

FRANCHISING, LICENSING AND DISTRIBUTION

ALERT

WHAT YOU NEED TO KNOW: FAQS ON THE INSURANCE IMPLICATIONS OF FRANCHISE DEVELOPMENTS

By Carl Anthony Maio

The franchisor/franchisee contractual relationship is one that incites many questions, particularly in terms of insurance. Although this article is not intended to provide legal advice, as specific fact patterns and state laws differ, it provides general principles regarding Frequently Asked Questions (FAQs) that can be used as guidelines.

Certificate of Insurance

FAQ 1. In circumstances where a franchisor requires the franchisee to produce a Certificate of Insurance, are any rights conferred upon the franchisor? Generally, the answer is no. A Certificate of Insurance is not an insurance policy. Rather, a Certificate of Insurance is a document providing evidence that certain general types of insurance coverages and limits have been purchased by the party required to furnish the Certificate. The Certificate is generally a one-page accord form produced by the franchisee and provided to the franchisor that is named as the Certificate Holder. The document merely satisfies as evidence of the insurance maintained by the franchisee. Examples of the type of insurance listed on the Certificate are: commercial general liability, property, bodily injury, personal injury, advertising injury, automobile and workers compensation.

In this Certificate Holder circumstance, the franchisor is not an additional named insured. The significance of this is that no rights of defense or indemnity are conferred upon the franchisor just because a Certificate of Insurance has been provided.

FAQ 2. What must a franchisor affirmatively request in order to be construed as an Additional Named Insured? At the time the franchisee makes application to an insurance underwriter for an insurance policy, a specific request must be made by the insured to add the franchisor as an additional named insured in the policy declarations. Once the policy is

issued, the franchisor entity has the same rights and responsibilities as the franchisee named as the insured in the policy declarations.

FAQ 3. When the franchise agreement is terminated, are there any options that can be added to existing insurance policies to extend the coverage? Generally, the answer is yes. General liability insurance policies customarily provide provisions which allow for:

- a. extended reporting; or
- b. tail coverage.

Commonly, extended reporting is referred to as an "extended discovery period." An extended discovery period is a designated period of time after the policy has expired. The purpose is to allow the insured to report claims that are made against the policy after the expiration date. The policy limits, occurrence and aggregate limit caps remain the same. The designation "tail" gets its name because the coverage applies as the end of the policy period. Generally in the professional liability or general liability context, a claims made policy provides for the purchase of a Tail prior to the expiration or cancellation of the policy and covers occurrences, acts or omissions committed on or after the policy expiration date. The policy itself will set forth a formula as to how a premium is calculated depending upon the length of time for which the tail is purchased.

Independent Contractors Versus Employee

Is the franchisor an employer of the franchisee, and are employees of the franchisee actually employees of the franchisor? These questions have been around a long time, and there are no easy answers because of contradictory case law. The questions come up in the context of workers compensation insurance as well as other liability scenarios. Individual states

have their own laws with respect to independent contractors and the Fair Labor Standards Acts. Some of the recent reported decisions that have received wide spread attention in 2013 are: *AWUAH v. Coverall North America*, and *Roosevelt Kary v. Supershuttle International, Inc.* (There are many, many others far too numerous to include in this brief article.) The point is there are fundamental guidelines that apply to determine if an individual is or is not free from control and direction from the franchisor. The controversy is not limited to workers compensation insurance and also applies to automobile and general liability insurance. The general factors derived from the Internal Revenue Code perhaps offer the most enlightened guidance:

- a. Behavioral. Who controls what the employee does in terms of general instruction, training, evaluations, location of work performance, reporting and supplies?
- b. Financial. How is the worker paid? Who provides tools and supplies, hours and lastly, employee benefits?
- c. Employment Practices. The risk factor increases for the franchisor upon involvement with labor relations, OSHA investigations or co-employer scenarios.

Insurers utilize a test that determines, as a basic element, the direction or oversight of the individual. The application of the definition is intentionally broad and ambiguous. As a result, individual states have passed or have pending proposed legislation amending the respective states Franchise Practices Act to bring that particular state's laws in compliance with the Federal Trade Commission's Franchise Rule. States that have

recent proposed legislation are: Massachusetts, Nebraska, Georgia, Vermont and California.

Franchisor Termination and Non-Renewal Rights

Currently in California, there is pending legislation designed to change California's Franchise Relations Act and the Franchise Investment Law. The legislation in its current form is franchisee friendly in circumstances of termination or non-renewal of the franchise agreement. The "good cause" rationale to terminate prescribes a notice to cure the failure, and then broadens the definition of what is a substantial or material breach.

Policy Exclusions

All policies issued by insurance companies contain exclusions either within the common policy provisions or by endorsement. The courts have spent decades interpreting policy coverage and exclusions – often without consistency or uniformity. Whether the policy is underwritten directly to the franchisor or the franchisor is listed as named insured in the policy of the franchisee, best practices require the franchisor to review the policy exclusions so as not to be lured into a false sense of security by the mere existence of an insurance policy.

Fox Rothschild can be helpful in those circumstances where there is uncertainty about insurance policy coverages.

If you have questions about this Alert, please contact Carl Anthony Maio at 215.918.3616 or camaio@foxrothschild.com, or any member of Fox Rothschild's Franchising Licensing and Distribution or Insurance Practices.

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