ISSUED DECEMBER 31, 1998

BEFORE THE ALCOHOLIC BEVERAGE CONTROL APPEALS BOARD

OF THE STATE OF CALIFORNIA

THE SOUTHLAND CORPORATION dba 7-Eleven 3515 Callan Boulevard South San Francisco, CA 94080 Appellant/Licensee, v. DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL, Respondent.	AB-7035 File: 20-236143 Reg: 96038161 Administrative Law Judge at the Dept. Hearing: Jeevan S. Ahuja Date and Place of the Appeals Board Hearing: September 2, 1998 San Francisco, CA Resubmitted October 7, 1998

The Southland Corporation, doing business as 7-Eleven (appellant), appeals from a decision of the Department of Alcoholic Beverage Control[1] which revoked the off-sale beer and wine license which had been issued jointly to Southland and Emelita L. Tolentino and Tomas B. Tolentino,[2] for their clerk, Angelito D. Galon, having sold an alcoholic beverage (a six-pack of Budweiser beer) to David M.

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[1]The decision of the Department, dated January 29, 1998, is set forth in the appendix.

[2] Southland's co-licensees, Emelita L. and Tomas B. Tolentino, were not represented and did not appear at the administrative hearing, nor are they parties to the appeal. They purported to surrender their license rights to Southland in November or December, 1996 (see Respondent's Exhibit AH; I RT 9), and Southland has operated the store as a company-owned store since that time.

Buelow, a minor participating in a decoy program conducted by the South San Francisco Police Department, being contrary to the universal and generic public welfare and morals provisions of the California Constitution, article XX, §22, arising from a violation of Business and Professions Code §25658, subdivision (a).

Appearances on appeal include The Southland Corporation, appearing through its counsel, James R. Parrinello, and the Department of Alcoholic Beverage Control, appearing through its counsel, Thomas M. Allen.

FACTS AND PROCEDURAL HISTORY

Appellant's off-sale beer and wine license was issued on October 2, 1989. On November 21, 1996, the Department instituted an accusation against appellant charging a violation of Business and Professions Code §25658, subdivision (a), alleging the sale by Angelito D. Galon, on or about September 27, 1996, to David Buelow, a minor. This was the third such accusation in the span of approximately one year.[3]

An administrative hearing was held on April 22, 1997, and July 1 and 2, 1997, at which time oral and documentary evidence was received. At the conclusion of the hearing, which generated approximately 440 pages of testimony and several hundred pages of exhibits, and after the receipt of extensive briefs from the parties, the Department entered a decision which sustained the charge of the accusation and ordered the license revoked.

Appellant Southland thereafter filed a timely notice of appeal, and now raises the

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[3] The Tolentinos operated the store from 1989 to 1995 without incident. The police officer who was in charge of the decoy operations which resulted in the three violations in 1995 and 1996 acknowledged that his department's decoy program was considered one of the most aggressive in the entire state [I RT 75].

following issues: (1) did the Department abuse its discretion in ordering outright revocation; (2) did the Department err in revoking the license when Southland did not violate the statute; (3) can the “strike”[4] at issue be considered a third strike as to Southland; (4) was Southland denied due process; and (5) did the sale at issue comply with Rule 141. To a large extent, issues 1 through 4, and the subsidiary questions which have been raised in the course of their discussion in Southland’s brief, are all directed at the broad question of what circumstances, if any, warrant the revocation of the license as to Southland. For that reason, these four issues will be addressed together.

DISCUSSION

I

Southland, through its franchised and company-owned 7-Eleven stores, is undoubtedly one of, if not the, largest sellers of alcoholic beverages in the State of California. The 7-Eleven stores are typical convenience stores, the type of store known to be a popular target for minors seeking to buy alcoholic beverages. Southland operated an average of 68 company-owned 7-Eleven stores in California during the period January 1, 1995 - June 18, 1997, and franchised an additional 1,100 stores in California over the same 18-month period. Southland owns the stores, and leases the stores to the franchisees. Only a few of the franchised stores are operated without a license to sell alcoholic beverages. Southland is a co-licensee with each of its licensed

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[4] Business and Professions Code §25658.1 authorizes the Department to revoke a license where the licensee has committed three sale-to-minor violations in a 36-month period. As with its counterpart in the criminal law, the violations have come to be called “strikes”.

franchisees, and derives considerable revenues from its franchised operations - under the franchise in question in this case, Southland was entitled to a share of the store's gross profits. Presumably, the other franchise agreements are similar.

Three sale-to-minor violations took place at the franchised location involved in this case in a span of only 12 months. The record indicates that Southland was aware that the franchisee had committed the violations involved in this case, but was only formally made a party to the Department's accusations in two of the three proceedings which led up to the Department's ultimate order of license revocation.

Absence of notice to Southland and its consequences

The record indicates that, Southland was aware that its franchisees, Emelita L. and Tomas B. Tolentino, did not follow its advice that they retrain their employees in order to prevent the selling of alcoholic beverages to minors, and did not require them to do so.[5] It might be said that, although the situation called for drastic action,

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[5] After the first violation, Southland encouraged the Tolentinos to send all of their employees to its Come of Age training program, a program certified by the Department as an appropriate training program [I RT 120; II RT 13; Exhibit E]. The franchisees did not do so [II RT 95-96; 108-109], and Southland took no action other than to demand that the Tolentinos pay the fine assessed against them by the Department.

Although Southland advised the franchisees, after the second violation, that they should put their store up for sale, it made no attempt to force changes in the manner in which the Tolentinos operated the store, such as, for example, to demand that they immediately subject their employees to the Come of Age training program.

Nor did Southland, after either the first or second strike, supply its own personnel to train the Tolentino store employees on an individual basis. Considering the imperiled state of the license, such personalized instruction and training on an intensive basis was perhaps warranted. That such minimal intrusion into the franchisees' day-to-day operation of their store might jeopardize the independent contractor relationship upon which Southland places such importance is most unlikely. This is only slightly different than offering such programs jointly with its franchisees, and encouraging their participation, which Southland, to its credit, already does.

(continued...)

Southland took none until it was too late.[6] Its failure to do so, we think, based upon our consideration of the record, can be blamed on three principal factors: its belief, perhaps unjustified, that it could continue under the license as a "surviving partner" caused it to be lulled into inaction at a time when action was necessary; its excessive reliance upon its belief it was not responsible for the actions of its independent contractor franchisee; and, its failure to actively defend against the charges in an earlier accusation because the Department, although naming it as a party respondent, did not formally or officially notify it of the proceeding, again possibly lulling it into a false state of confidence. It is the omission of this important procedural step in the intermediate strike proceeding which taints the order of revocation in the present case.

The Department has explained that, because the meeting at which the franchisee signed the stipulation regarding the second violation took place before the accusation was registered, no accusation package was sent to them. (Department's Memorandum regarding Southland's ... Request for Official Notice, at page 3).

Thus, some equities favor Southland, enough, we believe, to persuade us that the Department's order of revocation should be reversed because it is an abuse of discretion. One of the intermediate strikes counted by the Department involved a proceeding in which Southland was neither served nor appeared. Because of these unique and unusual circumstances, we think that the order of revocation is excessive. If the Department intends to deprive a co-licensee of its interest in a license, it must

[5](...continued)

[6] The Department has argued that Southland had an obligation to take more stringent action. We will address this issue later herein.

comply with traditional notions of fair notice and due process. Southland, and any other co-licensee, is entitled to timely notice of Departmental action which will be relied upon by the Department in a later invocation of the "three strikes" law against their license.

Southland subject to discipline for franchisee violation

This is not to say that Southland may ultimately escape some form of discipline in this case, because, as we shall explain, it was given notice of the proceeding which resulted in the third violation, or "third strike".

The Appeals Board has once before visited the issue presented in this case, albeit in a slightly different context. In The Southland Corporation (Sukhija) (April 10, 1998) AB-6930, the Board reversed and remanded for reconsideration a decision of the Department ordering revocation as to both Southland and its franchisee, doing so because the Department decision appeared to rest on the mistaken premise that the Department had no alternative under existing law. The Board wrote, in that case:

> "The ALJ clearly believed himself bound by the decision in Coletti v. State Board of Equalization, supra, with respect to the unitary nature of the license. If Southland is entitled to any relief on this appeal, it is because of the ALJ's belief regarding the import of the Coletti decision, and not his evidentiary ruling. There is no indication in the ALJ's proposed decision that he thought Southland had any involvement in the underlying criminal conduct that provoked the accusation.
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> "The Department argues that it is the relationship of Southland and the Sukhijas as co-licensees that is critical, and not whether they are partners or are in an independent contractor relationship. 'It is that relationship . . . that determines to whom the Department looks for the responsibility of the operation of a licensed premises, and where it derives its authority to discipline.' (Dept.Br. at 3).
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> "While Southland's relationship with its franchisee may be in the nature of an independent contractor relationship, that is a function of the contract between them. The Department is not a party to that agreement, and is not bound by it. The cases cited by Southland all involve, one way or another, either the relationship between the two parties to the agreement, or the relationship with a third party who dealt with only one of the parties to the agreement.

"Here, the Department issued its license to Southland and the franchisees. It is entitled to look to either or both for compliance with the obligations assumed by the acceptance of that license. Whether they be considered partners or joint venturers or something else, the clear fact is that they jointly obligated themselves to comply with all the laws applicable to one who holds a license to sell alcoholic beverages. That a separate agreement between the co-licensees allocates those responsibilities to one or the other has no binding force insofar as the Department is concerned.

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"Southland concedes that the franchise form of business has not yet been analyzed or examined in cases dealing with control of alcoholic beverages, but argues that 'the principles endorsed in the cases discussing civil liability are equally applicable to the considerations involved in assessing responsibility for liquor license violations.'

"Southland relies heavily on the case of Cislaw v. Southland Corporation (1992) 4 Cal.App.4th 1284 [6 Cal.Rptr.2d 386], a case where Southland was exonerated from liability in a civil wrongful death action brought against Southland and one of its franchisees which had sold clove cigarettes to plaintiffs' 17-year-old son, who died of respiratory failure after smoking them. There is nothing in the decision that suggests that Southland's independent contractor status under its franchise agreement, albeit sufficient to immunize Southland against liability for the tort of its franchisee, precludes the Department from exercising its constitutionally-mandated duty and power to suspend or revoke a license when necessary in order to protect the public welfare and morals.

"The Department is authorized by the California Constitution to exercise its discretion whether to deny, suspend, or revoke an alcoholic beverage license, if the Department shall reasonably determine for 'good cause' that the granting or the continuance of such license would be contrary to public welfare or morals. We are aware of nothing in the Department's charter that mandates it to accord special consideration or more lenient treatment to a person or firm merely because that person or firm does business in the mode of a franchisor or franchisee. To the extent the Department chooses to do so, that is a function of its exercise of discretion, based upon 'good cause.'

"Another reason the Department must be able to discipline Southland derives from the fact that Southland's '7-Eleven' service mark is the name by which the retail business is held out to the public. When there is a violation of the Alcoholic Beverage Control Act by that business, the public (including the police) will inevitably associate the illegal activity with that store and the name by which that store is held out to the public. If the business then continues without interruption, as Southland seeks in this case, the public could be led to think the store has some sort of immunity, and could lose respect either for the Alcoholic

Beverage Control Law or for the ability of the Department to enforce that law."

The Board went on, however, stating:

> "Nonetheless, we are persuaded by the arguments that the relationship between franchisor and franchisee with regard to the co-holding of an alcoholic beverage control license may be such as to warrant the future adoption by the Department of special rules governing the consequences of disciplinary action initiated against a license where the franchisor, in compliance with the obligations of the franchise agreement, has neither been involved in the violation alleged nor has permitted it by any practices or policies it has implemented pursuant to that agreement. The Department is in the best position to determine whether such rules would be useful, and consistent with its enforcement obligations, and, unlike this Board, has the requisite jurisdiction to do so."

Discipline not precluded by an independent contractor relationship

Needless to say, the present case comes to the Board in the absence of any special rules governing the situation where the license is held jointly by a franchisor and its franchisee, in a relationship intentionally structured to define the franchisee as an independent contractor

Southland asks, in its brief: "Did the Department proceed contrary to law in revoking the license when Southland did not violate section 25658?" Southland's question appears to be premised on an assumption that Southland is insulated from the violation because the Tolentinos were independent contractors. That assumption is incorrect. That is, as we shall explain, the Department has the power, in appropriate circumstances, to discipline or revoke the license, regardless of the fact that the relationship between Southland and its franchisees is an independent contractor relationship. Of course, the exercise of that power must be within the limits of the discretion bestowed upon the Department, measured by good cause and the need to protect the public welfare.

"While an administrative body has a broad discretion in respect to the imposition

> of a penalty or discipline, it does not have absolute and unlimited power. It is bound to exercise legal discretion, which is, in the circumstances, judicial discretion."

(Harris v. Alcoholic Beverage Control Appeals Board (1965) 62 Cal.2d 589 [43 Cal.Rptr.63].)

Southland has cited no cases which hold, or even suggest, that an alcoholic beverage co-licensee may delegate, to an independent contractor co-licensee, its duties and responsibilities under the law, and itself be insulated or immunized against the consequences of any violation of law by the co-licensee, and we are aware of none. Indeed, the case law is solidly to the contrary, and rests on the legal concept of nondelegable duty as it affects independent contractor relationships.

In McDonald v. Shell Oil Company (1955) 44 Cal.2d 785 [285 P.2d 902, 903-904], the Supreme Court explained the principles basic to the independent contractor relationship:

> "An independent contractor is one who renders service in the course of an independent employment or occupation, following his employer's desires only as to the results of the work, and not as to the means whereby it is to be accomplished. ... The general supervisory right to control the work so as to insure its satisfactory completion in accordance with the terms of the contract does not make the hirer of the independent contractor liable for the latter's negligent acts in performing the details of the work. ...
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> "[T]he owner may retain a broad general power of supervision and control as to the results of the work so as to insure satisfactory performance of the independent contract - including the right to inspect ... the right to stop the work ... the right to make suggestions or recommendations as to details of the work ... the right to prescribe alterations or deviations in the work ... - without changing the relationship from that as owner and independent contractor or the duties arising from that relationship."

The independent contractor relationship, as a limitation on the rights of third parties as to whom they may sue for breach of contract or when they are injured by someone's negligence, rests upon principles and policies fundamentally different than

those relevant in a licensing context where the public welfare is involved, and courts have recognized that to be the case. In the licensing context, the courts have held that, because of the legal principle of nondelegable duty, an employer cannot escape liability for the actions of an independent contractor.

The decision of the California Supreme Court in California Association of Health Facilities v. Department of Health Services (1997) 16 Cal.4th 484 [65 Cal.Rptr.2d 872], together with a number of court of appeal cases there cited, offers considerable guidance with respect to the issue. The parties in that case sought declaratory relief regarding the proper interpretation and application to be given language in §1424 of the Health and Safety Code. That section authorizes the issuance to long-term health care facility licensees, including nursing homes, of citations for violations of state and federal statutes and regulations, and also provides that a citation shall be dismissed if the facility is able to demonstrate that, despite the violation, it did what might reasonably be expected of a long-term health care facility licensee acting under similar circumstances, to comply with the regulation.

The concept of nondelegable duty of licensees

In language which is of interest in the present case, the court in California Association of Health Facilities v. Department of Health Services, supra, discussed the concept of nondelegable duty and its applicability to licensees:

> "... [W]e observe that the statute must be read in light of the well-established rule of nondelegable duty of licensees. The rule, akin to the rule of respondeat superior in tort law[5] is that 'the licensee, if he elects to operate his business through employees[,] must be responsible to the licensing authority for their conduct in the exercise of his license ... . By virtue of the ownership of a ... license such owner has a responsibility to see to it that the license is not used in violation of law."

> "5 For the sake of doctrinal clarity, we shall in the remainder of this opinion refer to a licensee's liability for its employees in a regulatory enforcement proceeding as the principle of the licensee's 'nondelegable duty,' and shall reserve the term 'respondeat superior' to apply only to an employer's *tort* liability for its employees."

(California Association of Health Facilities, supra, 16 Cal.4th at 295 (citations and internal quotation marks omitted).)

The Court explained that the rule of nondelegable duty for licensees was of common law derivation, with its essential justification one of ensuring the accountability of licensees so as to safeguard the public welfare.

Citing Van Arsdale v. Hollinger (1968) 68 Cal.2d 245 [66 Cal.Rptr. 20], overruled on other grounds by Privette v. Superior Court (1993) 5 Cal.4th 689 [21 Cal.Rptr.2d 72], for its observation that the rule of nondelegable duty for licensees is of common law derivation, the Court quotes extensively from a 1933 treatise by Professor Harper, who, in turn, explains that the idea behind the general tort rule of nonliability is the absence of control and authority over the work being done and the consequent apparent harshness of a rule holding one responsible for the manner of conducting an enterprise over which it lacks the authority to direct the operations. The Van Arsdale court observed that Harper's "prophecy" had come to pass, that the exceptions to the rule of nonliability have continued to expand, and offered its justification for the expansion:

> "There are numerous considerations which have led courts to depart from the rule of nonliability of a private employer for the torts of an independent contractor. Some of the principal ones are that the enterprise, notwithstanding the employment of the independent contractor, remains the employer's because he is the party primarily to be benefited by it, that he selects the contractor, is free to insist upon one who is financially responsible, and to demand indemnity from him, that the insurance necessary to distribute the risk is properly a cost of the employer's business, and that the performance of the duty of care is of great

importance to the public."[7]

The decision in California Association of Health Facilities v. Department of Health Services, supra, also cited and discussed, as an example of a case embodying the nondelegable duty concept, Camacho v. Youde (1979) 95 Cal.App. 3d 161[157 Cal.Rptr.26].

Camacho v. Youde arose from a disciplinary proceeding charging a violation of provisions of the Food and Agricultural Code which prohibited the spraying of pesticides on innocent bystanders. Camacho was the holder of an agricultural pest control license. The pilot hired by Camacho negligently sprayed toxic pesticides on two individuals who were in the field being sprayed. The administrative law judge suspended both Camacho, the licensee, and his pilot for 60 days. On appeal to the superior court, the suspension was affirmed as to the pilot but reversed as to Camacho. The Court of Appeal reversed, and, in broad language, rejected the licensee's claim that his own innocence was a bar to discipline. After citing a number of cases, including cases under the Alcoholic Beverage Control Act[8], which predicated discipline on the theory of respondeat superior, the court addressed the licensee's argument that "due process was violated if his license is suspended when he 'is entirely innocent of

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[7] Several of these considerations could be said to be present in this case, particularly that the enterprise remains Southland's since it is the one primarily to be benefited by it. In addition to its entitlement to a share of the gross profits of the store, Southland collects an initial franchise fee and, presumably, receives rent pursuant to its lease with the franchisees.

[8] Kirby v. Alcoholic Beverage Control Appeals Board (1973) 33 Cal.App.3d 732, 737 [109 Cal.Rptr. 291]; Cooper v. State Board of Equalization (1955) 137 Cal.App.2d 672, 678 [290 P.2d 914]; Mantzoros v. State Board of Equalization (1948) 87 Cal.App.2d 140, 144 [196 P.2d 657]; and Cornell v. Reilly (1954) 127 Cal.App.2d 178, 186 [273 P.2d 572].

wrong:"[9]

> "... [T]he objective of an administrative proceeding relating to a possible license suspension is to protect the public; to determine whether a licensee has exercised his license privilege in derogation of the public interest. ... It is necessary for the Department of Food and Agriculture to effectively regulate the dangerous business of pest control. Safety in the application of pesticides must be assured by fixing responsibility for that safety on the licensee. ... If respondent were correct, effective regulation would be impossible. He could contract away the daily operations of his business to independent contractors and become immune to disciplinary action by the licensing authority.
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> "'If a licensee elects to operate his business through employees he must be responsible to the licensing authority for their conduct in the exercise of his license and he is responsible for the acts of his agents or employees done in the course of his business in the operation of the license. [Citation omitted.]
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> "We view the duties of a licensee, including the ones breached here, to be nondelegable to either an independent contractor or to an employee ... and we hold Camacho to the conduct prescribed by statute for operating his licensed business. He may not insulate himself from regulation by electing to function through employees or independent contractors."

(Camacho v. Youde, supra, 95 Cal.App.3d at 164-165.)

Conceptually, there is little difficulty transposing the ruling in Camacho to the Southland facts. It can be said that Southland chose to do business through independent contractors in order to insulate itself against certain kinds of potential contractual or tort liability. Having done so, it does not follow that its manner of doing business also entitles it to the same degree of insulation against potential sanctions when it comes to its exposure under the Alcoholic Beverage Control Act.

The Supreme Court, in its decision in California Association of Health Facilities, supra, cited cases involving the Board of Pharmacy[10] and the Department of Motor

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[9] This is one of the contentions Southland has made in the present case.

[10] Banks v. Board of Pharmacy (1984) 161 Cal.App.3d 708, 713 [207 Cal.Rptr.
(continued...)

Vehicles[11] in support of the proposition that "the principle that a licensee will be held liable for the acts of its agents is one that has been applied whether the agent is an independent contractor or an employee," and then elaborated upon its reasoning (16 Cal.4th at 296-297):

> "Thus, the doctrine of nondelegable duties for licensees has at least one justification in common with the respondeat superior duty of employers for employees in the field of tort law; the prevention of future harm to the public by giving the licensees strong incentives to insure that their employees conduct conforms to law. ... Moreover, the imposition of nondelegable duties on licensees is also a recognition of the reality that many entities subject to administrative regulation are, regardless of the precise form of ownership, corporate ones that can only act through their agents and employees. Thus to speak of the 'liability of the licensee' without referring to the liability of the licensee's employees and agents would often be a meaningless abstraction and would make the enforcement of administrative regulations a virtual impossibility. [Citations omitted.]

Thus, the Court sustained the position of the Department of Health Services that the duty of long-term health care licensees is nondelegable, in accord with the common law of licensee liability, and concluded that the provision of the Health and Safety Code in question did not repeal the common law rule of licensee liability.

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[10](...continued)
835]; Arenstein v. California State Board of Pharmacy (1968) 265 Cal.App.2d 179, 192 [71 Cal.Rptr. 357], overruled on another point by Barber v. Long Beach Civil Service Commission (1996) 45 Cal.App. 4th 652 [53 Cal.Rptr.2d 4]; and Randle v. California State Board of Pharmacy (1966) 240 Cal.App.2d 254, 261 [49 Cal.Rptr. 485]. It should be noted that each of these cases involved the conduct of employees, and not independent contractors.

[11] Rob-Mac, Inc. v. Department of Motor Vehicles (1983) 148 Cal.App.3d 793, 797-798 [196 Cal.Rptr. 398]. Unlike the pharmacy cases cited in the preceding footnote, this case addressed the independent contractor issue and concluded that even if the person who committed the violation was an independent contractor, the licensee was subject to discipline. Its discussion of the policy reasons behind such a rule are echoed by those discussed in the Supreme Court's decision in California Association of Health Facilities.

The Court rejected the argument that, since the purpose of the code provision in question was to create incentives to comply with applicable laws and regulations, no purpose would be served by punishing the licensee when the licensee's management has done all that it possibly could to prevent the violation:

> "... [A] licensee that is liable for its employees will be more likely to exert constant effort to control the conduct of those employees than a licensee that is responsible only for having the proper management policies and procedures in place to control employee conduct, or so the Legislature could reasonably conclude."

(California Association of Health Facilities, supra, 16 Cal.4th at 304-305.)

Finally, while acknowledging language in an earlier case, which upheld findings that certain automobile dealer licensees were liable for misrepresentations made by their sales representative, that there may be some limitation on the doctrine under unusual circumstances, the Court declined to address the issue in the absence of a specific factual setting.

Southland's claim of limited ability to control its franchisees

Southland's argument that its right to control its franchisees is circumscribed by the franchise agreement and by case law is, essentially, a bootstrap argument. Southland undoubtedly drafted its franchise agreement to best suit its overall business objectives as a franchisor. Southland now seeks to use that business format as a regulatory shield. It was not obligated by any law to adopt that format. It could have elected to control every aspect of the store's operation, including its ownership and day-to-day management, even including the hiring and terminating of employees. Of course, it then would have to be accountable for the acts of those persons the law

would consider its agents. When Southland elected to utilize the franchise arrangement, it voluntarily ceded the day-to-day control of the business to its franchisees. Nothing in the law required it to do so, or prohibited it from doing so. And, once it and the franchisee had bound themselves by the franchise document, only that contract limited Southland's ability to control the day-to-day operations of the store.

The court in Cislaw v. Southland Corporation (1992) 4 Cal.App.4th 1284 [6 Cal.Rptr.2d 386], affirmed a trial court's grant of summary judgment based upon its determination that the franchisees were independent contractors as a matter of law, as a consequence of which Southland had no vicarious tort liability.

The principal issue addressed by the court of appeal in Cislaw was whether there was anything in the contractual relationship between Southland and the franchisee which gave Southland such control over the franchised operation as to justify holding it liable on a theory of respondeat superior. Since Southland did not control the manner and means by which the franchisees ran the store, and the franchise was not terminable at will, it lacked that degree of control which would have warranted its being held responsible for the acts of the franchisee.

The court of appeal reviewed several earlier decisions involving similar relationships, and concluded that "the franchisor's interest in the reputation of its entire system allows it to exercise certain controls over the enterprise without running the risk of transforming its independent contractor franchisee into an agent."

One of the cases the court discussed was Wickham v. Southland Corporation (1985) 168 Cal.App.3d 49 [213 Cal.Rptr. 825], a tort action for personal injuries and wrongful death resulting from an automobile collision involving an intoxicated minor who

had, prior to the accident, purchased beer from a 7-Eleven. The court of appeal sustained a trial court's refusal to give a jury instruction which would have permitted the jury to find Southland liable on a nondelegable duty theory for having failed to provide specified safeguards and cautions required by Business and Professions Code §§25602 and 25658. The jury found that there was no agency relationship, and the court of appeal rejected the argument that an agency relationship existed as a matter of law because the franchisor, by virtue of the franchise agreement, was in a position to exercise substantial control over the business operations of the franchisee. Conceding that the right to control was a substantial factor in such a determination, the appellate court emphasized that a principal-agency relationship exists as a matter of law only where the franchisor has complete control. Otherwise, control is one of a number of factors to be considered by the trier of fact in making such a determination. The court concluded:

> "The right to control the result is inherent in both independent contractor relationships and principal-agency relationships; it is the right to control the means and manner in which the result is achieved that is significant in determining whether a principal-agency relationship exists."

(Wickham v. Southland Corporation, supra, 168 Cal.App. 3d at 59.)

The court held there was no statutorily prescribed duty requiring Southland to provide safeguards or precautions as a franchisor, and found it even doubtful that the cited code sections, §§25602 and 25658, imposed such a duty on a co-licensee.[12] In addition, the court found that plaintiffs had not raised the issue of nondelegable duty until after all the evidence was in, so to permit such a change in trial theory so late in

[12] In an analysis not pertinent here, the court concluded that Southland was not a co-licensee.

the case would be unduly prejudicial to Southland.[13]

In this case, the Department quotes familiar language from Laube v. Stroh (1992) 2 Cal.App.4th 364, 379 [3 Cal.Rptr.2d 779], worth repeating here:

> "A licensee has a general affirmative duty to maintain a lawful establishment. Presumably this duty imposes upon the licensee the obligation to be diligent in anticipation of reasonably possible unlawful activity, and to instruct employees accordingly. Once a licensee knows of a particular violation, that duty becomes specific and focuses on the elimination of the violation. Failure to prevent the problem from recurring, once the licensee knows of it, is to 'permit' by failure to take affirmative action."

We read Laube v. Stroh as saying no more than that a diligent licensee, unaware of the existence of a violation or the reasonable possibility of its occurrence cannot be charged with having permitted it. In this case Southland was aware of the occurrence of the first and second violations in ample time to take measures to prevent the occurrence of a third.

Southland argues, in effect, that its hands were tied by the terms of its franchise agreement and California's laws regulating franchisors, asserting it was not free to take more aggressive, or even drastic, measures to ensure that its franchisee did not make any further sales to minors. We think the argument lacks merit.

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[13] Southland has also cited a third, unpublished, court of appeal decision, Isaac Martin, Jr. v. The Southland Corporation. This case was discussed in the testimony of Southland's expert witness, Michael R. Davis, an assistant general counsel of Southland, and the attorney in charge of Southland's Franchise Practices Group [II RT 142-143]. The case involved a tort claim against which Southland successfully asserted an independent contractor defense. A store clerk attacked a customer with a machete after the two had exchanged hostile words. The appellate court discussed the Cislaw and Wickham cases, as well as other cases which had addressed the independent contractor issue, and concluded that the facts established the independent contractor relationship as a matter of law.

The case did not involve in any way the sale of alcoholic beverages or the concept of nondelegable duty in a licensing context, nor did the court address that subject.

The Department contends, and we are inclined to agree, that Southland's claims that its hands were tied with regard to more drastic action are refuted by provisions of California's Franchise Relations Act (Bus. and Prof. Code §20000 et seq.), which permit immediate termination without opportunity to cure in a number of situations, including conduct by a franchisee which reflects materially and unfavorably upon the operation and reputation of the franchise business or system (§20021, subd (d)); repeated non-compliance with any federal, state or local law or regulation applicable to the operation of the franchise (§20021, subd. (e) and (f)), or repeated failure to comply with one or more requirements of the franchise (§20021, subd. (g)); or where the franchisee makes a reasonable determination that continued operation of the franchise by the franchisee will result in an imminent danger to public health or safety. The casual attitude displayed by the franchisees regarding sales to minors in this case would seem to implicate several or all of these provisions and empower Southland to act. Yet, so far as the record shows, Southland made no effort to invoke any of these provisions. Consequently, we must reject Southland's contention that it was unable to prevent the violation from occurring.

Indeed, to the extent equities have any role in this appeal, Southland's position would be measurably enhanced had it attempted, albeit even unsuccessfully, any of the more drastic steps suggested by the Department.

Southland's efforts to promote franchisee compliance with ABC Act

Southland complains that the decision of the Department fails even to acknowledge the lengths to which Southland has gone to assist its licensees in their efforts to comply with §25658, subdivision (a), as well as for the decision's failure to

mention that, following the third violation, Southland is, indeed, able to point to a number of steps it has taken to assist its licensees in complying with the mandates of the Alcoholic Beverage Control Act.[14] These are matters which, in the proper case, could well justify a penalty decision short of revocation in a third strike case. Southland argues that the record is replete with prophylactic techniques, training and age-checking devices Southland has supplied to its franchisees, some before the violations in question, others following.[15] Southland also stresses its involvement in and support of a number of programs intended to encourage compliance with the Alcoholic Beverage Control Act, such as its work with various franchisee groups.

The Department, in its decision, did not dispute Southland's evidence, or even discuss it. However, from that alone, it does not necessarily follow that the evidence was ignored. Instead, the Department may well have accorded greater significance to the rapid and repeated violations by the franchisee which occurred in spite of the efforts

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[14] The most impressive steps taken by Southland, such as the development of a card reader device to scan drivers' licenses, and, at substantial expense, the furnishing of such devices without charge to its franchisees, took place only after the events in this case. Similarly, when Southland finally did take over operation of the store in question, it implemented a policy of demanding identification from all purchasers of alcoholic beverages, without exception. This new policy is admittedly drastic, but, based upon the claimed results, totally effective.

[15] Prior to the administrative hearing, Southland contracted for the manufacture of card-reading devices capable of reading the information encoded on a California driver's license and indicating whether the owner of that license is old enough to purchase an alcoholic beverage. It has since furnished, at its expense, one of these devices to each of its nearly 1100 franchisees in the State of California, at a cost of $230 each.

of Southland.[16]

The importance of notice to co-licensees

Nonetheless, as we stated at the outset, we believe that the omission of an important procedural step by the Department compels us to conclude that the order of revocation was an abuse of the Department's discretion. The procedural step which was omitted, the service upon Southland of the second accusation, compels us to the conclusion that it is unfair to consider the violation to which only the franchisees stipulated, in response to that second accusation, as one of the three strikes upon which an order of revocation may be based.

The record shows that Southland was aware of the proceeding which resulted in the first violation, having been served with a copy of the accusation. It also appears from the record that Southland was never formally served with the accusation in the proceeding which resulted in the second of the three strikes upon which the Department has based its order of revocation. This, it appears, was the consequence of the Department's practice of dealing with a Southland franchisee only, but then

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[16] The Department offered the statistical results of a computer tabulation to show that Southland, either through its company-owned stores or through its franchisees, had an overall track record either worse than other supposedly comparable franchise operations, or only marginally better. This evidence was introduced through the testimony of a Department rebuttal witness, and was permitted over the objection of Southland's counsel. This tabulation was not discussed in the decision itself, so we cannot know what weight, if any, it was given by the ALJ.

Southland argued that it was unfair to compare Southland to operations other than Quik Stop, such as The Customer Company, Texaco and Circle K, because they were all company-owned stores. Southland claimed the only valid comparison, with Quik Stop, showed Southland with a better record of compliance.

We think it unnecessary to address the question whether the study rests upon valid comparisons; we find the study not particularly informative.

proceeding as if it had dealt with both the franchisee and Southland. We do not find persuasive the Department's argument that Southland could have appealed from the decision relating to the second violation.

Revocation: power, discretion and good cause

That the Department has the power in an appropriate case to order revocation, even in a case involving a franchise relationship, as we have indicated earlier in this decision, is not in doubt.[17]

Coletti v. State Board of Equalization (1949) 94 Cal.App.2d 61 [209 P.2d 984, 985-986], clearly holds that there may be circumstances where an innocent licensee can forfeit his license rights as a consequence of wrongdoing by his partner. We do not read the decision as saying the Department has no other alternative but that. The court was there focusing on the limitations upon the judiciary, and, we think, was emphasizing the deference which must be accorded to, at that time, the Board of Equalization, and now, of course, the Department, in the licensing process. Coletti's force is in its holding that a license is unitary, a principle with which we have no quarrel:

> "The provisions of the judgment that the board must restore physical possession of the license to Coletti might indicate a purpose to make him the sole licensee. If this was the purpose, it is clearly one which cannot be accomplished by the judgment. The Act contains elaborate provisions for the transfer of licenses, including the giving of notice, establishment of an escrow, payment of claims against the transferor, payment of a transfer fee, and the application must have the approval of the board, following a complete investigation ... . A transfer from a partnership to one of the partners is clearly subject to these provisions. [The

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[17] Southland points to an internal Department memorandum dated December 4, 1996 (attachment to Exhibit 12), written by the Director, which purports to describe the Department's policy regarding the new third strike law, and contends that the Department has unlawfully adopted an underground regulation to the effect that a third strike violation will automatically result in license revocation. In view of our disposition of this case, we do not deem it necessary to reach that issue.

disqualified partner's] interest in the license can only be taken from him by revocation. Even if the license could be revoked only as to his interest and if the order of the board should be given that effect, there would be nothing to transfer to Coletti. It was not competent for the court to create a new license with Coletti as the licensee. If he is to be made the sole licensee it must be through action by the board.

"There is, however, no authority in the board to revoke a partnership license as to the interest of one of the partners. There was but a single license, although it stood in the names of two partners. It cannot be invalid as to one partner and valid as to the other." (Citations omitted.)

It is true that in Rice v. Alcoholic Beverage Control Appeals Board (1979) 89 Cal.App.3d 30, 39 [152 Cal.Rptr. 285], the court found unconvincing the argument that, absent any culpability on the part of the co-licensee (the spouse of the partner convicted of selling narcotics), the power of revocation should be exercised subject to conditions permitting transfer of the licenses within a reasonable period of time. However, any leniency to the innocent spouse/partner would necessarily redound to the benefit of the guilty partner/spouse. It is obvious that, in such circumstances, the court was convinced the Department was exercising the broad discretion with which it was invested:

"[T]he propriety of the penalty to be imposed rests solely within the discretion of the Department whose determination may not be disturbed in the absence of a showing of palpable abuse. ... The fact that unconditional revocation may appear too harsh a penalty does not entitle a reviewing agency or court to substitute its own judgment therein ... ; nor does the circumstance of forfeiture of the interest of an otherwise innocent co-licensee sanction a different and less drastic penalty." (Citations omitted).

The court's reference to Department Rule 58 (Title 4, Cal.Code Regs., §58) suggests its awareness of the special implications, and potential problems, of spousal ownership of a license where one of the spouses is unfit to hold a license. Southland has cited no cases which weaken the holdings of Coletti and Rice to the effect that the license

rights of an innocent licensee can be destroyed as a consequence of the unlawful conduct of a co-licensee.

Southland's argument that, if the license is revoked, it would have to close the store and incur a loss of half the value of the store, or approximately $500,000, evokes a number of observations. First, one might wonder whether Southland's potential loss is greatly exaggerated. Conceivably, it could operate the store, admittedly at a loss, for the period of time until a new license could issue, but a loss far less than from closing the store completely. Southland acknowledged that certain of its franchised stores operated profitably without a license to sell alcoholic beverages. It would seem that, at least for a period of time, an attempt could be made to see if this store could do the same, rather than immediately absorb the loss resulting from the closure and/or sale of the store.

More significantly, if the license is critical to the survival of the store, would this not be true of all franchised or company-owned Southland stores? Is Southland's method of operation unique, or would this also be true with respect to other franchisors? Does Southland contend that because it risks a large investment, it is immune to the consequences of the third strike law? Should a business concern which benefits substantially from the retail sale of alcoholic beverages be treated with more leniency than the ordinary innocent partner, simply because it is a franchisor? Or should a franchisor be held to the exact same level of responsibility as its franchisee? Does the wide-spread existence of the franchise method of doing business, to the extent it involves the retail sale of alcoholoc beverages, require some middle ground?

We raise these questions not to answer them, but to illustrate that there are

considerations involved, when the license in question is one held by a franchisor and a franchisee, that do not fall into the usual mode when the problem is one of discipline for violation of the Alcoholic Beverage Control Act. That is why we said, in our earlier decision[18] that it may be necessary for the Department to adopt special rules governing the consequences of disciplinary action in the franchising context.

One reason why such rules may be necessary is illustrated by the testimony of Jerry Hook, one of Southland's market managers [II RT 60-61]. Hook is of the view that Southland benefits from its status as a co-licensee in at least two ways. Southland is included in communications from the Department, thus being informed of the operation of the store under the license, and, in Skinner's words, it is "the surviving partner from a license perspective" when a franchisee is displaced, leaving it in a position to continue the on-going sale of alcoholic beverages. From Southland's point of view, at least as expressed by Hook, it stands in the wings, ready and able to substitute itself for its franchisee when a franchisee terminates his or her relationship with Southland, either voluntarily or involuntarily.

It is the Department's concern over this potential for the uninterrupted sale of alcoholic beverages at a particular location, expressed in the Department's brief in the present appeal [Dept. Br., page 6], that leads it to believe it must be able to revoke a license even where significant hardship may result:

> "If Southland is not disciplined, it simply sells another franchise to a franchisee at this location, and continues to earn 52% of the gross proceeds from the store. For these same reasons, and contrary to Southland's assertions, revocation of the license is reasonably related to the operation of this particular premises. The 7-Eleven trademark and associated advertising are linked to this

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[18] The Southland Corporation (Sukhija) (April 10, 1998) AB-6930.

store, where three sales to minors violations took place within a 12-month period at this specific location. Thus in the public eye, Southland is as closely associated with this store as are the franchisees, and probably more so because of the 7-Eleven trademark usage."

This Board has itself expressed similar concerns.[19]

Against this background, it seems to the members of this Board that the Department has treated Southland and its franchisees not only as co-licensees, which they are, when it comes to the imposition of discipline, but also as partners, which they are not. This is an important distinction. The law is well settled that one partner can, in most cases, bind the partnership by his or her action. The law regarding franchisors and franchisees, as reflected in the cases Southland has cited, in which it was one of the party litigants, is different.

We have set forth our deep concerns regarding this anomaly in our decision in The Southland Corp. (Sukhija), supra, and in our comments in this case. It is not for this Board to formulate satisfactory rules and regulations which this situation demands. Further, we are concerned that this situation has been present for many years but did not come into focus until and after the enactment of Business and Professions Code §25658.1, in 1994. Even now, a reasonable resolution is reached, if at all, only with great difficulty. The Department is confronted with a situation that does not lend itself to satisfactory resolution through the law of partnerships or franchises.

We acknowledge that there are many ramifications to the franchisor-franchisee context involving the sale of alcoholic beverages, the discipline to be imposed when there are violations of law, and the implications of the third strike law, which cannot be

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[19] See The Southland Corporation (Sukhija), supra, note 17.

addressed at this stage by this Board, but which, we feel certain, will come before us as the Department's enforcement of the three strike law with respect to sales to minors goes forward. It is enough for us to say that, in this case, we do not believe it appropriate for the Department to impose third strike discipline, i.e., revocation, when it did not formally bring Southland in as a party to be bound in one of the three proceedings leading up to the order of revocation. We are satisfied that the Department has the power and the ingenuity to devise a more appropriate order of discipline in this case short of revocation and more in keeping with long-established concepts of fair notice and due process.

II

Southland also contends that the decoy did not display the characteristics or appearance of a minor. It argues that because he was a large male with dark hair, facial hair growth which required regular shaving, and a deep voice, hair neatly combed, displayed no acne, or teenage-looking clothing, wearing, instead, clothing which gave the appearance of a man coming home from work, he did not present the appearance of a person under the age of 21, as required by Rule 141(b)(2). Southland places particular emphasis on the manner in which the decoy wore his baseball cap, with the bill facing backward.

This claim requires little discussion. The ALJ and appellant's counsel each viewed the minor while the minor was wearing the baseball cap the way he wore it on the evening in question. When appellant's counsel suggested that the cap made the

decoy appear older, the following colloquy occurred [RT 60]:

> "Mr. Parrinello: Well, Your Honor, I -- my view is that the cap, and particularly with it being on backwards, does tend to alter the apparent age of the person and makes him look older, in my view. ... I realize that's a subjective interpretation, but that is my belief.
>
> "Judge Ahuja: That's fine. Your comment is noted for the record. I actually agree with you. I think it makes him look a little older. I agree.
>
> Are you implying in any way that he's looking older than 21? because I would disagree with that. For the record, I wouldn't state I believe he looks over 21. I don't believe he looks over 20, in my opinion."

The ALJ indicated that he was also taking into account other aspects of the minor's appearance in forming his view of the minor's apparent age (RT 61-62), and specifically found [Findings III-1; V-1] that the minor presented the appearance of a person under 21 years of age, as required by Rule 141.[20]

Southland further complains that the decoy did not display any of the objective criteria set forth in the Department's LEAD materials, arguing that the absence of such characteristics precludes a finding that the decoy presented the appearance of a person under the age of 21 years. The ALJ, who saw the decoy, and viewed a photograph of the decoy taken the night of the operation, disagreed.

The clerk did not testify, and the fact that the clerk examined the decoy's driver's license before making the sale is some support for the conclusion that the sale was the result of the clerk's negligence rather than his belief the decoy looked old enough to

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[20] Sergeant Michael Massoni, the police officer conducting the decoy operation, testified that, in his opinion, the manner of the decoy's wearing of the hat made no difference in his view of the minor's age [I RT 69]. A photograph of the decoy, taken the day of the decoy operation, was placed in evidence as Exhibit 5.

purchase the beverage in question.[21] In addition, there was no suggestion that the clerk ever had the benefit of the LEAD training materials, and the record seems clear he did not participate in Southland's own training programs.

Southland's subjective assessment of the decoy's appearance is simply in conflict with the ALJ's findings, to which the Board must defer.[22]

ORDER

The decision of the Department that Business and Professions Code §25658, subdivision (a), was violated is affirmed. The Department's order of revocation is reversed, and the case is remanded to the Department for its reconsideration of the penalty in light of our comments herein.[23]

RAY T. BLAIR, JR., CHAIRMAN
BEN DAVIDIAN, MEMBER
ALCOHOLIC BEVERAGE CONTROL
APPEALS BOARD

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[21] This is not to say that, in every instance where identification has been requested, an inference may be drawn that the clerk believed the purchaser to be under the age of 21. Many licensees, if not most, pursue a policy of requiring identification from anyone appearing to be under the age of 30.

[22] Appellant Southland has, by letter, called the Board's attention to the recent decision of the court of appeal in Acapulco, Inc. v. Alcoholic Beverage Control Appeals Board. That case involved a different issue under Rule 141, and has no application here.

[23] This final order is filed in accordance with Business and Professions Code §23088, and shall become effective 30 days following the date of the filing of this order as provided by §23090.7 of said code.

Any party, before this final order becomes effective, may apply to the appropriate court of appeal, or the California Supreme Court, for a writ of review of this final order in accordance with Business and Professions Code §23090 et seq.

JOHN B. TSU, MEMBER, did not participate in the decision in this matter.