope in Australian law for a claim that multiple entities can jointly employ a person’.⁶⁶ The Full Bench of the Australian Industrial Relations Commission⁶⁷ and various industrial relations panels⁶⁸ have shown enthusiasm for implementing the concept of joint employment particularly in situations where ‘related corporations are conducting a common enterprise and operating as a group with ill-defined boundaries’.⁶⁹

60 Adrian Brooks, ‘Myth and Muddle — An Examination of Contracts for the Performance of Work’ (1988) 11 *University of New South Wales Law Journal* 48, 48, citing Adrian Merritt, “‘Control’ v. ‘Economic Reality’”: Defining the Contract of Employment’ (1982) 10 *Australian Business Law Review* 105, 105–6, 112–8. See also K Lee Adams, ‘The High Court on Vicarious Liability’ (2003) 16 *Australian Journal of Labour Law* 214, 216.

61 Carolyn Sappideen, Paul O’Grady and Geoff Warburton, *Macken’s Law of Employment* (Thomson Reuters, 6th ed, 2009) 107 [3.110].

62 House of Representatives Standing Committee on Employment, Workplace Relations and Workforce Participation, Parliament of Australia, *Making it Work: Inquiry into Independent Contracting and Labour Hire Arrangements* (2005) 64 [4.39]–[4.41].

63 See, eg, Sappideen, O’Grady and Warburton, above n 61, 107 [3.110].

64 See, eg, W Michael Garner, Thomson Reuters, *Franchise and Distribution Law and Practice*, vol 2 (at September 2013) § 9.48; *Wilson v Wendy’s International, Inc* (SD Miss, No 3:97-CV-397WS, 29 September 1998) (Wingate DJ); *Lockard v Pizza Hut Inc*, 162 F 3d 1062 (10th Cir, 1998); *Alberter v McDonald’s Corporation*, 70 F Supp 2d 1138 (D Nev, 1999).

65 (2011) 209 IR 263, 293–4 [72].

66 *Ibid* 297 [78].

67 *Morgan v Kittochside Nominees Pty Ltd* (2002) 117 IR 152, 173–5 [72]–[75].

68 See, eg, *Matthews v Cool or Cosy Pty Ltd* [2003] WAIRC 10388 (24 December 2003) [320]–[323]. *McConnell-Imbriotis v Eurobanks Pty Ltd* [2004] NSWIRComm 1035 (12 May 2004) [37].

69 *Costello v Allstaff Industrial Personnel (SA) Pty Ltd* [2004] SAIRCComm 13 (29 March 2004) [125].

C Franchisee as Employee

For vicarious liability to apply in the franchising context, a franchisee would need to be in an employer-employee relationship with the franchisor. In *Commissioner of State Revenue v Mortgage Force Australia Pty Ltd*, a case involving payroll tax liability, the Western Australia Court of Appeal stated that classifying a relationship as a franchisor-franchisee relationship does not automatically make it an independent contracting arrangement or an employer-employee agreement.⁷⁰ All circumstances of the relationship must be examined in their totality.⁷¹ Buss JA (with whom Steytler P and Le Miere AJA agreed) stated that:

It does not follow from the Tribunal's mischaracterisation of the relationship between [the Respondents] and the consultants as 'akin to a franchise arrangement' or its failure to find that [the Respondents] in substance ran their businesses through the consultants, that the consultants were employees of [the Respondents] and not independent contractors. It remains necessary to determine that issue upon an examination of all the circumstances including the totality of the relationship between the parties, the identification of factors which are in favour of or against the relationship being an employment or not, and the attribution of relative weight to the various factors.⁷²

It is difficult to classify a franchisee as an employee of the franchisor. The franchisee is not paid a wage⁷³ and, in Australia, if a franchisee is incorporated it will most probably be precluded from an employee classification. Sappideen, O'Grady and Warburton note that '[i]t is assumed in the Australian authorities that incorporation automatically prevents an employment relationship with the other contracting party even if the person is sole owner and shareholder of the company and is providing personal services'.⁷⁴ Further, the majority in *Hollis* mentioned that a 'company does not usually have employee corporations'.⁷⁵ Sappideen, O'Grady and Warburton nevertheless point out that courts are '[o]ccasionally ... prepared to recognise that the incorporation is a false façade and the reality of

70 [2009] WASCA 24 (30 January 2009) [86].

71 Ibid.

72 Ibid.

73 Giles, Redfern and Terry, above n 7, [5.0120]. But in light of recent Australian case law, it would be too simplistic for the non-payment of a wage to alone preclude a franchisee from being legally recognised as an employee. The current Australian approach is to take an 'holistic' or 'in totality' approach taking into consideration a range of factors: see *Hollis* (2001) 207 CLR 21. See also *Abdalla v Viewdaze Pty Ltd* (2003) 122 IR 215, 228–31 [34] for a summary of the relevant factors derived from cases decided in the Australian High Court. On the issue of remuneration, the High Court in *Federal Commissioner of Taxation v Barrett* (1973) 129 CLR 395, 408 held that employees can be paid by commission even though payment by commission to a person normally suggests the person is an independent contractor.

74 Sappideen, O'Grady and Warburton, above n 61, 67 [2.190]. In *SJP Chicken Processor v WorkCover [No 3]* [2006] SAWLRP 7 (30 June 2006), the South Australian WorkCover Levy Review Panel accepted that an incorporated contractor could not be an employee for WorkCover purposes.

75 *Hollis* (2001) 207 CLR 21, 31 [19], quoting Meagher JA in *Vabu Pty Ltd v Federal Commissioner of Taxation* (1996) 33 ATR 537, 539. See also Stewart, above n 46, 256.

the situation is that there is an employer-employee relationship'.⁷⁶ In the absence of a clear precedent from the High Court that corporate status automatically precludes companies from being employees for vicarious liability purposes it might be premature to rule out any such possibility.⁷⁷ Of course, this uncertainty can be resolved by legislation. The State Payroll Tax Acts for example give the Commissioner the power to deem services provided by a natural person through a corporate structure to have been provided in an employment relationship and to deem payments made to be wages.⁷⁸ It follows that in Australia plaintiffs face real challenges in bringing vicarious liability actions against franchisors in respect of the conduct of their franchisees, particularly their incorporated franchisees.

The independent contractor or employee classification is particularly problematic in the case of small sole trader franchisees in unsophisticated franchising arrangements such as those, for example, involving domestic services. The recent decision of the United States District Court of Massachusetts in *Awuah v Coverall North America Inc*⁷⁹ has 'set off alarms in the U.S. franchising industry, as it challenges the long-held notion that franchisees are independent business people, not employees' and opened up the possibility of liability for employee entitlements.⁸⁰ Under Massachusetts' *Independent Contractor Statute*, an individual performing a service is considered an employee unless

- (1) the individual is free from control and direction in connection with the performance of the service, both under his contract for the performance of service and in fact; and
- (2) the service is performed outside the usual course of the business of the employer; and,
- (3) the individual is customarily engaged in an independently established trade, occupation, profession or business of the same nature as that involved in the service performed.⁸¹

Young DJ held that because the franchisor failed to establish the second prong of the statutory test — that the worker was 'performing services that were part of an independent, separate and distinct business from that of the employer' — the franchisees were employees.⁸² Potential vicarious liability is simply one of a range

76 Sappideen, O'Grady and Warburton, above n 61, 67 [2.190] (citations omitted). See, eg, *Hartnett v Aardvark Security Services Pty Ltd* (1998) 85 IR 315 (Wilcox J); *Inspector Hopkins v Byron McIntyre* [2003] NSWCMIMC 86 (8 October 2003); *Eurobodalla Shire Council v Dufty* [2004] NSWCA 450 (6 December 2004), cited in Sappideen, O'Grady and Warburton, above n 61, 67 n 287.

77 For a discussion of 'piercing the contractual veil', see Günter Teubner, 'Beyond Contract and Organisation? The External Liability of Franchising Systems in German Law' in Christian Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (Nomos, 1991) 105.

78 See, eg, *Pay-Roll Tax Assessment Act 1971* (WA) s 11E, discussed in *Commissioner of State Revenue v Mortgage Force Australia Pty Ltd* [2009] WASCA 24 (30 January 2009) [106].

79 707 F Supp 2d 80 (D Mass, 2010).

80 Richard Gibson, 'Franchisees: We're Employees, Not Contractors', *The Wall Street Journal* (online), 10 May 2010 <<http://online.wsj.com/article/SB10001424052748703880304575236101413316646.html>>.

81 Mass Gen Laws ch 149 § 148B (2004).

82 *Awuah v Coverall North America Inc*, 707 F Supp 2d 80, 85 (D Mass, 2010).

of consequences that flow from such a finding. The franchisees — described in the court papers as immigrants with a little to no fluency in English who were misled into paying high franchise fees to win cleaning jobs — were not typical of franchisees generally but the precedent is still a worrying one for the franchising sector.

IV AGENCY BASIS FOR FRANCHISOR LIABILITY

Agency is a relationship which arises when one person, the principal, authorises another person, the agent, to act on the principal's behalf. Where an agent enters into a transaction on behalf of the principal, the contract that is formed will be between the principal and the third party. A principal will also be 'liable for the torts of his or her agent when they are committed whilst the agent is acting within the scope of the agent's authority'.⁸³ An agency relationship is established by a conferral of authority (actual agency) or when the principal holds out to a third party that a particular agent has authority (ostensible agency).

The position in Australia is that an agent is one who has authority to act for another, and beyond that, there is no clearer definition.⁸⁴ The term 'agent' is often used colloquially to describe an intermediary in the nature of a 'dealer' or 'distributor' or 'acquirer', but these relationships are usually reseller or authorised service provider relationships rather than principal-agent relationships in the legal sense.⁸⁵ Conversely, denying an intention to create an agency may not preclude a court finding an agency relationship.⁸⁶ Taking into account the particular circumstances, an employee or an independent contractor can be an agent in the legal sense.⁸⁷ Likewise an independent contractor may or may not be an agent. Whether an agent is an employee depends on whether the relationship exhibits the legal requirements for an employment relationship. In Australia, whether an employee or an independent contractor is an agent depends on whether the employee or independent contractor has authority to act on behalf of the principal. In the US, there is greater opportunity for third parties to bring legal action against franchisors in respect of conduct of their franchisees because of the different tests which prevail. While apparent or ostensible agency through a 'holding out' operates similarly under both legal systems, the US test for

83 *Smith v Keal* (1882) 9 QBD 340, approved in *Kooragang Investments Pty Ltd v Richardson & Wrench Ltd* (1981) 36 ALR 142.

84 Dal Pont, *Law of Agency*, above n 23, 4; *South Sydney District Rugby League Football Club Ltd v News Ltd* (2000) 177 ALR 611, 646. See also Simon Fisher, *Agency Law* (Butterworths, 2000) 8–11 [2.1.1]–[2.1.3].

85 See generally *International Harvester Co of Australia Pty Ltd v Carrigan's Hazeldene Pastoral Co* (1958) 100 CLR 644 ('*International Harvester Case*').

86 *South Sydney District Rugby League Football Club Ltd v News Ltd* (2000) 177 ALR 611, 645–6, where Finn J held that describing the parties as 'independent contractors' did not preclude the Court from finding that the relationship between the two parties involved one of agency as the agreement was 'redolent of agency'.

87 McCarthy, above n 14, 4 [1.1].

actual agency, ‘control’, is wider than the Australian test and provides a greater opportunity for legal action against franchisors.⁸⁸

A Liability under Actual Authority

Actual agency is essentially a ‘creature of contract’,⁸⁹ under which there is a conferral of authority by the principal on the agent to act on the principal’s behalf.⁹⁰ Dal Pont points out that, unlike the situation in the US, control is not an important consideration in Australia, stating that an ‘element found in some conceptions of an agency relationship is the principal’s *control* over the agent’s actions. ... it should be noted here that in Australian law the alleged control element is arguably neither crucial to agency nor is it independent of the authority element’.⁹¹

US law focuses on control because of the view that the ‘relationship of employment is one of the accepted categories of agency’.⁹² Australian law determines agency by a ‘conferral of authority’ on an agent which may or may not include ‘control’ over the agent.⁹³ The liability of the principal is derived from his or her authorisation of the agent to act on behalf of the principal and not because of the inherent control that the principal has or ought to have over the agent.⁹⁴ Such authority may exist in the context of master franchising in which a sub franchisor may enter into franchise agreements on the master franchisor’s behalf,⁹⁵ but it would be exceptional in the standard business format franchisor-franchisee relationship.

B Liability under Ostensible Authority

To establish agency on the basis of ostensible authority the plaintiff must establish that the principal has represented or ‘held out’ the agent as possessing authority,⁹⁶ the plaintiff reasonably relied on the representation,⁹⁷ and the plaintiff

88 See King Jr, above n 4, 430–8.

89 *Yasuda Fire & Marine Insurance Co of Europe Ltd v Orion Marine Insurance Underwriting Agency Ltd* [1995] QB 174, 185, where Colman J held that an agency relationship is ‘almost invariably founded upon a contract between principal and agent’.

90 Dal Pont, *Law of Agency*, above n 23, 91 [4.3].

91 *Ibid.* See also *South Sydney District Rugby League Football Club Ltd v News Ltd* (2000) 177 ALR 611, 646 [137], where Finn J stated that ‘[control] does not appear to figure prominently as a decisive indicator of agency in common law case law’.

92 Dal Pont, *Law of Agency*, above n 23, 97 [4.13].

93 *Ibid.* 6 [1.4]. Dal Pont argues that emphasis on control as a core element of agency formation has difficulties and is inconsistent with at least professional agency relationships where the agent is more knowledgeable than the principal: see Dal Pont, ‘Agency: Definitional Challenges’, above n 22, 87.

94 Dal Pont, ‘Agency: Definitional Challenges’, above n 22, 81.

95 See, eg, *Poulet Frais Pty Ltd v Silver Fox Co Pty Ltd* (2005) 220 ALR 211; *Donut King Australia Pty Ltd v Barber* [1999] SASC 241 (11 June 1999).

96 *Lysaght Bros & Co Ltd v Falk* (1905) 2 CLR 421, 428.

97 *Hoare v McCarthy* (1916) 22 CLR 296, 305–6 (Isaacs J).

has suffered a detriment as a result.⁹⁸ A franchise agreement may expressly renounce an agency relationship but this does not prevent the finding of ostensible authority. There is nevertheless scant case law on this.⁹⁹ *Fitzgerald v H & R Block the Income Tax People Ltd*,¹⁰⁰ decided by the New Zealand High Court, illustrates the difficulty of satisfying the burden of proof to establish an agency through ostensible authority. The plaintiff sued the franchisor defendant for the fraud of the franchisee. The plaintiff claimed that the franchisor was estopped from denying an agency relationship on the basis that the franchisee's authorised use of the franchisor's trade names 'H & R Block' or 'H & R Block the Income Tax People' amounted to the franchisor holding out that the franchisee was an agent. Ellis J held that although the franchise agreement precluded an agency relationship existing between the parties it was open to the plaintiff to establish that the authority given to the franchisee to trade under the name 'H & R Block' or 'H & R Block the Income Tax People' amounted to the 'holding out' of authority for the franchisee to act as the franchisor's agent.¹⁰¹ Ellis J commented that:

It is well known that there are many H & R Block agencies throughout the country and indeed elsewhere, and I am satisfied that the plaintiff has not established that the description of [the franchisee] as 'H & R Block the Income Tax People' would mean to the plaintiff or a member of the public ... using [the franchisee's] services that they were dealing with the [franchisor].¹⁰²

His Honour opined that a reasonable person would not believe that he or she would be dealing with the franchisor when they saw the sign 'H & R Block the Income Tax People'.¹⁰³ The basis for Ellis J's ruling was somewhat narrower. Because the franchisee had used his own corporate letterhead, the plaintiff knew that his arrangements were with the franchisee and not with the franchisor: 'I accept that [the plaintiff] consulted [the franchisee] because he was attracted by the fact that he was one of H & R Block the Income Tax People, but it is plain that his dealings relating to investments were with [the franchisee]'.¹⁰⁴ It was material to the case that although it was well known that H & R Block were specialists in relation to income tax advice, the case concerned investment advice which was a parallel business that the franchisee ran on the side. Ellis J held that investment advice was significantly different from income tax advice and could not have been within the scope of any representation of authority in relation to income tax advice by way of 'holding out'.

98 For detriment as 'material disadvantage', see *Thompson v Palmer* (1933) 49 CLR 507, 547. For detriment as 'suffering harm', see *Grundt v Great Boulder Pty Gold Mines Ltd* (1937) 59 CLR 641, 674.

99 In Australia, *Gibney v SE Timber Pty Ltd (Home Building)* [2008] NSWCTTT 1387 (17 November 2008) was decided on the existence of ostensible agency in the franchising context.

100 (Unreported, High Court of New Zealand, Ellis J, 7 June 1990).

101 *Ibid* 4.

102 *Ibid*.

103 *Ibid*.

104 *Ibid* 5.

In *Commerce Commission v Contours Exclusive Ltd*, the New Zealand District Court, in a decision that did not refer to the H & R Block case, held that a franchisor was responsible under the *Fair Trading Act 1986* (NZ) for false advertisements placed by a franchisee under the New Zealand equivalent of s 84(2)(a) of the *Competition and Consumer Act 2010* (Cth) — conduct engaged in on behalf of a body corporate by an agent of the body corporate within the scope of actual or apparent authority.¹⁰⁵ Cadenhead J noted that one of the *Fair Trading Act*'s objectives was the protection of the public and considered that '[o]ne should not look too minutely, therefore at difficulties of contractual classification of the agency relationship'.¹⁰⁶ Cadenhead J then found that:

Here the [franchisor] permitted the franchisee to use such trade mark in its advertising, and despite the internal restrictions contained in the franchise agreement, I am of the view, that the [franchisor] by placing the franchisee in a position of using such trade mark held out, in a general way, to the public that the [franchisor] had endorsed such representational offers. Accordingly, the franchisee was an agent of the [franchisor] acting inside his apparent authority.¹⁰⁷

C Vicarious Liability in the Agency Relationship

The liability of a principal for the torts of its agents acting within authority is direct liability, not vicarious liability.¹⁰⁸ However in *CML* the High Court created an exception to the general rule and held that a principal was vicariously liable for the torts of its agent.¹⁰⁹ The appellant employed an independent contractor under an agency agreement to sell insurance. A term of the agreement prohibited the agent from making defamatory comments, but the agent did not comply with this obligation and made defamatory comments about the respondent — another insurance company. The Court held that vicarious liability was applicable where an agent commits a tort under a representative capacity of the principal regardless of whether the principal authorised or directed that particular act or not.¹¹⁰ Relying on *CML*, Lindgren J in *NMFM Property Pty Ltd v Citibank Ltd* explained that:

In Australia, the general principle is established that where [a principal] appoints [an agent] ... to persuade persons to contract with [the principal], [the principal] will incur liability to [a third party] if [the agent] makes tortious statements that are within the general class or scope of statements

105 (1998) 8 TCLR 390.

106 *Ibid* 405.

107 *Ibid*.

108 See Dal Pont, *Law of Agency*, above n 23, 90 [4.1]; Fleming, above n 22, 413–14; Balkin and Davis, above n 22, 731 [26.21]. Cf David Gardner and Frances McGlone, *Outline of Torts* (Butterworths, 2nd ed, 1998) 401 [20.13]; Kit Barker et al, *The Law of Torts in Australia* (Oxford University Press, 5th ed, 2011) 775 [17.7]; Harold Luntz et al, *Torts: Cases and Commentary* (LexisNexis Butterworths, 7th ed, 2013) 858 [17.1.3], where it is argued that vicarious liability is recognised by the law in principal-agent relationships.

109 (1931) 46 CLR 41.

110 *Ibid* 47 (Gavan Duffy CJ and Starke J).

that [the principal] authorised [the agent] to make, and put [the agent] in a position to make.¹¹¹

CML was approved in *Sweeney* but, as Burnett observes,¹¹² *CML* was '[given] an extremely narrow operation'¹¹³ by the majority in *Sweeney*, who limited vicarious liability to cases of slander made in order to persuade the third party to enter into legal relations with the principal. Such limitations would not be relevant under McHugh J's proposal for the recognition of a 'representative agent' attracting vicarious liability for negligence generally and not simply for statements whether defamatory or otherwise.

D The 'Representative Agent'

McHugh J in the High Court in *Scott v Davis*¹¹⁴ and in *Hollis* has suggested the creation of an intermediate category — 'representative agent' — which does not conform to either 'employee' or 'independent contractor' status but lies somewhere in between and is subject to vicarious liability.¹¹⁵ McHugh J argues that there are no policy reasons to uphold the strict classification of employees and non-employees in the law of vicarious liability and to do so could be at the cost of justice. McHugh J suggests that '[r]ather than expanding the definition of employee or accepting the employee/independent contractor dichotomy, the preferable course is to hold that employers can be vicariously liable for the tortious conduct of agents who are neither employees nor independent contractors'.¹¹⁶ His Honour had earlier said in *Hollis*:

Rather than attempting to force new types of work arrangements into the so-called employee/independent contractor 'dichotomy' based on medieval concepts of servitude, it seems a better approach to develop the principles concerning vicarious liability in a way that gives effect to modern social conditions. ... [T]he genius of the common law is that the first statement of a common law rule or principle is not its final statement. The contours of rules and principles expand and contract with experience and changes in social conditions. The law in this area has been and should continue to be 'sufficiently flexible to adapt to changing social conditions'.¹¹⁷

111 (2000) 107 FCR 270, 386 [520] (citations omitted).

112 Burnett, above n 59, 168.

113 *Sweeney* (2006) 226 CLR 161, 170 [22].

114 (2000) 204 CLR 333 ('*Scott*').

115 See David Rolph, 'A Carton of Milk, a Bump on the Head and One Legal Headache: Vicarious Liability in the High Court of Australia' (2006) 19 *Australian Journal of Labour Law* 294, 295. Rolph commented that this category would bring complexity to the application of vicarious liability arguing that it would require a court to consider not only whether a person was an employer or an employee or an independent contractor but also, in the event that it considered a person to be an independent contractor, to assess whether he or she was a 'true' independent contractor, in which case no issue of vicarious liability arises, or a 'representative agent', in which case vicarious liability might follow.

Rolph, above n 115, 303–4.

116 *Hollis* (2001) 207 CLR 21, 57 [93].

117 *Ibid* 50 [72] (citations omitted).

McHugh J's theory would allow vicarious liability not only for tortious statements as in *CML* but for all torts in general occurring in an undefined employer-independent contractor/agent relationship. In defining the test for determining the 'representative agent' in *Hollis*, McHugh J considered a number of factors:

Vabu had delegated to the courier a task that Vabu had agreed to perform; [t]he courier was not acting as an independent functionary but was carrying out the task as Vabu's representative; [t]he courier was subject to Vabu's general direction and control; and [t]he courier was acting within the scope of the authority conferred on him by Vabu.¹¹⁸

Although the 'representative agent' is not an agent under Australian agency law, Dal Pont has commented that the first three factors noted by McHugh J coincidentally coincide with three related concepts of 'delegation', 'representation' and 'control' reminiscent of the definition of 'agent' in the American *Restatement of the Law of Agency*¹¹⁹ — the instrument which has provided the basis for vicarious liability litigation against franchisors in the US. If McHugh J's representative agent proposal is adopted as law it could open the opportunity for vicarious liability litigation against franchisors in Australia to the same extent that the 'extent of control' test has provided the opportunity for vicarious liability litigation against franchisors in the US.¹²⁰

E Franchisee as Agent

The US position in which control is the basis for the finding of an agency relationship offers much greater scope for franchisor liability on agency principles than in Australia where the franchise agreement invariably expressly denies actual authority. While agency can be based on ostensible authority, a holding out of authority requires more than permission to use a trade mark.¹²¹ A distributor for a manufacturer which offers items for sale in association with the manufacturer's trade mark is not an agent on that basis alone.¹²² Resupplying another's goods, or providing services, in association with the franchisor's trade mark does not constitute an agency.

However, if McHugh J's view as to the introduction of the new category of 'representative agent' is adopted, the applicability of vicarious liability in Australia would expand and could capture more franchisor-franchisee

118 Ibid 50–1 [73].

119 Dal Pont, 'Agency: Definitional Challenges', above n 22, 79–80, citing American Law Institute, *Restatement (Second) of Agency* (1958) §1.

120 See above Part III. See also Killion, above n 4.

121 *International Harvester Case* (1958) 100 CLR 644. In *Commerce Commission v Contours Exclusive Ltd* (1998) 8 TCLR 390, Cadenhead J in New Zealand District Court held that a franchisor was vicariously liable for false advertisements placed by a franchisee under the New Zealand equivalent of s 84(2)(a) of the *Competition and Consumer Act* 2010 (Cth) — conduct engaged in by an agent within the scope of apparent authority.

122 *International Harvester Case* (1958) 100 CLR 644, 653; LexisNexis, *Halsbury's Laws of Australia* (at 11 May 2010), 15 Agency, '1 Nature and Formation — Agency' [15-5].

relationships. However, this is not currently the law in Australia. The majority in the High Court in *Sweeney* have maintained the orthodox and traditional dichotomy between employees and independent contractors and refused to extend the reach of vicarious liability outside the employer-employee relationship. It is interesting to note however that the ‘representative agent’ approach propounded by McHugh J has not been fully abandoned. Kirby J in a minority judgment in *Sweeney* expressly stated that he did not ‘favour the adoption of a rule which exposes a principal to vicarious liability in respect of torts committed by an independent contractor in circumstances where the contractor “represents” the principal simpliciter’.¹²³ However, vicarious liability under the long-standing *CML* principle could be imposed if the ‘principal [arms] the contractor with the means to hold himself or herself out “so that the very service to be performed [by the contractor] consists in standing in his [principal’s] place and assuming to act in his [principal’s] right and not in an independent capacity”’.¹²⁴

The principles laid out in *CML* have been successfully applied in the franchising context. In *Donut King Australia Pty Ltd v Barber*,¹²⁵ Sequin Close Pty Ltd (‘Sequin’) entered into a master franchise agreement with the Donut King Australia Pty Ltd (‘DKA’), whereby Sequin was authorised to enter into sub-franchise agreements with other potential franchisees on behalf of DKA. Sequin made misrepresentations in one negotiation for a franchise agreement and DKA was sued for liability for the tortious act of Sequin. The Full Court of the Supreme Court of South Australia held that Sequin as sub franchisor was an agent of the master franchisor DKA and as a result the master franchisor was vicariously liable for misrepresentations made in the contract entered into by the sub franchisor with a franchisee.¹²⁶ Duggan J held that:

In my view there is an analogy to be drawn between the recruiting function of Sequin Close in the present case and the role of the insurance agent considered by the High Court in [*CML*]. It is true that in the event of a contract resulting from the agent’s endeavours in [*CML*], the agreement would be entered into between the insurance company and the insured. ... In the light of Sequin Close’s role in promoting the franchised operation generally it is not surprising that representations would be made and this consideration underscores the role of Sequin Close as a promoter of DKA’s interests. For these reasons, I am of the view that Sequin Close was the agent for DKA when performing the duties imposed upon it in matters such as promoting the franchised operation, recruiting, supervising and advising franchisees.¹²⁷

Barber is the only known Australian case that applied the *CML* principle in the franchising context where a franchisor was held vicariously liable for the

123 *Sweeney* (2006) 226 CLR 161, 191 [99].

124 *Ibid* 191 [100] (Kirby J) (emphasis in original), quoting *CML* (1931) 46 CLR 41, 48–9 (Dixon J) (emphasis added).

125 [1999] SASC 241 (11 June 1999) (‘*Barber*’).

126 *Ibid* [42]–[45].

127 *Ibid* [42], [44]–[45] (Duggan J) (citations omitted), Doyle CJ and Debelle J concurring.

franchisee under agency principles.¹²⁸ In contrast, McHugh J's proposal for recognition for a 'representative agent' development would allow the *CML* principle to extend to franchisee negligent actions generally and not simply to statements whether defamatory or otherwise.

V REVIEWING VICARIOUS LIABILITY IN THE FRANCHISING CONTEXT

In *Lepore* Gaudron J commented that '[t]he absence of a satisfactory and comprehensive jurisprudential basis for the imposition of liability on a person for the harmful acts or omissions of others — vicarious liability, as it is called — is a matter which has provoked much comment'.¹²⁹ Anthony Gray has recently argued that vicarious liability should be abandoned: 'these principles have arguably become intellectually incoherent, isolated from their original *raison d'être*, no longer explicable by any one rationale of liability, and inconsistent with developments elsewhere in the law of tort'.¹³⁰ Vicarious liability is, nevertheless, now fully entrenched in tort law and the majority of commentators hold the view that its separation or abolition from tort law is inconceivable.¹³¹ Even though it departs from a fundamental principle of tort law — that responsibility should lie on the tortfeasor alone¹³² — the doctrine of vicarious liability aims to produce fair and just outcomes.¹³³ Neyers argues that 'the common law was right to maintain vicarious liability in the face of its criticism since the doctrine can sit comfortably beside a regime that imposes liability for fault'.¹³⁴ It is a form of strict liability justified by social realities and, since its inception in the seventeenth century, has served as a form of social insurance that allows victims to recover loss incurred

128 See *Sweeney* (2006) 226 CLR 161, 170 [22] (Gleeson CJ, Gummow, Hayne, Heydon and Crennan JJ), where the majority state that *CML*:

establishes that if an independent contractor is engaged to solicit the bringing about of legal relations between the principal who engages the contractor and third parties, the principal will be held liable for slanders uttered to persuade the third party to make an agreement with the principal. It is a conclusion that depends directly upon the identification of the independent contractor as the principal's agent (properly so called) and the recognition that the conduct of which complaint is made was conduct undertaken in the course of, and for the purpose of, executing that agency.

129 (2003) 212 CLR 511, 553 [106].

130 Anthony Gray, 'Why Vicarious Liability Must Be Abandoned' (2011) 39 *Australian Business Law Review* 67, 67.

131 See, eg, Gary T Schwartz, 'The Hidden and Fundamental Issue of Employer Vicarious Liability' (1996) 69 *California Law Review* 1739, 1745; Winfield V H Rogers, *Winfield and Jolowicz on Tort* (Sweet and Maxwell, 18th ed, 2010) 948; *Sweeney* (2006) 226 CLR 161, 173 [33] (Gleeson CJ, Gummow, Hayne, Heydon and Crennan JJ).

132 Gray, above n 130, 70–1.

133 See, eg, Atiyah, above n 16, ch 2. See generally W G Friedmann, 'Social Insurance and the Principles of Tort Liability' (1949) 63 *Harvard Law Review* 241.

134 J W Neyers, 'A Theory of Vicarious Liability' (2005) 43 *Alberta Law Review* 287, 289.

from employers of ill resourced employees.¹³⁵ Today, it still serves this role through allowing actions against insured employers.¹³⁶

Vicarious liability beyond the traditional employer/employee relationship is a confused, unsettled and uncertain area of law. Judicial moves to extend its application to agency relationships separate from an employment context — and suggestions of liability in intermediate categories — make this area of law both conceptually and legally complex. The application of this body of law to the franchisor/franchisee relationship is particularly challenging. Vicarious liability operates in the context of particular relationships and the sui generis nature of the franchising relationship, which draws on traditional categories but is nevertheless different from each of them, is a complicating factor.

There is a growing body of commentary in relation to the unique nature of the franchisor/franchisee relationship in the context of regulatory initiatives to redress the information and power imbalance which characterises the standard business format franchising relationship.¹³⁷ There is increasing recognition that the lens of traditional contract law is a very blunt instrument for addressing the relational realities of a franchise relationship and tailored solutions through regulatory intervention are increasingly crafted.¹³⁸ If the issue of franchisor liability for franchisee conduct was as common as the issues arising from the *inter partes* franchisor/franchisee relationship more attention may have been devoted to it. That, in Australia at least, this issue has not emerged suggests that the practical strategies applied by franchisors to deflect liability — public notification of the relationship as well as franchisor insurance, and indemnification and insurance provisions in the franchise contract — have been effective. Such strategies are less effective in the US where the emphasis on the control test in determining an agency relationship makes franchisors more vulnerable than their Australian counterparts and has led to extensive litigation.¹³⁹ Australian franchisors do not have to face the ‘perplexing dilemma’ which faces their US counterparts — that the more prescriptive the system the franchisor imposed, the more vulnerable they are to vicarious liability claims.¹⁴⁰ The extent and comprehensiveness of the

135 W V H Rogers, *Winfield and Jolowicz on Tort* (Sweet and Maxwell, 15th ed, 1998) 695, 727. See generally *Tuberville v Stampe* (1697) 1 Ld Raym 264; 91 ER 1072; *Hern v Nichols* (1709) 1 Salk 289; 90 ER 1154. See also American Law Institute, *Restatement (Second) of Agency* (1958) § 219; *Fruit v Schreiner*, 502 P 2d 133, 139 (Alaska, 1972). However there is debate as to whether the origins of vicarious liability are Roman or Germanic law: see, eg, John H Wigmore, ‘Responsibility for Tortious Acts: Its History’ (1894) 7 *Harvard Law Review* 315, 315; Susan Vincent and G Thomas MacIntosh II, ‘Insuring Against Franchisor Vicarious Liability’ (Paper presented at the 34th Annual Legal Symposium, Washington DC, 2001) 2.

136 Balkin and Davis, above n 22, 12 [1.15].

137 See generally Andrew Terry, ‘Franchising, Relational Contracts and the Vibe’ (2005) 33 *Australian Business Law Review* 289.

138 *Ibid* 298.

139 See, eg, *Singleton v International Dairy Queen Inc*, 332 A 2d 160 (Del Super Ct, 1975); *Coty v US Slicing Mach Co Inc*, 373 NE 2d 1371 (Ill Ct App, 1978); *Miller v McDonald’s Corporation*, 945 P 2d 1107, 1110 (Or Ct App, 1997); *Billops v Magness Const Co*, 391 A 2d 196, 197–8 (Del, 1978); *Parker v Domino’s Pizza Inc*, 629 So 2d 1026 (Fl Ct App, 1993); *Miller v D F Zee’s Inc*, 31 F Supp 2d 792 (D Or, 1998).

140 Hanson, above n 4, 92.

franchisor's system, training, support and compliance strategies are commonly accepted *indicia* of good franchising and it would be unfortunate if, as part of a strategy to minimise potential vicarious liability, less prescriptive systems were imposed.

VI CONCLUSION

In *Scott*, Hayne J noted that there might be no single thread running through the general fabric of vicarious liability other than 'the cynical conclusion ... that the real reason is that damages are taken from a deep pocket'.¹⁴¹ His Honour commented that

whether that conclusion is expressed as a search for a deep-pocket defendant or, in less pejorative terms, as being justified by 'the principle of loss-distribution', it seems plain that considerations of insurance and the relative capacity of employers and employees to pay damages have had a significant influence on the development of vicarious liability, even if they may not provide a unifying or sufficient justification for the rules that have developed.¹⁴²

Although judges concede that vicarious liability is conceptually grounded in policy and is not an exercise in analytical jurisprudence, there can be little argument with the comment of McHugh J in *Hollis* that '[i]f the law of vicarious liability is to remain relevant in the contemporary world, it needs to be developed and applied in a way that will accommodate the changing nature of employment relationships', and that this must be done without affecting other areas of established law.¹⁴³ Similarly, Kirby J in *Sweeney* acknowledged that the basis of vicarious liability is a combination of policy considerations and his Honour held that in applying legal doctrine in this area the court 'must keep in mind the changing social conditions that affect economic activities of employment, or quasi-employment, in contemporary Australia'.¹⁴⁴

Those who support a more expansive role for vicarious liability may take comfort from the recent UK decision in *JGE v The English Province of Our Lady of Charity*.¹⁴⁵ Despite the Court holding that the relationship in question was not one of employment, it nevertheless gave rise to vicarious liability. MacDuff J had regard to the 'nature and closeness of the relationship' albeit acknowledging that '[t]his close connection may be easier to recognise than to define'.¹⁴⁶ His Honour stated that the 'question will be whether on the facts before the court it is just and fair for the defendant to be responsible for the acts of the tortfeasor,

141 (2000) 204 CLR 333, 435–6 [300] (Hayne J), quoting *Soblusky v Egan* (1960) 103 CLR 215, 229.

142 *Ibid* 436 [300] (citations omitted).

143 (2001) 207 CLR 21, 54 [85].

144 *Sweeney* (2006) 226 CLR 161, 174 [37].

145 [2013] QB 722.

146 *Ibid* 735 [41].

not in some abstract sense, but following a close scrutiny of (i) the connection and relationship between the two parties and (ii) the connection between the tortious act and the purpose of the relationship/employment/appointment.¹⁴⁷ Nevertheless, it would be surprising and unfortunate if the 'close connection' between franchisor and franchisee was held to be sufficient to attract vicarious liability: surprising as neither precedent nor policy in Australia support such a development and unfortunate as franchising as a proven business expansion strategy would be threatened if franchisors were routinely liable for the wrongful acts of their franchisees.¹⁴⁸

147 *Ibid* 735 [42].

148 Killion, above n 4, 165.