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# Insuring Your Franchise: The Risks Around the Corner

By Richard M. Mitchell, Esq., CPCU

You are part of one of the fastest growing industries and major contributors to the U.S. economy, the franchise industry. Great job! You have thought carefully about how to grow your business, but have you really considered the slings and arrows around the corner because of that growth? What follows is not an exhaustive list of those risks or how to address them. It should, however, give pause to think about what you have built and how to protect it.

## Potential Trouble is Everywhere

Many franchisors believe they maintain adequate insurance coverage by requiring their franchisees to name them as additional insureds on their general liability policies. This may be a sufficient remedy under some circumstances, but not all. Both franchisors and franchisees face not only potential damages for injuries to third parties, but also litigation costs. When franchise disputes end up in court, the legal costs can run into the hundreds of thousands of dollars.

Some risks are obvious. A customer slips and falls while in a franchisee's store. A driver gets into an accident during the course of employment. Sometimes the franchisee is named in subsequent litigation. At other times, both the franchisee and franchisor are named. Under these circumstances, a franchisor may have protection as an additional insured on a franchisee's general liability policy. Nonetheless, the franchisor should, generally, have its own liability policy.

Franchisors often assume that such policies cover most of their practical business risks. That assumption is flat-out wrong. Other potential pitfalls that can result in substantial, expensive litigation include:

- *Alleged misrepresentations* in the franchise documents. These could include Item 19 representations or estimated costs to open a franchise.
- *Shareholder disputes*. Litigation involving board member or employee claims can be devastating. So can claims by franchisees brought against

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franchisors.

- *Non-compete agreements.* When the relationship doesn't work, a franchisee may want to continue working in a particular industry, just not with its former franchisor. These claims generally involve questions of scope and reasonableness of non-compete clauses.
- *Vicarious liability.* No discussion of franchise headaches would be complete without this topic. It is perhaps the largest potential exposure to franchisors. Third-parties allege that the franchisor is responsible for the actions of the franchisee and its employees, even where there is no active negligence on the part of the franchisor.

## Available Coverages

In addition to a general liability policy, Directors and Officers ("D&O") policies can provide reliable coverage. Like all insurance policies, the language varies between carriers and it is important to read the policy language. Some policies expressly exclude litigation brought by a franchisee against a franchisor under certain circumstances. Often, however, these policies do provide such coverage. At a minimum, they will generally include a duty to defend the insured in litigation. Those costs, by themselves, can be substantial.

Other products have also developed in recent years. One of these is Franchisor's Errors and Omissions ("E&O") insurance coverage. Such coverage can expressly provide insurance for claims arising from representations in the franchise documents.

A related product is Franchise Litigation Insurance. These policies can be expensive and the language is often tailored toward specific types of losses. Many business owners are deterred both by cost and their unfamiliarity with these types of policies. They can, however, provide coverage for claims arising from the sale, transfer or assignment of a franchise, renewal or termination of franchise agreements, or representations in offering circulars. Without coverage, the litigation costs in these types of claims can greatly exceed the policy premium.

Franchisors and franchisees also face the same risks as any other type of business. Among the fastest growing areas of litigation are claims by employees for discrimination or wrongful termination. Sometimes governmental agencies, such as the U.S. Equal Employment Opportunity Commission, pursue these claims on behalf of aggrieved employees. Even employees that can be terminated without cause are protected from retaliatory action of employers based on race,

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gender, religion, or a variety of other protected categories. Employment Practices Liability insurance (“EPLI”) provides coverage for these types of claims.

Also, as with any other business, the risk of employees injuring third parties while driving in the course of employment is always present. A careful examination of your hired and non-owned auto coverage is essential.

Finally, one of the greatest risks faced by all businesses today relates to data and security breaches. You are responsible not only for securing your own information, but also that of your customers and clients. Depending on the size and scope of your business, losses from these breaches can run into the millions of dollars. A few years ago, cyber security policies were uncommon. Today, they form an essential part of the insurance program for any prudent business owner.

## **Conclusion**

Franchisors and franchisees face unique business risks. It is essential to have a plan to grow your investment. It is just as essential to assure that you adequately protect what you have built. It is necessary to consider the particular risks you face in your business. As always, you should discuss these risks and policy language with your insurance broker to make sure you cover yourself properly.

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If you would like to discuss this issue further, please feel free to contact Rick Mitchell at [rmitchell@maddinhauser.com](mailto:rmitchell@maddinhauser.com).