Proving A National Real Estate Franchisor's Joint Venture Tort Liability

By Richard Alexander, Esq.

INTRODUCTION

In *Singh v. ERA* (Santa Clara County) two pedestrians were struck by a vehicle operated by a real estate agent in the course of business. The agent's broker was a franchisee of a nationwide real estate firm. The broker had insufficient coverage to satisfy the plaintiffs' damages and absent a recovery against the nationally known franchisor, the plaintiffs would have been substantially penalized. Clearly, the franchisor was not an employer of the tortfeasor and initially appeared to be primarily in charge of a national advertising campaign from its headquarters in Kansas City with no actual control over day-to-day operations in California.

Suit was filed against the franchisor under a theory of joint venture liability for the negligent acts of its franchisee's employees, since the liability of one joint venturer or his agents/employees, incurred in connection with the venture, is imputed to all others. (*Hupfeld v. Wadley* (1948) 89 Cal.App.2d 171, 175-176; *Knight v. Cook* (1963) 212 Cal.App.2d 613, 616.) Under California law, existence of a joint venture is a triable question of material fact (*April Enterprises, Inc. v. KTTV* (1983) 147 Cal.App.3d 805), even though the franchise agreement recites the franchisee is an independent contractor. Such a recital does not foreclose a finding of joint venture because the conduct of the parties may create a joint venture despite an express declaration to the contrary. (*Ibid.*; *Universal Sales Corp. v. California Press Manufacturing* (1942) 20 Cal.2d 751, 764, 765.)

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CALIFORNIA LAW ON JOINT VENTURES

BAJI No. 13.40 provides:

> A joint venture is a relationship which arises from an agreement between two or more persons to undertake some common objective for the benefit of all in pursuit of which each is authorized to act for the other[s]. Such an agreement may be expressed in words or may reasonably be implied from the circumstances.

A joint venture by definition is an undertaking by two or more persons jointly to carry out a single business enterprise for profit. (*Nelson v. Abraham* (1947) 29 Cal.2d 745, 749.) Joint venturers combine their property, money, efforts, skills or knowledge in some common undertaking, have a community of interest in the venture to jointly participate in the conduct of the business, share profits and losses, and have the right to exert mutual control. (40 Cal.Jur.3d, Joint Ventures, Sections 2-3, pp. 181-182.)

Franchisees and franchisors have the common objective of profiting from the sale of their products and/or services. Satisfying this objective creates profits for both and together they combine their property, money, efforts, skills and knowledge to maximize their sales. Thus, franchisors and franchisees have a community of interest in maximizing sales of their product or service. The franchisor might share in the profits by requiring the franchisee to pay a fee based on gross sales volume. More importantly, when a franchisee increases its sales, the franchisor profits from the strengthening of its own name recognition which directly enhances the value of the franchise system as a whole and gives value to every franchise it sells. (Frew and Jud, *The*

Value of a Real Estate Franchise, 14 A.R.E.U.E.A. Journal 2 (1986).) Sharing of losses is inferred if one member of the venture provides the capital and the other the services. *Kovacik v. Reed* (1957) 49 Cal.2d 166, 169 states:

> Moreover, where a joint venture involves the contribution of capital by one party and services by the other, neither party is required to reimburse the other for losses sustained. In the event of a loss, the party contributing the capital loses the capital and the one contributing labor loses the value of his efforts.

In the franchise context, a joint venture analysis is advised where the franchisor and franchisee have divided responsibilities and maintained categorical control over different aspects of the venture. Under California law, mutual control exists so long as members of the joint venture participate in the management and operation of the venture even if their respective activities are limited to different aspects of the business. (*Universal Sales Corp. v. California Press Manufacturing, supra,* 20 Cal.2d at p. 764.) In *Universal Sales,* the plaintiff contributed advertising and promotional efforts to create a market for a pellet press while the defendant contributed a manufacturing facility. The *Universal Sales* court found that a joint venture arose from this cooperation which was promotive of the common enterprise and combined the skill and efforts of both the plaintiff and the defendant.

In a franchise relationship, each of the parties has the right to control in some measure the conduct of the other. Our law wisely recognizes division of labor and will find a joint venture exists even "... where the parties have unequal control of operations." (40 Cal.Jur.3d, Joint Ventures, Sections 2-3, pp. 181-182, citing *Banks v. Puma* (1951) 37 Cal.2d 838.)

PROVING FRANCHISE CONTROL

Because a persuasive case can be made that a franchisor which seeks to maximize profits via numerous incentives is exercising control over its franchisees, discovery was designed to analyze the complete working relationship between the franchisor and its franchisees.

In the instant case, all franchisees had agreed to abide by the franchisor's operations manual which described in detail the franchise system's operational methods. The franchisor required the franchisee to pay fees mandated and unilaterally determined by the franchisor, to follow record keeping and reporting rules, and to submit for franchisor approval all public uses of its trademarks, service marks, designs, logos, colors, color patterns and business methods. The franchisee agreed not to challenge the validity of franchisor's ownership of these fundamental and necessary components of a real estate company's image. Under the franchise agreement, the franchisor could unilaterally cancel the franchise if the franchisee failed to comply with its operating manual and could use this right to control its franchisees.

The franchisor could mandate changes or modifications to the franchise's marketing system, and members agreed not only to accept these changes but to finance them. As a result the franchisor controlled the fund which drove the system from which both venturers earned revenues. Franchisees agreed to provide funding for a national advertising fund solely managed by the franchisor and to cooperate with other joint venturers in marketing plans governed by the by-laws of the franchise's regional council. The franchisor could unilaterally amend these by-laws and thus control marketing efforts and priorities. Franchisees were bound by franchisor rules regarding advertising and advertising policy and had to submit to the franchisor for approval its signs, logos, charts and other items relating to "image." The franchisee also needed franchisor approval to open a new office or to change the home office location, and the franchisor influenced and controlled by veto power the broker's selection of a name and to some degree the clothing worn by the agents. In this way the franchisor, the senior of the venturers, controlled the junior ventures' "image."

In addition to being controlled in the vital areas of marketing and image, the franchisee submitted to the control of the franchisor in other areas fundamental to the operation of a business. The franchisee agreed to transmit referrals exclusively through the franchisor's system. This mandated exclusivity effectively controlled a component of current revenue and a component of client-base expansion. The franchisee also agreed to comply with franchisor rules governing referral follow-up and reporting to the franchisor. Franchisees agreed to share listing inventories with the franchisor and to allow the franchisor to transmit listing data at its discretion. The franchisor thus exercised a measure of control over an important asset of the brokerage companies.

Franchisees had to conform to rules relating to, and forms used for, record keeping. These financial and operating records were subject to audit by the franchisor. In addition, the amount, type, term, underwriter and named insureds on franchisee insurance policies were controlled by the franchisor. Competition with other franchisees was restricted, and sales of materials or supplies by one franchisee to another franchisee was prohibited without franchisor consent. Franchisees also agreed to use "best efforts" to promote and sell the insurance products underwritten by the franchisor in order to add to the revenue stream. The membership, itself an acquired and paid for asset, was restricted in transferability by franchisor mandate with respect to liability and related insurance coverage.

The franchisee had to share profits with the franchisor through fees based on annual gross sales volume and the mandated national advertising fund contributions which were indexed to sales volume. The franchisee also had to pay a marketing fee on each real estate transaction from which the franchisee received compensation of more than a certain amount and another fee if they elected to expand by opening branch offices. Franchisees agreed to share losses (as well as benefits) with the franchisor under the terms of one of the franchise products and agreed to franchisor examination of "loss ratios" incurred under home protection contracts. They further submitted to expulsion from participation in these plans should the franchisor so mandate.

When the franchisee offered the franchisor's products to a client, it was acting on behalf of the franchisor (as well as profiting the franchisor). These products were created, controlled and administered by the franchisor but were sold by the franchisee. The franchisee could not independently offer many of these products due to both the high cost and risk.

As a result of this detailed analysis of the franchise's operations, plaintiffs were successful in defeating the national franchisor's motion for summary judgment on its claim of "lack of control" and subsequently obtained a major contribution towards settlement from the franchisor's carrier. In attempting to prove a joint venture against a franchisor, obtain a copy of the franchise's operations manual since this document will likely discuss the detailed control exerted by the franchisor that the franchise contract fails to mention. Copies of regional and headquarters' business plans are helpful to prove that "incentives" are "controls." Depose local representatives of the franchisor, as well as headquarters management, since these local representatives work for the franchisor and directly monitor and control the franchises within their region. And look for economic as well as day to day operational controls: if a franchisor requires payment into certain funds and controls the use of those resources, it is exerting *de facto* control over its franchisees.

Plaintiffs' successful opposition to defendant's motion for summary judgment and trial brief on joint venture liability of franchisor (and "non-application" of Proposition 51) are available upon request in writing to Richard Alexander, Alexander & Bohn, P.O. Box 1330, San Jose, CA 95109-1330. ■