An E. coli O157:H7 Outbreak at a Chain Restaurant: A Case Study on How Easily Legal Liability Can Spread to a Franchisor

By Denis W. Stearns

In early January 1993, the American public was introduced to a deadly pathogen that has remained in the news ever since: E. coli O157:H7. Hundreds of people were injured and four children died in what is still referred to as the Jack in the Box outbreak, even though a primary cause of the outbreak was adulterated hamburger patties manufactured and sold to the restaurant chain by one of its long-time suppliers.

The litigation that resulted from this outbreak was widespread and took years, and tens of millions of dollars, to resolve. It involved not only personal injury lawsuits against the restaurant and its supplier, but also a shareholders' lawsuit and a lawsuit filed against Jack in the Box by its franchisees. And when the last of the lawsuits were finally over, there were still the sales to win back, and the need to repair a much-damaged brand name.

Overshadowed by the Jack in the Box outbreak was another E. coli outbreak that received little attention at the time. This one, also in the Pacific Northwest, involved four steak-and-salad-bar restaurants in Washington and Oregon, later found out to be part of the Sizzler chain. An investigation into the outbreak concluded that cross-contamination from beef within the restaurant kitchens, where meat and multiple salad-bar items were prepared, was the cause of the outbreak. (An abstract of the investigation report can be found at http://archinte.ama-assn.org/cgi/content/abstract/160/15/2380.) Specifically, the steaks at the restaurants were cut on-site from larger pieces of meat and then needle-tenderized and marinated in close proximity to where fruits, vegetables, and other salad-bar items were being prepared. As was perhaps inevitable, cross-contamination occurred, and quite a few people were made seriously ill. Fortunately, no one died.

In apparent response to what was learned from the outbreak-investigation, the corporate parent of this restaurant chain switched to a pre-cut, pre-tenderized steak. Because the steaks no longer needed to be cut and tenderized on-site, the risk of cross-contamination was mostly eliminated. But while all Sizzler corporate stores were switched to the new product, franchise stores were given the option to switch or stay with the prior, arguably dangerous, practice and product. This decision—to make the switch-over optional among franchisees—would come back to haunt the company.

In August 2000, almost seven years to the day after the first E. coli outbreak associated with Sizzler, a second outbreak occurred under almost identical circumstances. And this time, because someone died, the outbreak became big news all across the country. The bad publicity that Sizzler had avoided with the first outbreak thus came back to it in spades. (To get a sense of the outrage, just type the terms "Sizzler" and "E. coli" into Google.)

The litigation that arose from the Sizzler E. coli outbreak is instructive for a lot of reasons, but most notably for what it can teach us about how quickly liability can spread, especially when there is limited insurance available and too many injured persons seeking compensation for substantial damages. This article should then be read not only as a case study in how product liability law typically works, but also as an object lesson about why it is always a good idea to have more than adequate insurance coverage.

While product liability law varies from state to state, its broad contours are fairly uniform. In this case, the franchisee (the owner and operator of the restaurant where the outbreak occurred) is considered a **manufacturer**, and the food it sold is considered a **product**. As a product manufacturer, the restaurant is strictly liable for injuries caused by its product as a result of its defective or unreasonably dangerous nature. (It should go without saying that a food product that is contaminated with a deadly pathogen is considered both defective and unreasonably dangerous. The test here is the consumer-expectation test, and plainly no consumer expects to be poisoned by the food he or she is served at a restaurant.)

As a strictly liable manufacturer it is not surprising that the restaurant owner, in this case a franchisee, would be the first to be sued. And it was. But the lawsuits did not stop there. As the attorneys began to suspect that the available insurance might be insufficient to cover all claims, the hunt was then on for other potentially liable parties, and here there were two: the franchisor of the restaurant, and the supplier of the allegedly contaminated meat that was believed to have been the source of the E. coli O157:H7 that caused the outbreak.

The potential liability of the supplier of contaminated meat is probably obvious. It makes sense that if a supplier sells a contaminated product that causes an outbreak, the supplier should be held legally responsible for the resulting damages. But what if the supplier is a distributor who did nothing but act as a conduit for a product it did not manufacture? In many states, being merely a conduit makes no difference because there is what is called “chain-of-distribution” liability. That is, anyone who basically has contact with the product, even minimal contact, can be held strictly liable if it is later determined that the product was defective and the defect injures someone. While a good number of states no longer follow this rule and apply strict liability only to manufacturers (not to non-manufacturing resellers), there are enough states that continue to follow the rule to make it a good idea to assume that everyone in the chain of distribution will be held liable. That is also why it is increasingly common for distributors to disclaim liability in writing and to require “hold-harmless agreements” from the manufacturers of the products distributed. (The numerous ways, including hold-harmless agreements, that product manufacturers, distributors, and sellers can use contracts and other written agreements to avoid, limit, or allocate risks, including liability for defective products, is too extensive to address in this article.)

Chain-of-Distribution Liability

Given the relatively straightforward nature of chain-of-distribution liability, the question of how a franchisor can be held legally responsible for the acts of its franchisee is, as one might suspect, not quite as easy to explain. There are basically two theories of liability, both of which were alleged to apply in the Sizzler case.

First, a franchisor can be held liable for its own negligence. Using the Sizzler case as an example, a plaintiff here would argue that: (1) because of the prior outbreak, Sizzler Corporate had actual knowledge of the risk of cross-contamination created when raw meat is trimmed and tenderized in the area adjacent to where salad-bar items are prepared; (2) this actual knowledge made the second outbreak foreseeable and, thus, avoidable; (3) a company has a legal duty to avoid a foreseeable risk, especially if the cost of avoiding the risk is minimal in comparison to the severity of the risk avoided; and

(4) because it probably would have cost Sizzler Corp. little or nothing to require its franchisees to use a "safer" product and procedure, it was allegedly negligent in failing to do so. Sizzler Corporate is therefore, according to this argument, liable to those who were injured as a proximate result of its negligent conduct.

The second theory by which a company like Sizzler could be held liable for the conduct of its franchisees is based on the company's status as a franchisor. Most courts that have dealt with the question ruled that franchisors can be held strictly liable as product-liability defendants when the defective product is being sold under its brand name.

The rationale for linking liability to brand name is twofold. First, it is assumed that brand names are licensed in order to induce consumers to buy or use a product based on the reputation for product quality possessed by the owner of the brand name. Consumer reliance on the owner's reputation rests on the assumption that the owner (in this situation, a franchisor) has contributed in a substantial way to the quality of the product sold by its franchisee.

Second, because the franchisor has the actual ability to control the manner in which the product is manufactured, through the issuance of specifications and otherwise, it makes sense to hold the franchisor responsible for the product's quality—or, in this case, defect. And this holds true even in a case like this, where the product defect originated in an ingredient manufactured by someone else. Because most franchisors either approve the suppliers from whom their franchisees can buy, or at least have the power to do so, if the supplier turns out to have a slipshod operation, the franchisor is expected to share responsibility based on its selection of the supplier, or its failure to adequately monitor the quality of the goods it supplied.

The Jack in the Box and Sizzler outbreaks are but two examples among many in which a brand name was devalued and a company's business put at serious risk because people were sickened by the sale of contaminated food. For both Jack in the Box and Sizzler, litigation resulted and waves of bad publicity followed.

Insurance can be purchased to cover the risk of litigation, to hire attorneys, and to pay the cost of settlements and verdict. But there is no insurance against lost sales and a battered public perception—that is, except, to prevent the outbreak from occurring in the first place.

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