FRANCHISOR/FRANCHISEE INSURANCE CHALLENGES & BEST PRACTICES

Eleanor Gerhards, Partner, Fox Rothschild LLP
Elizabeth Weldon, Partner, Snell & Wilmer
Doug Imholte, Franchise Programs Practice Leader Marsh & McLennan Agency
TODAY’S DISCUSSION

• Where to Start

• Insurance Coverages 101

• Additional Insured Status

• Franchisor’s E&O: What Does it Cover?

• Structuring Insurance Against Vicarious Liability & Joint-Employer

• What Does Cyber Liability Coverage Provide?

• Best Practice Take Aways
When anyone asks me how I can best describe my experience in nearly forty years at sea, I merely say, uneventful... in all my experience, I have never been in any accident... of any sort worth speaking about. I never saw a wreck and never have been wrecked nor was I ever in any predicament that threatened to end in disaster of any sort.

Captain EJ Smith of the Titanic
WHERE TO START

• Assess Your Risk
• What Services/Products Do Your Franchisees Deliver
• Think About How You Are Supporting Your Franchisees
• Review Your FDD Insurance Requirements
• Audit Your Franchisees’ Coverage vs. Requirements
• Ignorance is not a Defense
WHERE TO START: (ASSESS & EVALUATE)

• It’s Not the Same Old World
  • New Products/Services = New Exposures
  • Franchise Development Plans
  • Legal & Industry Ramifications

• New Legislation

• (It’s tougher once the horses are out of the barn 😊)
INSURANCE COVERAGE 101

• **General Liability:**
  • Property Damage & Bodily Injury
  • Excludes many Professional Liability Coverages
  • Not Created Equal

• **Auto:**
  • Non-Owned Auto

• **Property:**
  • Business Income/Extra Expense
  • Actual Loss Sustained

• **Workers Compensation:**
  • Experience Modification Rating

• **Excess/Umbrella**
INSURANCE COVERAGE 101

Professional Liability Lines:

• Employment Practices Liability
• Directors & Officers
• Errors & Omissions
• Fiduciary (Benefit Plans/ERISA)
• Cyber/Data Privacy
• Crime (Better than Bond)
ADDITIONAL INSURED: IS IT THE MAGIC PILL?

• Definition: A person or organization not automatically included as an insured under an insurance policy who is included or added as an insured under the policy at the request of the named insured. (IRMI)

• Limited to:
  • General Liability
  • Auto
  • Umbrella

• Blanket Additional Insured Per Contract
  • Remember the limitations

• What If AI is Not on the Franchisee’s Policy?

• Drafting Tips
ADDRESSING NEW EXPOSURES THROUGH INSURANCE

• Vicarious Liability Growth
• Joint-Employer
• Utilization of Independent Contractors
• Employment Practices Liability
• Handling Confidential Data
• Franchisor’s Errors & Omissions
VICARIOUS LIABILITY

Vicarious liability - A party can be held liable for the actions of another party if there is a special relationship (e.g., agency, employment) or circumstance (e.g., right of control) between the parties.

Consider additional insurance to cover franchisee negligence.
VICARIOUS LIABILITY

• Vicarious Liability Issues Facing Franchisors Today > beyond joint employment

• Claim Examples

• Best Methods to Reduce & Prevent Vicarious Liability Exposure
  • Insurance, indemnity, separation/risk management

• Insurance Structure Advice
JOINT-EMPLOYER: DEFINITION

• Legal overview
  • Vicarious liability in the context of employment control
  • Anecdotally, rising in popularity

• Case study
  • Ochoa v. McDonald’s Corp., 133 F. Supp. 3d 1228 (N.D. Cal. 2015)
JOINT-EMPLOYER

Structuring Insurance in a Potentially Joint-Employer World

• What policies would this impact?
  • Franchisee’s Employment Practices Liability (EPL)
  • Franchisor’s E&O policy
  • Franchisor’s EPL or Cyber policy
  • Director’s & Officers
EMPLOYMENT PRACTICES: ADDRESSING FRANCHISEE’S RISK....

EPLI Coverage
• Harassment
• Wrongful termination
• Hazardous workplace

Growing Exposure
• 1st Party = employees
• 3rd Party = vendors and clients
EMPLOYMENT PRACTICES: ADDRESSING FRANCHISEE’S RISK CONTINUED....

• How are Wage & Hour issues Addressed?
  • Wage & Hour claims are excluded
  • Defense sublimit included (usually 100K)

• Addressing Independent Contractors

• NLRA
  • No coverage for CBA violations
  • Civil/Criminal Fines
EMPLOYMENT PRACTICES: ADDRESSING POTENTIAL FRANCHISEE’S EMPLOYEES RISK....

- Franchisees should carry primary coverage
- No Additional Insured language on EPL policy
- Co-defense language in Franchisee’s policy
- Defense sublimit in Franchisor’s policy
- Franchisor should carry their own EPL policy
- Best workplace practices is risk prevention
FRANCHISOR’S ERRORS & OMISSIONS

• Professional Liability definition: “Performance of Franchisor Services”

• Provides Coverage to the Franchisor for alleged errors, omissions, or negligence in their professional services to the franchisees

• Common Examples:
  • Territory Issues
  • Franchise Development
  • Lack of Support per Franchise Agreement
  • Renewal/termination issues

• Defense Costs Are Covered:
  • Can we negotiate counsel?
FRANCHISOR’S ERRORS & OMISSIONS

• Retroactive Date: What is it and how does it impact us?
• E&O Policy structure:
  • Can list Area Developers as Additional Insured
  • Insured vs. Insured exclusion
• Can Joint-Employer & Cyber Exposures Affect E&O?
FRANCHISOR’S ERRORS & OMISSIONS

Key Policy Provisions & Exclusions

• **Return of Fees**: Want the trigger to be broader than return of fees

• **Failure of Investments to Perform as Desired**: Limit to guaranty (not advice, promise, etc.)

• **Failure to Maintain Insurance Exclusion**: Remove this, it should not be tied to whether franchisees have maintained coverage

• **Vicarious Liability**: Carriers manage this by either providing a sublimit for vicarious liability or are silent in their policy thereby providing coverage
WHAT IS DATA PRIVACY/CYBER LIABILITY?

Responsibility to Protect Confidential Information of Others

Actual release or disclosure of information to an unauthorized individual/entity that relates to a person and that may cause the person or your company inconvenience or harm

- Includes financial and reputational information:
  - Personally Identifiable Information (PII)
  - Protected Healthcare Information (PHI)
  - Customer Data, Applicant Data
  - Current/Former Employee Data, Applicant Data
  - Corporate Information/Intellectual Property
NOTIFICATION & REMEDIATION LAWS

• Patchwork of laws (47 states, D.C., Puerto Rico, Virgin Islands)

• No Federal law yet in place

• The business that owns the clients owns the response
WHAT DOES A CYBER POLICY COVER?

1st Party Expenses:
• Forensics/Investigation/Data Restoration
• Notification and Credit Monitoring
• Crisis management expenses
• Business income

3rd Party Expenses:
• Damages
• Plaintiff attorney’s fees and expenses

Proper First Party Handling Reduces Third Party Exposure!
WHAT DOES A CYBER POLICY COVER?

• Regulatory Fines and Penalties
• PCI Fines and Costs
• Cyber Extortion

Scrubitize Sub-limits, Exclusions and Conditions!
UNDERWRITING PROCESS

• Revenue
• Number of Records
• Security Measures
• Contractual Agreements
FRANCHISE SYSTEM INSURANCE PROGRAM

• Writing Proper Insurance Requirements:
  • What are the right Coverages?

• Managing Compliance
  • Certs vs. Insurance Policy

• What’s In It for Franchisees?
  • Carrot works better than the Stick

• Approved Supplier Pros/Cons:
  • Time
  • Consistency
  • Lack of Unknowns
BEST PRACTICES: ARE YOU READY NOW?

• Make it a Strategic Initiative
• Write the Proper Insurance Requirements
• Additional Insured Where You Can
• Assess & Identify Franchisees Required Coverage
• Manage Your Risks/Stay Current on Exposures
• Collect Certificates of Insurance/Policies
• Maintain Insurance Compliance
• Rinse & Repeat
ADDITIONAL SCINTILLATING TOPICS IN PAPER

- Franchise Agreement Drafting Tips
- AM Best Ratings
- Risk Retention Groups, Risk Purchasing Groups and Captives
- Navigating an Insurance Claim
- Denial and Reservation of Rights Letters
QUESTIONS?

Doug Imholte
Marsh & McLennan Agency
(763) 746-8221
Doug.imholte@marshmma.com

Eleanor Vaida Gerhards
Fox Rothschild LLP
(215) 918-3642
everhards@foxrothschild.com

Elizabeth M. Weldon
Snell & Wilmer L.L.P.
(714) 427-7461
eweldon@swlaw.com