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# **The Devil is in the Details: Mitigating Franchise Risk Through Effective Insurance Programs**

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*The Devil is in the Details:  
Mitigating Franchise Risk Through Effective Insurance Programs<sup>1</sup>*

Franchise systems face a unique challenge in selecting and implementing appropriate insurance programs. The task of understanding available insurance packages is daunting. Acquiring outside assistance should be considered, especially if the decision maker is not an expert in insurance. Once the exposures are fully understood, the challenge of building an effective risk management program begins. This requires a holistic review of the space in which the franchisor and franchisees operate, the structure of their respective businesses, and the risks facing the franchisees. The utility of an effective risk management program can be invaluable to a franchisor.

This paper first guides franchisors and franchisees through various types of coverages available to their businesses. Next, the paper discusses how to properly implement an effective risk-management structure to adequately protect the franchise system. Finally, the authors discuss the importance of insurance coverage in the real world with an emphasis on the litigation aspects of insurance.

**I. What's in a Name? A Primer on Insurance Coverage**

Any successful insurance program begins with an understanding of the coverages. A functional overview of risk coverage requires a working knowledge of both insurance coverage and unique exposures of the franchise industry. It is critical that the franchise risk manager also fully understands what the policies include or omit, as well as grasp how endorsements, retentions, terms, conditions and limits will apply. This section provides franchise brands with the basic

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knowledge of the various types of insurance, as well as a broad view of how the policies function and what they can actually cover in franchising.

### **Defining Key Insurance Terms**

A “Claim” is a demand made by the insured to the insurance company or companies for payments of coverage conferred by the policy. “Coverage” is the scope of protection provided under an insurance policy. “Exclusions” are conditions not covered by the insurance contract. “Occurrence” (Wrongful Act) is an event which results in an insured loss. A “Policy” is the written contract that confers insurance upon the insured.

### **Basic Business Insurance Coverage Explained**

In the environment in which franchisors operate, basic insurance coverages can be narrowed into two types: General P & C Insurance and Management/Specialty Insurance. General P & C Insurance would include General Liability, Property, Workmans’ Comp, and Umbrella. Management/Specialty Insurance would include; Franchisors’ Malpractice, Directors’ & Officers’ Liability, Employment Practices, Crime and Cyber. Each form of insurance provides unique benefits and should be carried for differing reasons. Ultimately, franchisors need to be aware of both types in order to properly understand their risk transfer, insurance policies and protections.

#### *General Liability Insurance*

General liability insurance is what most business professionals envision in a typical insurance package. A GL policy traditionally covers liability arising from bodily injury, property damage, and advertising and personal injury.

### *Property Insurance*

Property insurance protects the insured against damage of insured's property, most often buildings. The coverage may include perils, such as fire, wind, earthquake, etc.

### *Worker's Compensation*

Workers' compensation is a form of insurance providing wage replacement and medical benefits to employees injured in the course of employment in exchange for mandatory relinquishment of the employee's right to sue their employer for the tort of negligence

### *Umbrella*

Designed to help protect from major claims and lawsuits, this policy provides extra limits of liability (insurance) for many, but not all perils.

## **Management/Specialty Risk Coverage Explained**

In addition to the traditional insurance coverages, management risk coverages are critical to understand in the franchising environment. These types of policies offer specific protection to significant exposures that potentially have devastating impact. Management/Specialty insurance coverages have become increasingly necessary in recent years and provide critical protection for the franchisor and its directors and officers.

### *Franchisors' Malpractice (Errors and Omissions Insurance)*

The concept of errors and omissions (malpractice) insurance exists in many business models, but the franchise industry creates unique challenges not faced by other industries. Comprehensive Malpractice (E & O) insurance protects a franchisor from numerous types of litigation filed against the company by prospective, current, and former franchisees, regulatory agencies, competitors, and consumers.

Franchisor Malpractice insurance is intended to protect a franchisor against claims arising primarily out of breach of contract, allegations of services not rendered, misstatements and misrepresentations in the FDD, statements made during the franchise development process, and issues arising out of non-competition covenant claims. These types of allegations traditionally arise when a franchisee fails or is otherwise unhappy with being a part of the franchise system. Both large and small franchisors face litigation from numerous sources.

#### *Employment Practices Liability Insurance*

Employment practices liability insurance provides protection against litigation brought alleging violation of employment laws. Also known as Human Resources' Malpractice Insurance, EPLI protects employers from claims arising from discrimination laws, wrongful termination, failure to hire an applicant, and retaliation in the workplace, amongst other threats. Be sure to include franchisor-owned locations. Joint Employer has become a significant exposure which needs to be addressed under EPLI, but most insurance companies do not address joint employer issues.

#### *Directors and Officers Liability Insurance*

Directors and Officers liability insurance protects the franchisors' balance sheet AND the personal assets of the directors and officers arising out of litigation alleging mismanagement (business malpractice), illegal acts, fraud, mis-statement, misleading statement, and other management-related claims committed by the directors and officers of the company acting in their professional capacity. Specifically, it protects the personal assets of these individuals along with the company itself.

D & O Insurance operates in tandem with the indemnification provisions in the franchisor's bylaws. These provisions themselves ensure officers and directors will not be held personally.

D & O Insurance packages are comprised of three insuring clauses, each applicable to a certain type of litigation. The first clause, known as “Side-A,” provides coverage to directors and officers when state or federal laws or financial inability prevents the corporation from indemnifying them. These types of claims are significant because the personal assets of the directors and officers are at stake. Second, D & O insurance policies contain a “Side-B” clause. This language provides coverage for a company when it does have an indemnification provision shielding directors and officers from liability. This, similar to property insurance, makes the franchisor whole. With litigation costs and fees usually in the six to seven figure range, Side B is important protection for the balance sheet. The third common clause is referred to as a “Side-C”. Under this provision, coverage is granted to the company itself for entity’s legal liability. Side-C clauses require the scrutiny and review by the insured to ensure the coverage reaches the areas it is intended to cover.

### *Cyber Insurance*

One of the most popular types of specialized insurances is Cyber Insurance. Initially offered to protect intellectual property, the focus and primary concern has shifted to privacy. As the technology, legal environment, and hackers continues to expand Cyber Insurance becomes increasingly necessary.

Cyber Insurance is divided into two coverage types, first-party and third-party. First-party insurance covers a potential or real data breach. This policy would cover the costs of notifying clients of the breach, purchasing credit monitoring services for customers who were exposed by the data breach, forensic costs to determine the significance, and a public relations campaign to restore the reputation of the company after the breach, amongst other services. Third-party cyber insurance protects the franchisor from litigation brought by third parties, including victims of the

breach, regulatory agencies, etc. The frequency and severity of cyber has grown each year since the late 1990s.

### **Understanding Coverage Exclusions**

Securing the appropriate types of insurance coverage is only half the battle. Far too often, franchisors acquire coverage without fully understanding what is covered, and equally important, what is not. Many insurance policies come with exclusions that potentially undercut the purpose of carrying insurance.

#### *Franchisee Exclusion*

The most glaring exclusion to be aware of is one excluding suits brought by franchisees. This exclusion most often appears in the D & O coverage. The franchisee exclusion exempts any litigation arising out of a controversy with a franchisee. Having this coverage is compulsory because the most frequent litigation is one brought by a failed or unhappy franchisee. Franchisee suits pose a significant threat to the franchisor's financial ability to survive. This type of sophisticated litigation is very costly and settlements are frequently large.

#### *Breach of Contract Exclusion*

A specific exclusion often found in policies which requires special attention is the breach of contract exclusion, which uniformly appears in all D & O and E & O policies. These exclusions remove protection from the insured for any claim of breach of a contract by the franchisor. Essentially, if the company failed to abide by a contract, this exclusion exposes it to defense and settlement.

While a franchisor is unable to remove this exclusion from the policy completely, it should ensure claims related to the FDD and franchise agreement are *not* included in this exclusion. As a practical matter, almost all franchisor litigation is directly or indirectly related to the FDD and

franchise agreement. The process for drafting the FDD and franchise agreement is complicated and arduous. An innocent mistake can easily be made when drafting either document. The franchisor should therefore insist that claims related to these two documents are not included in an exemption.

#### *Property Damage Exclusion*

Franchisors' Malpractice (E & O) insurance contains a property damage exclusion, which can be problematic for franchisors with a business model that could result in property damage in the course of business. The purpose of this exclusion is that in most industries the Property Insurance would address this peril; however, the correct Franchisors' Malpractice policy would be tailored to cover the vicarious liability that arose out of the property damage.

For a franchisor who does not operate in a space where property damage is common, this exclusion does not require deletion. However, if a franchisor can reasonably expect that a franchisee (or more often the employee of a franchisee) may damage property at some point, eliminating this exclusion is necessary to shield the franchisor from vicarious property-based claims. With this exclusion in place, the franchisor is exposed to suits arising out of conduct over which it has no control, and therefore cannot prevent. This lack of protection is unnecessary since the provision can be negotiated out of the policy.

#### *Bodily Injury Exclusion*

Similar to a property damage exclusion, bodily injury exclusions in the Franchisors' Malpractice (E & O) policy should be closely analyzed. Traditionally, bodily injury is covered under General Liability insurance, but the franchisor model and resultant potential vicarious liability often necessitate coverage in the E & O policy as well. The General Liability coverage does NOT provide coverage for allegations of vicarious liability. With this exclusion in place, the

franchisor could be vicariously liable for any bodily injury that occurs in relation to the operation of a franchisee's location. This is a broad net, which is why it should be avoided in any franchise insurance policy. Franchisor owned locations should also be included when this exclusion is negotiated out of the insurance policy.

If franchisees are operating in an industry in which bodily injury is a likely possibility, then franchisors should ensure there is no bodily injury exclusion in the E & O insurance policy. Any franchise system that operates in the food, lodging, activity, beverage, remodeling, cosmetic, or message industries is a candidate for bodily injury vicarious liability. To these businesses, the exclusion is more important than to others which are less likely to face threats of litigation resulting from bodily injuries. Both models, though, should attempt to remove this clause from their policies. If the exclusion is present, the franchisor is left exposed to potential major lawsuits, threatening its longevity.

#### *Regulatory Exclusion*

The regulatory exclusion, specifically for actions commenced by the Federal Trade Commission ("FTC"), as well as state attorneys general, removes any coverage from federal and state enforcement of rules and regulations. In addition to the rules franchisors must comply with, the industry in which the franchisees operate may expose the franchisor to further risk via vicarious liability for failure to comply with the industry-specific rules. Recently, international regulatory bodies are taking a more assertive effort to enforce their laws against U.S. franchisors. For international franchisors, please be aware of this potential gap in coverage.

This clause should not just be altered but avoided entirely. Protecting one's self against these actions is one of the primary purposes for acquiring insurance for many franchisors. In

addition, certain regulatory actions may directly affect the personal assets of the directors and officers of the franchisor.

#### *Hammer and Settlement Clauses*

Hammer Clauses and Settlement Clauses apply when the insurance company recommends a company accept a settlement offer. If the insured subsequently rejects the offer, it becomes liable for any additional costs above what that settlement would have been if the company had accepted. Without a modified “settlement” provision in place, the franchisor might be forced to settle on otherwise unfavorable terms for the system in order to avoid the risk of a large potential unfunded liability.

This provision gives insurance companies a motive to recommend a settlement early in the litigation process, even if reaching settlement has a long-lasting negative impact on the brand. Unfortunately, most, but not all, insurance companies are unwilling to eliminate the clause entirely. In these circumstances, the holder should try to negotiate the clause to cover various costs arising after a rejected offer instead of exempting all post-settlement offer costs from the policy.

#### *Dishonest Acts Exclusion*

A Dishonest Acts Exclusion will always be included in a policy. Insurance companies are unwilling to eliminate it, and not without reason. Provisions of this sort preclude liability based on knowingly wrongful or fraudulent conduct on the part of the policy holder. Some courts have held that such insurance would in any event be against public policy. Some of these types of exclusions withhold liability from acts arising in whole or in part from this type of action, while others do not include any coverage.

There are ways to advantageously modify this exclusion. One way is to include a clause which protects individuals until a final adjudication determines that the insured is actually guilty of intentional misconduct, rather than permitting the insurance company to deny coverage merely because of allegations in the complaint. Some insurance companies may have an incentive to declare the act “dishonest,” since this allows the insurer to escape having to make the insured whole. Hedging the company’s coverage or lack thereof on a final determination by the enforcing entity will be fair to the business and provides greater protection.

### **Understanding How Endorsements and Limits Work**

Endorsements are provisions within an insurance policy which extend or amend coverages. Traditionally, an endorsement adds an area of coverage at an additional cost to the insured, but a rider can work in an exclusionary manner as well. Standard policies normally do not allow for customization beyond the simple selection of deductibles and coverage amounts; but, in the business context, riders do become relevant occasionally.

While not every policy carries a rider, nearly all business insurance plans come with limits. The structure of limits varies based on the insurance policy. Some policies will have one singular limit for all liabilities covered under the policy, while others will split the limits into different categories, and potentially by claim types. Understanding how the limits are structured is crucial when acquiring a policy so that a business can evaluate exactly how much coverage it will have. While all the terms included in the policy may be favorable, a lower limit provides little protection. Naturally, a higher limit comes with a higher cost. Weighing a particular business’ risks and exposure plays a key role in determining where the limit should be in a coverage package.

## **II. Building the Perfect Beast - Creating Effective Programs for Franchisors and Franchisees**

Formulating an effective risk management strategy presents a daunting and unique task for franchisors. The owners of franchise systems face additional levels of risk to which traditional businesses are not exposed. This section of the paper identifies the various types of risks franchisors encounter, discusses how to effectively plan for those risks, and outlines the benefits of having a well-crafted strategy. Ultimately, the following analysis provides franchise brands with guidance, regardless of their size, and addresses how to efficiently protect franchise brands in light of the current business environment.

### **Managing Risk**

Franchise organizations, like many businesses, are continually exposed to a diverse set of risks. While franchisors and their franchisees experience different risk factors than other business models, a similar approach to strategic risk management is warranted. Strategic risk and insurance planning, if done properly, can mitigate risks to franchise systems, thereby providing a security blanket.

Under the guidance of internal and external subject matter experts, risk management programs can go beyond providing an added level of protection, and affirmatively create an invaluable competitive advantage. In order for a system to avail itself of these benefits, upper level management must engage in a planning process involving all management and employee levels. This enables a business to proactively identify and plan for events that may affect the system, and to manage risk in a deliberate manner. Including all levels of employees enables a business to properly determine what its “risk appetite” may be, and to craft a plan to manage the identified risks within that level of risk. Further, different levels of employees have knowledge

pertaining to their daily operations which may help identify risk that was hidden from upper level management. Finally, an enterprise-wide strategy for risk and insurance transforms the process from an upper-level management task to a truly all-encompassing effort with more involvement and attention.

Engaging in a thorough process can, in turn, help provide a reasonable level of assurance to the organization's stakeholders that entity objectives will be achieved rather than disrupted or thrown off course. The latter tends to occur as a result of a failure to plan, because the leaders of a brand merely kept their fingers firmly crossed and hoped for the best. While certain business owners may enjoy this romanticized view of business operations, they are in the minority. The realities of the modern business environment are rooted in the realization of some risk. Instead of worrying fingers are not crossed tightly enough, the operators of franchise systems can enjoy peace of mind when a well thought out risk management system is in place. Even if trouble strikes the business, the response and eventual outcome are known and adequately planned.

Engaging in a methodical planning process is the equivalent of fire prevention in other industries. All franchise brands, whether emerging or firmly established, will agree that fire prevention is smoother, more efficient, and generally more preferable than firefighting. Perhaps Benjamin Franklin was more eloquent: “[a]n ounce of prevention is worth a pound of cure.” Ultimately, once an incident does occur, retroactive protection is impossible. The brand's only option is to implement a crisis response plan<sup>2</sup> with the aim of resolving the crisis quickly with

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<sup>2</sup> Crisis management response and plans go beyond the scope of this paper. The focus here is insurance and risk planning *before* an incident or crisis strikes.

minimal damage. Even a poorly-designed risk management program will yield better results than any response plan.

The following sections guide franchise brands, irrespective of their size or sophistication, as they begin their own strategic pre-incident risk assessment efforts and provide a general model for the continual development of intentional risk mitigation, management, and communication plans. When things do “go bump in the night,” as they most certainly will, brands that have taken time to plan will hold higher ground in managing, surviving, and quickly recovering from incidents that may sink competitors who have failed to implement similar programs.

### *Risk Assessment*

The threshold step in developing a plan to mitigate and manage risk effectively is to take stock of the potential threats facing the brand. This is initially where a company-wide effort pays dividends. A brand can accomplish this by identifying areas of vulnerability in all sectors. A franchise system faces vulnerability in a variety of forms. For example, vulnerability may come in the form of exposures, which pose the biggest threat to the company’s ability to operate successfully over time. In addition, vulnerability may take the form of reputational damage or impacts on the company’s viability.

Many of the risks faced by franchise systems are shared by nearly every other business. These include economic and market forces, accidents, and natural events. A plethora of other risks stem specifically from the product or service industry in which the franchisor operates. There are also risks specific to franchise systems which require special attention in the assessment process. Franchise systems have a unique challenge in managing each independently owned and operated franchise unit. This creates operational and compliance risks not faced in a distribution system comprised entirely of corporate-owned units.

### *Establish a Brand's Risk Philosophy and Appetite*

Once a brand has identified its vulnerabilities, the franchisor needs to establish the brand's risk philosophy and appetite, which should align with its corporate culture. A company needs to engage in a similar process as the risk assessment in order to determine this overarching philosophy. The assessment begins with a systemic approach to evaluate and prioritize the identified vulnerabilities faced by the business while considering three factors.

In order to evaluate a brand's risk philosophy, a franchisor must first determine *its general tolerance for risk*. Certain systems may face exposure to unique risks that require a large amount of investment to defend. In the franchisor's discretion, the benefits may not outweigh the risks in various circumstances. Regardless of the level of risk the franchisor is willing to tolerate, the determination should be purposeful, intentional, and methodical. The resultant level of tolerance provides the framework for further analysis of a brand's risk philosophy.

Secondly, the brand needs to run an analysis focused on the *probability of each risk actually occurring*. These evaluations can involve statistical considerations, similar experiences from other franchisors in the same sector, and individual conceptions. Ideally, empirical data will serve as the foundation for these types of determinations. With individual franchisees, however, a more nuanced, less objective evaluation may be appropriate. Human behavior is unpredictable, which is one of the greater difficulties franchisors face in determining the probability of these risks coming to fruition.

The final step in this process is to *determine the potential severity of any such risk* should it ever materialize. Primarily, this analysis encompasses the penalties or damages that would occur in a worst-case scenario. Accurate identification of the risk serves a large purpose at this juncture. Failure to properly diagnose the risk leads to a faulty determination of the severity of

consequences. Once all of this information is gathered, then appropriate risk responses can begin to develop.

### *Risk Responses*

By aligning a brand's risk appetite with its enterprise-wide strategic objectives, a brand enhances its risk response decisions and reduces operational, financial, and compliance surprises. In order to implement proper risk response strategies, the risk must be properly identified. Generally, risks can be divided into four distinct categories. A risk is classified as "High Risk" when the *impact of the event is high*, and the *probability the risk will occur is high*. "Medium Risk" arises in two scenarios: (i) when the *impact of the risk is low*, but it is *accompanied by a high level of occurrence*, and (ii) when *the impact is high*, but the *probability is low*. Lastly, a "Low Risk" is one that has a *low probability of occurrence* and would theoretically *have a low impact*.

In addressing a "High Risk" event, the company has three available responses: (1) avoid carrying the product in the first place, (2) drop the product from the system, or (3) price the risk into the product or service. An example of a High Risk event is an outbreak of E. coli or some other foodborne illness. In many restaurants, the idea of micro managing all employees at all times is impossible. Likewise, it is impossible to watch over all suppliers at all times. As the news bears out, many food-based franchise systems are faced with a similar type of problem with the safety of their food from time to time. These events are likely to occur and create significant brand damage. Food franchises cannot cease selling food, so their only option is to price these risks into their products.

The first subset of Medium Risk events, which have a low impact, yet high probability, are dealt with through mitigation and control. A franchise system should develop processes and

accountability protocols to reduce exposure to this risk. For example, in many franchises, floors are occasionally slippery. The likelihood of someone falling at some point during the operation of the franchise is very high, but the impact is fairly low. A franchise should implement reasonable procedures to attempt to reduce the frequency of an event like this, though they certainly do not need to overhaul their business model or pricing to accommodate for this.

The second subset of Medium Risk requires a different response. For these low probability, high impact events, a franchise should attempt to shift some risks to others through insurance, outsourcing, joint ventures, or exiting altogether. A terrorist attack is an example which would qualify under this category. The likelihood of this happening is extremely low, yet the effects could be devastating. The appropriate way to deal with this type of risk is to purchase insurance to ensure the event does not crumble the business to the ground and cause irrecoverable losses throughout the system.

Responding to Low Risk events requires the least amount of planning and efforts. If an event that has a low probability of occurring and results in a low impact, does occur, the prospective strategy should be to accept and absorb the consequences. The franchise system does not need to take any affirmative action to counter this type of event other than paying and accepting the consequences. This type of risk is generally unforeseeable. For example, if an under-aged drinker brings in an alcoholic beverage into a franchise location that does not serve alcohol, the franchise should pay the fine and proceed with its business. This type of event is difficult in nature to predict, and does not warrant consideration in planning a risk strategy.

### *Brokers and Insurance Policies*

As previously alluded to, shifting a substantial portion of a brand's risk through the purchase of insurance is an often used and effective technique to respond to and manage risk. Under the right circumstances, insurance can be a very meaningful risk management tool. However, too often insurance policies are procured without even being vetted by legal counsel or a broker to ensure the coverage and other policy terms actually cover the risks for which a company believes it is receiving insurance. All too often, companies only learn of the limits or exclusions in their coverage after they pursue coverage for a claim.

Remember, insurance policies are contracts, albeit complex ones. As such, companies should approach these policies with the same diligence as any other material contract. When negotiating insurance policies, companies must avail themselves of the required subject matter experts. The experts may be in-house or external counsel, or could be a broker with the industry background and experience needed to ensure the policies being procured actually provide the coverage and contain the policy terms which align with the company's risk assessment and appetite.

In this regard, a broker can provide tremendous support to a brand that does not have internal or readily available external legal counsel familiar with the nuances of insurance policies and the claims reporting and management process. Before engaging a broker, the company must determine what kind of broker support it requires and whether it will issue a Request for Proposal ("RFP") for those services.

Selecting a broker for assistance hardly ends the company's process, however. Once a broker is selected, the company's counsel must ensure the broker is bound by a written agreement which explicitly outlines the scope of services that the company seeks from the broker. In all

instances, the broker agreement must set forth lines of coverage that the broker is authorized to obtain. Companies will engage some brokers, for example, because of their expertise in assessing an enterprise's coverage needs and analyzing policies that purport to provide said coverage. If engaged for those purposes, the contract should specifically state that the broker is expected to provide such services as opposed to being hired to simply shop for the insurance the company has requested. The aforementioned services are very different. Clarity in which service the broker will provide helps delineate where responsibility lies if the coverage procured later turns out not to meet the insured's needs. However, not all companies need or desire to engage a broker to select an appropriate insurance plan, and not all brokers have the requisite skill set or expertise to accomplish this task.

Additionally, companies need to analyze the insurance companies being offered. Legal counsel potentially plays a vital role at this juncture. After review, the company should feel confident the terms in the contracts cover the intended losses and exposures for which it is paying for protection. Specifically, the reviewers, acting for the company, must pay close attention to any exclusions that may significantly limit or even eliminate coverage which the insured believes it is ultimately acquiring. They should further advise of changes to standard insurance forms from year to year in order to provide the company with complete information. The level of review shrinks significantly when the policy being acquired is an "excess policy." These policies follow the same terms of the initial coverage, but add greater financial protection against the same risks. If this is truly the case, the policy is said to be acquired on a "followed form" basis. If, however, the excess policy provides changes to a few material terms, which often happens, then the policy does not follow form, but is still an excess policy rooted in the original coverage. Naturally, a policy done

on a followed form basis requires the least additional analysis, while other excess policies demand a deeper level of scrutiny.

In the initial draft of an insurance policy, two types exist which each require different levels of involvement from various parties. “Standard forms” are traditional insurance policies which are essentially generic, and may be altered before the parties proceed to a final agreement through manuscript provisions. Standard forms do not call for involvement from any counsel or broker in the drafting phase, but their review will still be necessary before any agreement is finalized. On the other hand, manuscript provisions are drafted with a particular insured party in mind. The broker, along with legal counsel, should be heavily involved in the negotiating of these provisions. The lack of counsel input will not be immediately noticeable, but as previously alluded to, often is apparent when a claim is denied. At that point, the damage will have been done. Counsel is of the utmost importance when negotiating manuscript provisions.

What oftentimes gets lost in this process is the difference in the role of legal counsel and that of brokers. While both are necessary to effectuate the right risk-management plan through the insurance acquisition process, each should be left to handle their specific role. Leaning on just one to fulfill both roles is a dangerous proposition, and should be avoided at all costs. Brokers should assist with sourcing the coverage and completing the applications, while legal counsel should be ultimately responsible to ensure that complete and proper disclosures are made. Material omissions in the application can result in the insurance policy’s rescission, a consequence which should not be risked. Any known claims against a company, losses, and risk exposures must appear in the disclosures. Traditionally, in-house counsel (if such a position exists) is best positioned to identify these as well as any omissions in the disclosure which may have been prepared by other in-house departments.

## **Developing and Implementing Risk and Insurance Programs for Franchisees**

An effective and all-encompassing strategic risk and insurance management plan for a franchised brand needs to go beyond the four walls of a franchisor's headquarters and corporate units. It must account for the vicarious liability, joint employer, cyber security, privacy, and brand risks, which are distinct and inherent vulnerabilities for franchisors of franchise systems. A franchisor cannot account for a majority of the actions and decisions made within its system, which is where these plans provide their value.

Franchise systems are often prominent consumer brands. A common investment in the brand by franchised and company-owned units allows for system wide marketing efforts, which establishes and then enhances the brand's image. Traditionally, this is a good thing, until it is not. Contrary to the view espoused by many of today's media moguls, there really is such a thing as bad publicity. Adverse publicity relating to the brand, however it arises, can immediately lead to a loss of consumer confidence in the brand and thus lost sales at each corporate and franchised location. Likewise, lawsuits or government investigations, which tarnish a brand name and reputation, can do long-lasting harm to a franchise system as a whole. (See Section III of this paper for more discussion on this topic.) The consuming public and media do not distinguish the behavior of a franchisee or his/her employee from the brand as a whole, whether from a legal or public relations perspective. Unfortunately for franchisors, consumers' legal counsel (including class-action counsel), regulators, and enforcement agencies all refuse to distinguish the two entities as well.

In today's environment, every franchised organization—public or private, big or small—must plan for the inevitable risks that its franchisees and the franchisor will face on a near consistent basis. While strategic risk and insurance planning cannot alone insulate the system from

an incident that arises, it can serve as a critical tool to help a franchisor and its afflicted franchisees mitigate and manage risks on the front end. This will better prepare both parties to identify, isolate, and resolve any incident or risk as it unfolds. What does not kill a brand in times of trouble, if properly planned for and managed after occurrence, can indeed make it stronger.

### *Insurance Requirements for Franchisees*

Virtually all franchise agreements require that franchisees comply with system standards and applicable laws, but just what that means can vary widely. Often system standards are defined as some combination of mandatory specifications, standards, operating procedures, and/or rules that a franchisor may periodically prescribe for the development and operation of a franchised location. These standards may be found in the franchise agreement as well as in system operation and related procedural manuals.

Most franchisors universally consider the following to be system standards that it may and should regulate: (i) design, layout, décor and appearance of a franchised location; (ii) remodeling and replacement of obsolete or worn-out leasehold improvements, fixtures, furnishings, equipment and signs at a franchised location; and (iii) required standards and specifications for products, equipment, materials, and supplies and services that a franchised location uses and/or sells. Whether, and the extent to which, franchisors address insurance requirements as system standards in franchise agreements or system manuals, however, is much less certain or consistent.

As a best practice, franchisors should regard insurance requirements for franchisees as system standards that it has the right to, and in fact should, regulate. At the outset of its franchising business and on a regular cadence thereafter (often annually), franchisors should consider the types, amounts, terms and conditions of insurance coverage that it will require its franchised units to obtain and maintain at the franchisee's expense. A franchisor should call on its internal

resources, such as its legal, risk, finance and operations team, and its external resources, such as its corporate insurance program brokers, to assess the goods and services offered at the franchised units and the various risks posed to the franchisee, the franchisor and the brand as a result thereof. Often, corporate insurance program brokers can provide insurance program services to franchisees on a unit by unit basis based on their already established relationship with and understanding of the franchisor and its business. Franchisors working with experienced franchise system brokers might find this to be a compelling value add service (for the benefit of both the franchisee and itself) that it may wish to make available on either a preferred or mandated basis to its franchise system.

Irrespective of the type of franchised business or the goods and services it offers, it is typically appropriate to require that franchisees carry property, professional liability, general liability and motor vehicle liability insurance. Franchisors should consider other types of insurance based on the industry within which the franchised units operate and the risks inherent thereto, as well as the franchisor's risk philosophy and appetite as discussed above. Any required liability insurance should cover claims for bodily injury, death and property damages caused by or occurring in connection with a franchised location's operation or the activities of the franchisee's personnel in the course of their employment (within and without the location's premises).

Franchisors should also consider whether to mandate or at least strongly recommend that its franchisees purchase supplemental liability insurance products that can provide tailored protection for information security risks associated with data breaches, Payment Card Industry Data Security Standards (or PCI compliance) and other similar risks. Such risks have been steadily increasing in both cost and frequency over the past few years as demonstrated by the near constant media reports of organizations that have experienced a data breach or other information security

incident and suffered financial losses, been faced with significant liabilities as a result thereof and incurred significant legal and other remediation costs such as the cost of reissuing new payment cards to consumer impacted by the incident.

Information security risks pose serious concerns for all organizations - no company or brand is immune - but such risks are even greater for retail businesses, so many of which are franchised. Franchise systems must deal with the additional challenge that any information security incident at a single franchised unit will inevitably have a negative impact on the entire system and brand. Requiring that franchisees purchase supplemental insurance products to help mitigate the financial exposure associated with such risk benefits both the single unit franchisee and the franchisor and brand as a whole. In the absence of this supplemental coverage, the franchisee, many times a smaller independent business owner whose unit was the purported cause or location of the security incident, may find themselves facing financial ruin and as a result, permanent closure and even personal bankruptcy. For example, the franchisee may be inadequately prepared to pay the significant costs needed to defend any regulatory or consumer actions resulting therefrom, including those types of actions that may be brought against the franchisor under vicarious or other theories of liability and for which the franchisee will owe the franchisor indemnification under their franchise agreement. Furthermore, the franchisee will likely be facing substantial penalties, fines or other damages such as losses for fraud or payment card replacement costs, all for which supplemental insurance coverage of this type may provide some coverage.

All policies, whether customary or supplemental in nature, should contain the minimum coverage that the franchisor may prescribe from time to time and should not have deductibles that exceed an amount specified by the franchisor. The franchisor should periodically consider whether to increase the amounts of coverage required under these insurance policies and/or require different

or additional insurance coverage to reflect such things as inflation, newly identified risks, changes in law or standards of liability, higher damage awards or other relevant changes in circumstances. Additionally, a franchisor may want to require that the insurer under any required policy maintain a specified rating (typically at least an “A” or better) as rated by Best’s Insurance Reports or a similar rating designated by the franchisor.

In addition to obtaining and maintaining the types and amounts of insurance coverage prescribed by the franchisor, franchisors should require that its franchisee designate the franchisor and its affiliates as named additional insureds on any such policies. As another best practice, franchisors should mandate that these insurance policies provide for 30 days’ prior written notice to the franchisor of a policy’s material modification, cancellation or expiration. Furthermore, all such insurance policies should contain a waiver of subrogation rights against the franchisor, its affiliates and its and their successors and assigns.

As noted above, these requirements can be included within franchise agreements, as well as system operation and related procedural manuals. To help ensure compliance with such requirements, a franchisor should require franchisees to routinely furnish it with copies of their certificates of, or other evidence of, the required insurance coverage, as well as the payment of the insurance premiums. Should a franchisee fail or refuse to maintain the required insurance or fail to furnish satisfactory evidence of such insurance (as discussed further below), the franchise agreement should provide that such a failure constitutes a default of the franchise agreement that can give rise to termination if not cured within a specified period of time following notice. A franchisor should also specify in its franchise agreement or system manuals that if a franchisee fails or refuses to obtain and maintain the mandated insurance, then in addition to any other remedies available to it (including termination), the franchisor may (but need not) obtain such

insurance for the franchisee and its franchised location on franchisee's behalf, and as noted above, any such insurance policy will designate the franchisor and its affiliates as named additional insureds. In any such event, the franchise agreement should also specify that the franchisee must cooperate with and reimburse franchisor for all premiums, costs and expenses it incurs in obtaining and maintaining the insurance. A franchisor might also consider charging a reasonable fee for the time it incurs in obtaining such insurance on a franchisee's behalf.

As a means to confirm compliance with the foregoing requirements, a franchisor should mandate that its franchisees furnish it with copies of their certificates of insurance or other evidence that they maintain the minimum required insurance coverage and are paying their premiums. In particular, a franchisor should require that its franchisees provide it or its designated agent (such as a corporate insurance broker), as a condition to opening the franchised location for business, with certificates of coverage evidencing the insurance policies. In the case of retail and restaurant-based franchise systems, it is important for the franchisee to provide evidence of insurance even before the franchisee begins construction of the franchised location.

Tracking franchisee compliance with insurance requirements, however, is another matter altogether. How and to what extent to do this depends entirely on the size of the franchised system and the internal and external resources available to a franchisor. In larger, more developed systems, a franchisor might handle this process in a formal, automated fashion through an internal risk management team or professional, an insurance broker or an insurance certificate tracking company. In smaller, start-up systems, the tracking process may be more informal and manual and may be managed by franchise administration, sales or similar professionals.

### *Crisis Management for Franchisees*

Strategic risk and insurance planning in franchise systems requires addressing more than just insurance requirements at franchised locations. Wise franchisors should also address crisis management preparedness throughout their franchise systems, and not just at corporate headquarter or corporate unit level locations.

In this regard, once a franchisor has developed a contingency plan for its brand in the event of a crisis, it needs to consider which franchise stakeholders (e.g., the franchisee and the franchisee's unit level personnel) should be trained on it, how those different franchisee stakeholders should be trained and when they should be trained (e.g., annually; as significant changes are made to the plan; as an individual on-boards with the franchise system).

As a best practice, any crisis training program that is designed for franchisees and their employees should stress the importance of those parties coordinating with the franchisor and its employees in preparation for, during and in the recovery phase of any crisis. This is critically important because, depending on the nature of the crisis, franchisees and their employees may be on the front-lines fielding customer questions and answering media calls with respect to the issue at hand. One way to manage this issue is to provide high level training to franchisees and their employees on the brand's crisis management and communication strategy, coupled with a summary crisis guide that is written in user friendly language. The summary crisis guide can then be prominently housed in all franchised locations and can serve as the initial response blueprint in the event of a crisis impacting the location itself. The benefit of the summary guide is that is extremely user friendly – it contains just enough information to allow the unit level team to manage a safe environment in the acute, initial stages of the crisis.

### **III. When the Rubber Meets the Road - The Importance of Insurance Coverage in the Real World**

Other than trial lawyers, no one enjoys litigation. For the individuals involved, it can be time consuming, distracting, and emotionally draining. For franchisors, it can be expensive and pose a high degree of financial risk even if the company prevails.

Fortunately, civil litigation rarely begins with the filing of a lawsuit. It is commonly preceded by discussions among the parties to try and resolve the dispute. Settlement discussions create an opportunity for franchisors to simultaneously inventory and assess the risks and rewards of the pending litigation.

When assessing the financial impact of a dispute, the discussion will logically include the topic of insurance. More specifically, the question of whether the franchise company has insurance to cover the attorney's fees, costs and any potential settlement or unfavorable judgment arising out of or related to the dispute must be analyzed and answered. The answers to these questions will positively or negatively impact how the company views the risks and rewards of the dispute.

Franchisors with a risk management strategy that includes liability insurance will be much better positioned to aggressively defend their rights when disputes arise. Those who do not will be creating unnecessary and in some instances catastrophic risks for what is an inevitable reality for most franchise companies.

#### **████████ Risk Assessment**

Large franchisors generally have a standardized process for managing and performing a risk assessment of new litigation matters. The fundamental issue to be decided is one of "fight or flight." Whether or not the franchisor has a standardized process, at a minimum, the company

should consider the following types of question when performing a risk assessment related to new litigation matters:

➤ **Litigation Strategy & Assessment**

- What are the legal issues involved in the dispute?
- What is the dispute really about?
- What strategy will put us in the best possible position to prevail?
- What do we have to gain if we win?
- What is the best possible outcome?
- What is the most likely outcome if we win?
- What do we have to risk if we lose?
- What is the worst possible outcome?
- What is the most likely outcome if we lose?
- What are the odds of winning?
- What are the odds of losing?

➤ **Damage & Cost Assessment**

- Do we have any financial or non-financial leverage early in the process to help persuade our opponent to resolve the dispute on favorable terms prior to litigation?
- How long is the dispute likely to last?
- How much is the dispute likely to distract us from our core business?
- How much time will we need to dedicate to the dispute to put us in the best possible position to win?
- How much, if at all, will the dispute impact the growth and bottom line of our core business?
- How much money is the opposing party likely to be awarded if we lose?
- How much money can we afford to pay to the opposing party if we lose?
- What are our options if we cannot afford to pay the judgment awarded to the opposing party and how will the options impact our core business?
- How much money are we going to have to budget and likely pay in attorneys' fees and costs to put us in the best possible position to win?
- Do we have enough money to fund the litigation budget?
- Can we recover some or all our attorney's fees and costs if we prevail?
- How much money can the opposing party afford to pay us in attorneys' fees and costs if we prevail?
- What are the chances of collecting the money awarded to us attorneys' fees and costs if we win?
- What are the non-financial benefits if we win?
- How important are the non-financial benefits to our company?
- What are the non-financial risks if we lose?
- How important are the non-financial risks to our company?

- How important is the dispute to our franchise company?
- Will the dispute have a negative impact on the image of our company?
- If so, how and what can we do to minimize any such public relations issues.

A separate but equally important part of the risk-benefit analysis of litigation involves questions related to insurance, including:

- Have we tendered the claim to our insurance broker to determine whether we have insurance coverage?
- Do we have insurance to cover some or all the attorney's fees and costs we are going to incur in this dispute?
- Do we have insurance to cover all or some of the judgment we may have to pay in the most likely outcome if we lose?
- Do we have insurance to cover all or some of the judgment we may have to pay in the worst-case scenario if we lose?
- Do we have insurance to cover all or some of the attorney's fees and costs we may have to pay to the opposing party if we lose?

The answers to these insurance related questions will have a significant impact on how a franchise company assesses the risks, benefits, and appetite for litigation.

If the answers to these questions is yes, then the risk assessment process will not be burdened with the questions of how to pay for attorneys' fees and judgments. Instead, it will more appropriately be focused on whether the dispute is important to the future of the company and what needs to be done to prevail. As discussed below, the insurer may exercise some level of control over the course of the litigation and may elect to settle the case, even cases involving matters of principle for the company. At the same time, most insurance policies restrict the insured's right to settle a case without the consent of the insurer.

If the answers to these questions are no, then the burden of how to pay for attorney fees or potential adverse judgments may force the franchisor to agree to an unfavorable compromise or

forego the enforcement of its rights, even if it may hurt the long-term viability of the franchise company.

To illustrate the impact insurance coverage may have on a company's decision-making process, consider the following hypotheticals:

### ***Bone Dry***

*Bone Dry is an emerging regional franchise chain located in the Northwest that specializes in the sale of rain coats, umbrellas and water proof hats. Just last week a lawsuit was filed by an independent reporter from Seattle claiming he was severely injured when he slipped and fell on a wet floor when he went to the corporate headquarters in Pullman, Washington for a scheduled interview with the company President, Dan Mulhern. The reporter has demanded an out of court settlement in the amount of \$900,000. The Road Runner Insurance Company has appointed legal counsel to defend the claim and has agreed to pay an unfavorable judgment up to the general liability policy limit of \$1,000,000. Bone Dry intends to vigorously defend this claim and base its defense on the testimony of their receptionist, Douglas White, who is expected to testify that the reporter was actually injured when he tripped over his own camera bag after he got up from his chair in the reception area to meet with President Mulhern.*

### ***Smooth***

*Smooth is an emerging chain of tapioca pudding franchises operating in the states of Alabama, Florida and Georgia. Recently, a lawsuit was filed against the company and its Founder/President, Eric Edinger. The lawsuit was filed by their former officer manager who is claiming the she was a victim of sexual abuse, subjected to a hostile work environment, and terminated due to her gender. She is seeking damages of \$1,000,000 plus the cost of her attorney's fees. President Edinger has adamantly denied the claims made against him and the company. The Acme Insurance Company has appointed legal counsel to defend the claim but reserved its right not to pay an unfavorable judgment because Smooth did not purchase this type of employment law claim coverage.*

The primary difference in these hypotheticals is whether the insurance company will indemnify their insured against an unfavorable judgment. The examples illustrate the importance of having sufficient insurance coverage in the event of a claim. On one hand, there is going to be minimal financial risk or distraction associated with Bone Dry defending against the Seattle

reporter's questionable personal injury claim. The company has adequate insurance to pay an unfavorable judgment and defend against what appears to be a frivolous lawsuit. The absence of adequate insurance coverage, however, has created a real quandary for Smooth. Regardless of what happens, the founder/president of its company is going to be embroiled in a sexual harassment, hostile work environment, and gender discrimination claim. To make matters worse, the company will most likely have to pay any adverse judgment because Smooth did not purchase employment law insurance to cover these types of claims. So, while Smooth is in the midst of a public relations quagmire, the company will need to set aside valuable working capital to pay a potentially adverse judgment, instead of being free to use the cash to help grow the company.

The forgoing hypotheticals demonstrate that it is important to have the appropriate insurance coverages in place in order to defend and indemnify the company for third-party claims. It is too late to secure insurance coverage after the claim has been asserted. The appropriate insurance coverages should reflect the foreseeable risks and exposures, arising out the Company's operations.

### **Selection of Counsel**

The general rule is that the liability insurer who has an obligation to defend the insured under the policy will also have the right to select defense counsel. An exception to this would be director & officer liability policies, where the insured is usually permitted to select defense counsel subject to insurer approval and is reimbursed. When negotiating and purchasing insurance, franchisors would be wise to try and negotiate the right to select their own attorney in the event of litigation.

As a practical matter, it will be challenging to negotiate the right to select counsel when purchasing standard insurance products such as general liability or automobile liability policies.

This industry reality is commonly attributed to the belief among insurance companies that claims arising from those types of policies can be handled by almost any moderately experienced trial attorney and does not require a particularized education, training or expertise. This has led to a framework where insurance companies create working relationships with law firms in each state (often known as “panel counsel”) who agree to work for below market rates in exchange for the hope of a steady volume of cases over time. The “below market” rates for these types of cases are often materially below the market rates for more sophisticated and specialized litigation disputes paid for by insurance companies, and grossly below market rates for sophisticated commercial litigation disputes.

In contrast, franchisors may have more success when negotiating the purchase of specialty coverage such as errors & omissions coverage, and franchisor-franchise litigation coverage. The reason is that insurance companies are more likely to appreciate and acknowledge the need for trial counsel with specialized education, training and experience to handle the complex legal issues involved for these types of cases. Even if the insurance company will not allow the company to choose its own trial counsel, the insurer may still give the franchisor input or agree to select counsel with the expertise and training that is needed to handle the types of cases covered by a specialized policy.

While it may seem like a burden, the time invested on the front-end negotiating for these rights will pay dividends in the long run (*see* Section II above). For example, by developing long-term working relationships with experienced and talented trial attorneys, franchisors will get the added benefit of counsel who understand and appreciate their business and corporate culture.

Another tool in the franchisor’s toolbox may be the law in the state where the franchise company is located. While some states grant insureds no flexibility when it comes to the selection

of defense counsel, in other states an insured may be able to select defense counsel when an insurer reserves rights on matters critical to the claim or in the event of certain types of unfavorable judgments. The statutes and case law that grant these rights are based on the premise that by reserving rights while providing a defense, an inherent conflict exists between the insurer and insured during the litigation, so the insured must be able to select its own independent counsel as opposed to a member of the insurer's panel counsel.

An example of statutory authority for selecting independent counsel due to a conflict between insurers and insureds can be found in California. The conflict issue was raised by California courts as early as 1971, in the case of *Executive Aviation, Inc. v. National Insurance Underwriters*, 16 Cal. App. 3d 799, 810. In *Executive Aviation* the court held that in a conflict-of-interest situation, “[t]he insurer’s desire to exclusively control the defense must yield to its obligation to defend its policyholder,” allowing the insured to control the defense of its own case. In 1984, the court in *San Diego Federal Credit Union v. Cumis Ins. Soc’y, Inc.*, 162 Cal. App. 3d 358, determined that when an insurer reserves rights on issues critical to the defense of the case, a conflict of interest arises for the attorney appointed by the insurer to defend and gives rise to the right of an insured to hire independent counsel at the insurer’s expense. In 1987, California codified the decision in *Cumis* creating California Civil Code § 2860 which outlines the rules for rights and obligations with respect to independent counsel. Section 2860 states the following:

**§ 2860. Provision of independent counsel to insured; Conflicts of interest; Selection of counsel; Waiver of right to counsel**

(a) If the provisions of a policy of insurance impose a duty to defend upon an insurer and a conflict of interest arises which creates a duty on the part of the insurer to provide independent counsel to the insured, the insurer shall provide independent counsel to represent the insured unless, at the time the insured is informed that a possible conflict may arise or does exist, the insured expressly waives, in writing,

the right to independent counsel. An insurance contract may contain a provision which sets forth the method of selecting that counsel consistent with this section.

(b) For purposes of this section, a conflict of interest does not exist as to allegations or facts in the litigation for which the insurer denies coverage; however, when an insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by counsel first retained by the insurer for the defense of the claim, a conflict of interest *may exist*. No conflict of interest shall be deemed to exist as to allegations of punitive damages or be deemed to exist solely because an insured is sued for an amount in excess of the insurance policy limits.

(c) When the insured has selected independent counsel to represent him or her, the insurer may exercise its right to require that the counsel selected by the insured possess certain minimum qualifications which may include that the selected counsel have (1) at least five years of civil litigation practice which includes substantial defense experience in the subject at issue in the litigation, and (2) errors and omissions coverage. *The insurer's obligation to pay fees to the independent counsel selected by the insured is limited to the rates which are actually paid by the insurer to attorneys retained by it in the ordinary course of business in the defense of similar actions in the community where the claim arose or is being defended.* This subdivision does not invalidate other different or additional policy provisions pertaining to attorney's fees or providing for methods of settlement of disputes concerning those fees. Any dispute concerning attorney's fees not resolved by these methods shall be resolved by final and binding arbitration by a single neutral arbitrator selected by the parties to the dispute.

*Id.* (emphasis added).

It is important to note that if independent counsel is selected they must still work within the compensation framework previously established by the insurer. More importantly, the statute makes clear in subsection (a) that not every conflict of interest requires independent counsel. This has generally been interpreted by California Courts to mean that a conflict must be “significant, not merely theoretical, actual, not merely potential.” *Dynamic Concepts, Inc. v. Truck Insurance Exchange*, 61 Cal. App. 4th 999 (1998). In other words, it is not a reservation of rights itself that triggers the right to independent counsel. It must be a reservation of a right that deals directly with the issues being litigated in the underlying case. *See, e.g., McGee v. Superior Court*, 176 Cal. App. 3d 221 (1985) (reservation of rights regarding resident relative exclusion does not give rise to

rights to independent counsel); *Blanchard v. State Farm Fire & Casualty Co.*, 2 Cal. App. 4th 345, 347 (1991) (reservation of rights that certain types of construction-related damages were not covered by the insurance policy does not give rise to right to independent counsel).

Maine provides similar protection to insureds based on several rulings of the Maine Supreme Court, sitting in its capacity as the Law Court. *In Travelers Indem. Co. v. Dingwell*, the Law Court opined in dicta that insurers have an obligation to provide independent legal counsel to its insureds when a conflict arises:

Of course, the insurers' obligation to defend can lead to a serious dilemma for the insurer. In some cases, the parties may agree that the insurer hire independent counsel for the insured...The difficulties which these cases may pose will have to be addressed as they arise. For the case at bar, it is sufficient for us to hold that the complaint here does generate a duty to defend, because it discloses a potential for liability within the coverage and contains no allegation of facts which would necessarily exclude coverage.

414 A.2d at 227 (citing *Magoun v. Liberty Mut. Ins. Co.*, 346 Mass. 677, 195 N.E.2d 514 (1964))

The Maine Supreme Court directly addressed the issue again in *Patrons Oxford Ins. Co. v. Harris*, 905 A.2d 819 (Me. 2006). The *Patrons Oxford* case involved the review of a settlement entered into by counsel appointed by the insurer for the insured, in a case which was being defended under a reservation of rights. The Law Court made clear that it agreed with and was adopting the position of other courts who had previously determined that “when an insurer reserves the right to deny coverage they give up the right to control the defense of a lawsuit brought against its insured by an injured party.” *Id.* (citing *Travelers Indem. Co. v. Dingwell*, 884 F.2d 629, 638-39 (1st Cir. 1989); *see also Cay Divers, Inc. v. Raven*, 812 F.2d 866, 870 (3d. Cir. 1987); *United Servs. Auto. Ass'n v. Morris*, 741 P.2d 246, 252 (Ariz. 1987) (stating that “[t]he insurer's reservation of the privilege to deny the duty to pay relinquishes to the insured control of the

litigation"); *Ins. Co. of N. Am. v. Spangler*, 881 F. Supp. 539, 543-44 (D. Wyo. 1995); 22 ERIC MILLS HOLMES, HOLMES' APPLEMAN ON INSURANCE 2d § 136.7, at 49 (2003) (stating that, "if the insurer has reserved its right to deny coverage, the insurer cannot compel the insured to surrender control of the litigation").

The *Patrons Oxford* court stated that from its perspective:

This position strikes a fair balance between the insurer and the insured. If the insurer could continue to control the insured's defense despite reserving its rights to later deny coverage, it could assert a liability defense and insist on fully litigating the insured's case, thus exposing the insured to personal liability if there is a verdict favorable to the claimant. If the verdict is favorable to the claimant, the insurer still has another opportunity to avoid liability by doing exactly as Patrons did here, litigating coverage in a declaratory judgment action. Thus, we agree with the Arizona Supreme Court that the insured "risk[s] financial catastrophe if [he is] held liable, while the insurer may save itself by litigating both issues—the insured's liability and the coverage defense—and winning either." *Morris*, 741 P.2d at 251.

*Id.*

The right to select independent counsel initially derived from hotly contested litigation disputes involving insurance coverage issues between insurers and insureds. Now that these rights exist in certain states, they can be asserted by a franchise company to select defense counsel that it believes will put the company in the best possible position to be successful in the case, while at the same time continuing to establish relationships with experienced and talented trial attorneys, who understand and appreciate their business and corporate culture.

To assist franchise companies as a starting point in this analysis, attached as Appendix A is a recent survey of identifying how the fifty (50) different states in the United States have most recently addressed with the issue the right to select defense counsel.

## **Control Over Litigation**

The purchase of appropriate insurance coverage by the company assures that there will be adequate financial resources available to defend third-party claims and to fund any settlement or judgment. However, in securing appropriate liability insurance coverage, the company does give up, to a certain extent, control over the litigation.

Control over the litigation when defending against third-party claims can come in all shapes and sizes. The most common or obvious forms of control include, without limitation, the following: (i) the selection of counsel outlined above; (ii) direct and indirect control over the strategy pursued in defense of the third party claim; (iii) funding of the defense of the claim and scrutiny over what expenses are permissible; (iv) with respect to the insurer's control of the defense of a covered matter, the insured will have a duty to cooperate with the insurer in its defense of the case, pursuant to express obligations set forth in the policy; and (v) control of the decision as to when and how to settle covered claims. This last example permits the insurer, in most cases, to settle covered claims for an amount within the policy limits without the consent of the insured. In a closely held business or those involving professional services, giving up this type of control to the insurance company can be difficult to swallow if the first time the company learns about it is after the company has been sued. On the other hand, when the insured is in control of the defense of a third-party claim, the company is still generally precluded from entering into a settlement agreement with the claimant without the consent of the insurer.

The lesson to be learned here is that while liability insurance does provide protection against financial risks to the company arising out of third-party litigation, that protection comes with strings as it relates to the loss of control over litigation matters, which may involve matters of principle to the company or the franchise system.

## **Attorney's Fees and Costs**

As most trial lawyers will tell you, bold promises to fight for principle do not generally last long when the franchisor is solely responsible for paying the legal bills and reserving money from its business operations in the event of an unfavorable judgment. That is why it is commonly said among trial lawyers that they could retire early if they had a dollar for every time they were told by clients that “money is no object because winning this case is a matter of principle”.

A commonly repeated mantra is that an average 95% of civil litigation cases are resolved prior to trial. Even if that number is anywhere near accurate, then it creates two challenges for franchisors to consider when engaged in litigation. First, under the American Rule, more often than not the franchisor will have to pay for its own attorney and costs incurred during the litigation process even if the company prevails on the merits of this case. Second, one party is unlikely to persuade the opposing party to pay for its attorney's fees and costs as part of a settlement agreement though the cost of litigation can and should be factored into the financial terms of any settlement.

On one hand, franchisors will more often than not be responsible for paying the attorneys' fees and costs of their affirmative claims against other parties. The exception to this general rule is when a contract or a state or federal statute calls for reimbursements of attorney's fees and costs. This is one of the primary reasons franchise agreements commonly grant the franchisor or the prevailing party the right to recover their attorney's fees and costs in disputes among franchisors and franchisees.

On the other hand, if the franchisor plans carefully and has an appropriate insurance program in place, the company should seldomly be responsible for paying its attorney's fees and costs when it is sued by a third party or the subject of a counterclaim after the commencement of

litigation. The best way for a franchisor to accomplish this goal is to have a risk management strategy that includes appropriate liability insurance for litigation.

A carefully crafted insurance litigation plan will greatly increase the likelihood that the insurance company will provide a defense for the company in the event the company is affirmatively sued by a third party or is the target of a counterclaim in a case where the company affirmatively commences litigation. While determining whether an unfavorable judgment is covered by an insurance policy can be elusive, courts have consistently set a very low bar when it comes to determining whether an insurance company has a duty to provide a defense when one of their insureds has been sued. For a liability insurance policy that imposes an obligation on the insurer to defend an insured, the general rule is that an insurer will have a duty to defend if there is any possibility that any of the claims in the third-party complaint would be covered by the policy. In most policies, the duty to defend is triggered by a lawsuit. However, under some policies, the duty to defend is triggered by a “claim,” which is typically a defined term in the policy and can include a substantive demand letter.

If a franchisor has liability insurance coverage to defend claims made against it, the company will be much better positioned to affirmatively enforce or aggressively defend its rights when disputes arise. Those who do not have such coverage will be creating an unnecessary financial risk for what is an inevitable reality for most franchise companies. They also may have foregone the opportunity to make the appropriate decision as to whether to aggressively prosecute or defend the case solely because of the inability to afford to pay legal counsel – rather than to do what is in the best interests of the long-term success of the franchise business.

To illustrate the undo pressure that can be put on franchisors when they are faced with litigation and do not have insurance to pay for defense counsel, consider the following hypotheticals:

### ***Sugar***

*Sugar is an emerging maple syrup conglomerate of franchised retail stores based in New Hampshire. The Company is embroiled in a dispute with the State of New Hampshire over the environmental impact of its maple syrup manufacturing facilities and adjacent maple tree farms. If New Hampshire prevails the ruling may threaten the company's ability to expand and/or operate its core business. Fortunately, Sugar purchased an environmental insurance liability policy from Granite State Insurance Company. While Granite State has issued a reservation of rights letter regarding any potential adverse judgment, the company has agreed to provide coverage for the expense of legal counsel and costs associated with the litigation.*

### ***Scotch House***

*Scotch House is a popular chain of luxury bars located in southern New York and northern New Jersey. The company recently began franchising its scotch and cigar concept throughout the United States after obtaining venture capital financing from a group of wealthy hedge fund managers who first became familiar with the concept as regular patrons. A lawsuit was recently filed against the company by its founder Dan Thorton. Thorton claims he was duped into selling his stock for less than fair market value by his former business partner Doug Brunetti who failed to reveal that he was secretly working with the hedge fund managers to force him out of the business. Brunetti is adamant the claim is frivolous because he only approached the hedge fund managers after Thorton asked to be bought out, Thorton was represented by legal counsel throughout the transaction, and they commissioned a third-party appraisal of the business to determine the purchase price of Thorton's stock. Nonetheless, Thorton is seeking \$15 million dollars in damages, plus treble damage and attorney's fees. Scotch House's insurer, Tri-State Insurance has denied the franchisor's request to defend and indemnify against Thorton's lawsuit.*

The primary difference in these hypotheticals is whether the insurance company will defend their insured against the lawsuits brought against these two franchisors. These examples illustrate the importance of having insurance coverage to pay for the defense of potential litigation claims. On one hand, while Sugar, with the assistance of its liability insurer, may not be able to

quickly extract itself from its “sticky” environmental dispute, the franchisor will be able to carefully and patiently analyze the merits of the environmental claims brought by the State of New Hampshire at each stage of the litigation and objectively decide whether it makes sense to resolve or aggressively defend the claims being made against it. On the other hand, despite facing what appears to be Thorton “blowing smoke” as he cries over “spilled scotch,” the Scotch House may still be forced to try and settle a frivolous case. The alternative is to put growth of the company on hold for several years while spending valuable time, and newly acquired investment capital, to defend against Thorton’s frivolous claims. In the meantime, it is likely that other similar concepts may beat them to the marketplace in developing a national franchise of luxury scotch and cigar bars.

### **Examples of Real World Cases Where Coverage Saved the Company or Failure to Have Coverage Doomed the Company**

The risk associated with having to pay an unfavorable settlement or judgment at the conclusion of a trial or arbitration will inevitably create cash flow challenges for even the most prudent franchisors if they do not have adequate insurance liability coverage. While franchisors involved in litigation matters who do not have adequate liability coverage may have several years to set aside reserves, the mere prospect of having to pay a large unanticipated settlement or judgment is likely to set back the growth and development of the franchised business for years to come. Of course, that assumes the franchisor has adequate cash flow or resources available in its operational profits, cash reserves or existing assets to set aside enough money to cover a potential unfavorable settlement or judgment. Otherwise, the company will have created an unnecessary risk for what is an inevitable reality for most franchise companies. In the “worst case scenario,” some of these situations may force an otherwise healthy and growing enterprise into insolvency, bankruptcy or the “fire sale” of its franchised concept or assets.

When exploring this concept more deeply, there are a few types of “worst case scenario” circumstances and some practical advice when franchise companies are creating or periodically examining the proper amount and type of liability insurance to include in its risk management strategy.

The first type of “worst case scenario” circumstance is encountered when a franchise company is sued by a third party and has no liability coverage to pay to defend itself or pay an unfavorable judgement. This situation is akin to a modified version of the hypothetical scenario outlined above involving *Smooth*, the tapioca pudding franchise company:

### ***Smooth 2.0***

*Smooth is an emerging chain of tapioca pudding franchises in the states of Alabama, Florida and Georgia. Recently, a lawsuit was filed against the company and its Founder/President, Eric Edinger. The lawsuit was filed by their former officer manager who is claiming she was a victim of sexual abuse, subject to a hostile work environment, and terminated due to her gender. She is seeking damages of \$1,000,000 plus the cost of her attorney’s fees. President Edinger has adamantly denied the claims made against him and the company. The Acme Insurance Company has denied a request to pay for legal counsel defend the claim and issued a letter saying it will also not pay an unfavorable judgment because Smooth did not purchase this type of employment liability claim coverage.*

In Smooth 2.0, the franchise company is faced with a “worst case scenario” because it failed to obtain any employment law liability claim coverage. This means the company has to harness and expend all of the company’s existing and future cash flow and assets to: (i) engage in a challenging public relations battle; (ii) defend against what appears to be an expensive legal battle; and (iii) reserve enough money to pay an unfavorable judgement that could be in excess of a million dollars.

This type of worst-case scenario is easily preventable. The same is true of most any type of personal injury or products liability claim involving property, products or vehicles owned by a

franchise company. Prudent franchisors should collaborate with their insurance agents to determine the most likely claims that may arise from the operation of their franchised business and obtain an appropriate level of liability insurance. Not doing so could, in certain circumstances, be argued to be a breach of a franchise company leadership team's fiduciary responsibilities to the franchised company. That does not mean franchisors have to or should purchase an unlimited amount of all types of liability coverage. However, it does mean a careful and realistic assessment of the risks their franchise company is likely to face and buying a reasonably prudent amount of liability insurance to cover those requests.

The second type of "worst-case scenario" scenario is encountered when a franchise company does not have adequate liability insurance coverage to pay an unfavorable settlement or judgement arising out of a claim that it is less likely to foresee in the industry in which it operates. Insurance coverage is available for unique or specialty liability risks. Coverage is commonly purchased and documented in the form of a Rider to an existing general liability policy (*see* Section II above for more details); and less commonly through insurance carriers who specialize in certain products, services, or industries.

The primary challenge in dealing with uncommon risks is finding and purchasing affordable liability insurance to act as a firewall in the event of a claim. Collaborating with a talented and resourceful insurance broker on the front end will help a franchisor assess its options and decide which types of risks are worth taking and which ones are not. On one hand, it does not make sense to purchase wildly expensive liability insurance coverage. On the other hand, it is unwise to forego liability coverage for uncommon risks that are unique to products, services, industry.

In addition to properly assessing and maintaining adequate insurance coverage to defend and provide coverage against third party claims, there are a few additional practical strategies for franchisors to consider in order to protect their financial assets in the event of third party claims. First, franchisors should insist that their franchisees make the franchisor an additional insured on all of the franchisee's liability policies required per the terms of their franchise agreement. The typical additional insured endorsement will provide coverage for the liability of the additional insured arising out of the named insured's operations. Second, franchisors should insist on contract language in the franchise agreement that obligates the franchisee to indemnify and hold the franchisor harmless for any liability arising out of or relating to the mis, mal, or nonfeasance of the franchisee. Third, franchisors should be careful to limit the amount of control insisted upon and exercised over the business operations of their franchisees, lest they become the target of a vicariously liable claim by a plaintiff's attorney in search of deeper pockets.

It is important to keep in mind that in order for the first two strategies to be successful, franchisors must vigilantly monitor and enforce the requirement that they be named and maintained as an additional insured on the liability policies of their franchisees and that their franchisees maintain the policies in good standing throughout the initial and any renewal term of the franchise agreement. Waiting until a claim is filed is too late. So, a franchisor will need to make it part of their standard practice to obtain and examine all such policies on at least an annual basis to confirm for itself the additional insured coverage is in place and the exact terms of the additional insured coverage.

Franchisors who decide not to heed the advice set forth in this paper do so at their own peril and risk becoming a statistic or storyline in a long list of companies who did not survive the end of unfavorable litigation awards. The best way for any franchise company to avoid this fate

is to consider expanding beyond general liability policies and exploring specialty insurance coverage for items like directors & officers, employment practices, and franchisor malpractice. They are not fool proof but will go a long way to limiting catastrophic liability for a franchise company.

While understanding and implementing appropriate insurance programs can be difficult, resources exist to simplify the process. The most effective insurance programs will be constructed with assistance from industry specialists, who will help a franchisor determine what is in his or her best interest. Diligence is crucial when acquiring a risk-protection plan, as a good plan can keep the franchisor afloat, while a poorly designed plan can sink the business entirely.

Appendix A

**50 State (and D.C) Survey:**

**The Insured’s Right to Independent Defense Counsel When  
There is a Conflict Between the Insured and Insurer**

Jurisdiction	When is Insured Entitled to Independent Counsel?	Relevant Authority
Alabama	When insurer breaches its enhanced obligation of good faith.	<p><b>Caselaw:</b> The issuance of a reservation of rights does not entitle insured to engage defense counsel of its choice at the expense of the insurer, so long as the insurer complies with its enhanced obligation of good faith. <i>L &amp; S Roofing Supply Co., Inc. v. St. Paul Fire &amp; Marine Ins. Co.</i>, 521 So. 2d 1298, 1303 (Ala. 1987). The insured’s duties under the “enhanced obligation” include fully informing the insured of all coverage issues, disclosing all settlement offers made by the insurer, and refraining from conduct that shows a greater concern for the insurer’s financial interests than the insured’s. <i>Id.</i></p> <p>An insured is entitled to control the litigation through his or her own counsel <i>only if</i> the insurer breaches its enhanced obligation of good faith to the insured. <i>Strength v. Alabama Dept. of Finance</i>, 622 So. 2d 1283, 1290-91 (Ala. 1993). In such circumstances, the insurer shall pay the reasonable fees of independent counsel. <i>Id.</i></p>
Alaska	When the insurer issues a reservation of rights (the per se conflict rule).	<p><b>Statute:</b> ALASKA STATE § 21.96.100. This statute sets forth the circumstances in which an insurer must provide independent counsel to an insured. It provides:</p> <p style="padding-left: 40px;">If an insurer has a duty to defend an insured under a policy of insurance and a conflict of interest arises that imposes a duty on the insurer to provide independent counsel to the insured, the insurer shall provide independent counsel to the insured unless the insured in writing waives the right to independent counsel. An insurance policy may contain a provision that provides a method of selecting independent counsel if the provision complies with this section.</p> <p>Alaska Stat. Ann. § 21.96.100(a). The statute expressly states what are and are not conflicts of interest between the insurer and the insured. <i>Id.</i> at § 21.96.100(b)-(c).</p> <p><b>Caselaw:</b> Under Alaska law, any policy provision that entitles the insurer to reimbursement of fees and costs incurred by the insurer defending under a reservation of rights is unenforceable. <i>Attorneys Liability Protection Society, Inc. v. Ingaldson Fitzgerald, P.C.</i>, 370 P.3d 1101, 1112 (Alaska 2016), answering certified questions from the Ninth Circuit, 838 F.3d 976, 979-80 (9th Cir. 2016).</p>

Jurisdiction	When is Insured Entitled to Independent Counsel?	Relevant Authority
Arizona	When there is a conflict of interest between insured and insurer, including when insurer issues a reservation of rights (the per se conflict rule).	<p><b>Caselaw:</b> When there is a conflict of interest between the insured and the insurer, “public policy” requires the insured to be able to choose his or her own counsel without relieving the insurer of the obligation to pay for the defense. <i>Joseph v. Markovitz</i>, 551 P.2d 571, 577 (Ariz. Ct. App. 1976). A conflict of interest exists between the insured and the insurer when the insurer reserves its right to seek reimbursement of payments arising out of representation. <i>Fulton v. Woodford</i>, 545 P.2d 979 (Ariz. App. 1976). This conflict may be waived by the insured. <i>Id.</i> “An insured that is notified of its insurer’s reservation of rights is on notice of the conflict of interest and is free, upon proper notice to the insurer, to act to protect its rights in the litigation with the claimant.” <i>Pueblo Santa Fe Townhomes Owners’ Ass’n v. Transcon. Ins. Co.</i>, 178 P.3d 485, 491 (Ariz. Ct. App. 2008).</p> <p>When there is a reservation of rights, an insured may choose to enter into a “Morris Agreement,” in which the insured may stipulate to judgment and assign his policy rights to the claimant in exchange for a covenant that the claimant will not execute the judgement against it. <i>United Services Automobile Ass’n v. Morris</i>, 741 P.2d 246 (1987). A Morris Agreement must be preceded by notice to the insurer and an opportunity for the insurer to withdraw the reservation of rights. <i>Parking Concepts, Inc. v. Tenney</i>, 83 P.3d 19, 22 (Ariz. 2004).</p>
Arkansas	When the insurer issues a reservation of rights (the per se conflict rule).	<p><b>Caselaw:</b> No instructive state law on this issue, but there are federal court decisions applying Arkansas law. In <i>Union Ins. Co. v. The Knife Co.</i>, 902 F.Supp. 877, 880 (W.D. Ark. 1995), the District Court held that an insurer’s reservation of rights creates a per se conflict that allows the insured to choose its own counsel and be reimbursed reasonable fees by the insurer. See also <i>Northland Ins. Co. v. Heck’s Service Co., Inc.</i>, 620 F.Supp. 107 (E.D. Ark. 1985) (same) and <i>Bituminous Cas. Corp. v. Zadeck Energy Group, Inc.</i>, 416 F.Supp. 2d 654 (W.D. Ark. 2005) (same).</p>

Jurisdiction	When is Insured Entitled to Independent Counsel?	Relevant Authority
California	When the insurer issues a reservation of rights, the issue is assessed on a case-by-case basis.	<p><b>Statute:</b> An insured’s right to independent counsel was codified by California Civil Code § 2860. That statute provides in relevant part that a conflict of interest may arise “when an insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by counsel first retained by the insurer for the defense of the claim.” <i>Id.</i> at 2860(b). Section 2860(b) makes clear that “[a] conflict of interest does not arise under all circumstances.” If a conflict of interest arises, “the insurer shall provide independent counsel to represent the insured” unless the conflict is expressly waived by the insured. <i>Id.</i> at 2860(a).</p> <p><b>Caselaw:</b> California Civil Code § 2860 codified the Court of Appeals of California’s decision in <i>San Diego Federal Credit Union v. Cumis Ins. Soc’y, Inc.</i>, 162 Cal. App. 3d 358 (1984). This is among the seminal decisions on this issue (“<i>Cumis</i> counsel”). In <i>Cumis</i> the court held that a conflict of interest arises for an attorney appointed by an insurer when the insurer reserves rights on issues critical to the defense.</p> <p>Section 2860 does not answer whether a conflict exists giving rise to the insured’s right to independent counsel. This issue is left to the courts to decide. The conflict between the insured and insurer must be “significant, not merely theoretical, actual, not merely potential.” <i>Dynamic Concepts, Inc. v. Truck Ins. Exchange</i>, 71 Cal. Rptr. 2d 882 (Cal. Ct. App. 1998). A critical issue to the analysis is whether the issue giving rise to the reservation of rights “can be controlled by the defending counsel” first retained by the insurer. Civil Code § 2860(b). <i>James 3 Corp. v. Truck Ins. Exchange</i>, 111 Cal. Rptr. 2d 181 (Cal. Ct. App. 2001) (setting forth some circumstances where conflict of interest requires the insurer to provide independent counsel).</p>
Colorado	Unclear	<p>No instructive state law on this issue.</p> <p><b>Caselaw:</b> It is noteworthy that in <i>Shelter Mut. Ins. Co. v. Vaughn</i>, 300 P.3d 998, 1002 (Colo. Ct. App. 2013), the court noted that under the Colorado Rules of Professional Conduct the attorney that the insurer retained for the insured owed a duty to the insured only.</p>
Connecticut	Unclear, but it appears that a Connecticut court would find that when a conflict exists an insured is entitled to independent counsel.	<p>There is no statute and there are no reported cases that are instructive on this issue.</p> <p><b>Caselaw:</b> In <i>Aetna Life &amp; Cas. Co. v. Gentile</i>, 1995 WL 779102 (Conn. Super. Ct. Dec. 12, 1995), an insurer sought a declaration that it had no duty to defend or indemnify its insured. The court noted that when “an insurer perceives a conflict of interest between itself and its insured prior to or during the course of trial, it is customary, legally appropriate, and often legally necessary for the insurer to provide independent counsel to the insured, so as not to jeopardize the insured’s rights under the terms of the contract.” The decision in <i>Gentile</i> was later abrogated by <i>ACMAT Corp. v. Greater N.Y. Mut. Ins. Co.</i>, 923 A.2d 697 (Conn. 2007).</p>

Jurisdiction	When is Insured Entitled to Independent Counsel?	Relevant Authority
Delaware	Unclear	<p>There is no statute and there are no reported cases that are instructive on this issue.</p> <p><b>Caselaw:</b> In <i>Corrado Bros., Inc. v. Twin City Fire Ins. Co.</i>, 562 A.2d 1188, 1191 (Del. 1989) the Delaware Supreme Court suggested that when a claim exceeds coverage limits the insurer has a heightened duty to advise the insured of such implications and a duty to permit the insured an opportunity to participate through independent counsel.</p> <p>In <i>Int’l Underwriters, Inc. v. Stevenson Enters., Inc.</i>, 1983 WL 935827 (Del. Super. Ct. Oct. 4, 1983), a Delaware trial court held: “If an insurer has a conflict of interest, either real or potential, it is not relieved of its duty to defend. The insurer must either provide independent counsel to represent its insured, or pay the cost of defense incurred by the insured.” <i>Id.</i> at *3.</p>
District of Columbia	Unclear	<p>No District of Columbia court has addressed this issue, but a Federal Court in the District of Columbia touched on it.</p> <p><b>Caselaw:</b> In <i>Athridge v. Aetna Cas. and Sur. Co.</i>, 2001 WL 214212 (D.D.C. Mar. 2, 2001), the District Court suggested that an insured who is defended under a reservation of rights is entitled to independent counsel, but found that there was no conflict between the insurer and insured in this case.</p>
Florida	When the insurer issues a reservation of rights, but insured must first reject the defense offered by insured.	<p><b>Statute:</b> FLA. STAT. ANN. § 627.426 requires the insurer to retain “independent counsel which is mutually agreeable to the parties” if the insurer seeks to deny coverage based on a particular coverage defense. <i>Id.</i> at § 627.426(2)</p> <p><b>Caselaw:</b> “[W]hen an insurer offers to defend under a reservation of rights, Florida law provides that the insured may, at its election, reject the defense and retain its own attorneys without jeopardizing its right to seek indemnification from the insurer for liability.” <i>Travelers Indem. Co. of Illinois v. Royal Oak Enters., Inc.</i>, 344 F.Supp.2d 1358, 1370 (M.D. Fla. 2004). “It is well-settled law that, when an insurer agrees to defend under a reservation of rights or refuses to defend, the insurer transfers to the insured the power to conduct its own defense, and if it is later determined that the insured was entitled to coverage, the insured will be entitled to full reimbursement of the insured's litigation costs.” <i>BellSouth Telecommunications, Inc. v. Church &amp; Tower of Fla., Inc.</i>, 930 So.2d 668, 670–71 (Fla. Dist. Ct. App. 2006). If the insured wishes to hire its own attorneys and control the defense, the insured must first reject the defense offered by the insurer. <i>Aguero v. First American Title Ins. Co.</i>, 927 So.2d 894, 898 (Fla. Dist. Ct. App. 2005); <i>EmbroidMe.com v. Travelers Prop. Cas Co. of Am.</i>, 845 F.3d 1099, 1108 (11th Cir. 2017) (insured must first reject the defense offered).</p>

Jurisdiction	When is Insured Entitled to Independent Counsel?	Relevant Authority
<b>Georgia</b>	When the insurer issues a reservation of rights, the insurer must seek the consent of the insured to defend matter.	<b>Caselaw:</b> Under Georgia law, an insurer that issues a reservation of rights and seeks to proceed with defense of the claim may not do so absent the insured’s express or implied consent. <i>Richmond v. Georgia Farm Bureau Mut. Ins. Co.</i> , 231 S.E.2d 245, 248 (Ga. Ct. App. 1976). “[W]here the insured refuses to consent to a defense under a reservation of rights, the insurer must thereupon (a) give the insured proper unilateral notice of its reservation of rights, (b) take necessary steps to prevent the main case from going into default or to prevent the insured from being otherwise prejudiced, and (c) seek immediate declaratory relief including a stay of the main case pending final resolution of the declaratory judgment action.” <i>Id.</i>
<b>Hawaii</b>	An insured is free to reject the insurer’s appointed counsel, but in doing so waives the right to defense costs.	<b>Caselaw:</b> In <i>Finley v. Home Ins. Co.</i> , 975 P.2d 1145 (Haw. 1998), the Hawaii Supreme Court held that an insured does not have a right to independent counsel solely due to an insurer’s reservation of rights. The Court declined to accept the argument that the insurer’s appointed counsel would favor the insurer over the insured. Rather, the Court concluded that if the appointed counsel follows the Hawaii Rules of Professional Conduct the insured’s interest will be adequately protected. HPRC Rule 1.7 bars an attorney from representation only if the conflict between the insured and insurer “materially limit” the lawyer’s representation of the insured. The insured is free to reject the insurer’s appointed counsel but if it does so it waives the right to defense fees. <i>Id.</i> at 1155.
<b>Idaho</b>	Unclear	<b>Caselaw:</b> The Idaho Supreme Court indirectly addressed whether an insured is entitled to independent counsel when a conflict of interest exists in <i>Boise Motor Car Co. v. St. Paul Mercury Indem. Co.</i> , 112 P.2d 1011 (Idaho 1941). In <i>Boise</i> the insurer reserved its right to withdraw and invited the insured to associate with and pay for its own attorney. The insured did not consent to the reservation of the insurer’s right to withdraw and had no real option other than to continue to pay its own attorney to protect itself. After the dispute with the claimant was settled, the insured sought to recover from the insurer the amounts that it paid to its own attorney. The Court held that the insurer was in breach of its duty to defend and held that the insured’s fees for its own counsel were properly chargeable to the insurer.  Since the <i>Boise</i> case there has been no further elaboration on the insured’s right to independent counsel.

Jurisdiction	When is Insured Entitled to Independent Counsel?	Relevant Authority
Illinois	When an actual conflict exists between the insurer and the insured, decided on a case by case basis.	<p><b>Caselaw:</b> Under Illinois law, if there is an actual conflict of interest between the insured and the insurer, then the insured has the right to obtain independent counsel at the insurer’s expense. <i>Murphy v. Urso</i>, 430 N.E.2d 1079, 1084 (Ill. 1981). The Illinois Court of Appeals discussed tests employed to assess whether there is a conflict of interest in <i>Stoneridge Dev. Co. v. Essex Ins. Co.</i>, 888 N.E.2d 633, 645 (Ill. App. Ct. 2008), as follows:</p> <p>“[W]e must compare the allegations of the underlying complaint against the insured to the terms of the policy at issue. If, after comparing the complaint to the insurance policy, it appears that factual issues will be resolved in the underlying suit that would allow insurer-retained counsel to ‘lay the groundwork’ for a later denial of coverage, then there is a conflict between the interests of the insurer and those of the insured. Put another way, if, in the underlying suit, insurer-retained counsel would have the opportunity to shift facts in a way that takes the case outside the scope of policy coverage, then the insured is not required to defend the underlying suit with insurer-retained counsel.</p> <p><i>Stoneridge</i>, 888 N.E.2d at 645 (citations omitted). A conflict exists if comparing the complaint's allegations to the policy's terms, the insurer's interest “would be furthered by providing a less than vigorous defense to those allegations.” <i>Id.</i></p> <p>When there is an actual conflict the insurer must pay the reasonable costs incurred by the insured in defending the action with counsel of his own choosing. <i>Ill. Masonic Med. Center v. Turegum Ins. Co.</i>, 522 N.E.2d 611, 613 (Ill. App. Ct. 1988).</p>
Indiana	When an actual conflict exists between the insurer and the insured, decided on a case by case basis.	<p><b>Caselaw:</b> Under Indiana law, when there is a coverage dispute the insurer must either hire independent counsel for the insured or file a declaratory judgment action. <i>Nat’l Union Fire Ins. Co. v. Standard Fusee Corp.</i>, 917 N.E.2d 170, 187 (Ind. Ct. App. 2009), vacated on other grounds, 940 N.E.2d 810 (Ind. 2010). A conflict of interest exists where there is a “significant risk that an attorney selected by and under the control [of the insurer] would be materially limited in the representation” as a result of the relationship with the insurer and the reservation of rights. <i>Armstrong Cleaners, Inc. v. Erie Ins. Exch.</i>, 364 F. Supp. 2d 797, 808 (S.D. Ind. 2005) (emphasis added). The District Court in <i>Armstrong</i> declined to adopt the rule that a reservation of rights is a per se conflict of interest. <i>Id.</i> at 816.</p>
Iowa	Unclear	There is no statute and there are no reported cases that are instructive on this issue.

Jurisdiction	When is Insured Entitled to Independent Counsel?	Relevant Authority
Kansas	When there is a conflict of interest, but it remains unclear what qualifies as a conflict of interest and who has the right to select independent counsel.	<p><b>Caselaw:</b> When there is a conflict of interest between the insurer and the insured, the proper procedure to protect the rights of both parties is for the insurer to hire independent counsel to defend the insured and notify the insured that it was reserving all rights under the policy. <i>Patrons Mut. Ins. Ass'n v. Harmon</i>, 732 P.2d 741, 745 (Kan. 1987). In <i>Patrons</i>, the claim involved liability that could have been based on negligence or intentional conduct.</p> <p>It is unclear whether the insured has the right to select its own counsel. <i>See Hackman v. Western Arg. Ins. Co.</i>, 275 P.3d 73 (Kan. Ct. App. 2012) (“When an insurer hires an attorney to defend an insured in a lawsuit under a reservation of rights, the attorney's client is the insured and not the insurer. When there are facts to demonstrate that the attorney violated these rules and allowed the insurer to direct or control the attorney's actions in defending the insured, the attorney likely will be considered the agent of the insured and, in turn, the insurer may be held vicariously liable for the attorney's negligent conduct.”).</p>
Kentucky	Unclear, but likely when the insurer issues a reservation of rights.	<p><b>Caselaw:</b> Under Kentucky law, “an insured is not required to accept the defense offered by the insurer under a reservation of rights.” <i>Med. Protective Co. of Fort Wayne, Ind. v. Davis</i>, 581 S.W.2d 25, 26 (Ky. App. 1979). When an insurer reserves its right to withdraw its obligation to provide indemnification “the insured has the right to refuse the proffered defense and conduct his own defense.” <i>Id.</i> It is unclear whether the insured is obligated to pay for the defense in such situations, but it is likely that it would be, as the Court of Appeals in <i>Davis</i> stated that it was aligned with rulings from Missouri, Florida, and California.</p>
Louisiana	When the insurer issues a reservation of rights or denies coverage but chooses to provide a defense (the per se conflict rule).	<p><b>Caselaw:</b> Under Louisiana law, “if the insurer chooses to represent the insured but deny coverage it must employ separate counsel” for the insured, and “[i]f it fails to do so, the insurer is liable for the attorney fees and costs the insured may incur defending the suit.” <i>Dugas Pest Control of Baton Rouge, Inc. v. Mut. Fire, Marine and Inland Ins. Co.</i>, 504 So.2d 1051, 1054 (La. Ct. App. 1987). When the insurer chooses to represent the insured but denies coverage the insured is allowed to select its own counsel for its defense at the insurer’s expense. <i>Belanger v. Gabriel Chemicals, Inc.</i>, 787 So.2d 559, 565 (La. Ct. App. 2001); <i>Smith v. Reliance Ins. Co. of Illinois</i>, 807 So.2d 1010 (La. Ct. App. 2002).</p>
Maine	When the insurer issues a reservation of rights the insurer gives up the right to control the defense (the per se conflict rule).	<p><b>Caselaw:</b> In <i>Patrons Oxford Ins. Co. v. Harris</i>, 905 A.2d 819 (Me. 2006), the Supreme Judicial Court of Maine held that “an insurer who reserves the right to deny coverage cannot control the defense of a lawsuit brought against its insured by an injured party.” <i>Id.</i> at 825-26. The Court in <i>Harris</i> did not provide any further guidance on what it means by “the right to control the defense.” However, in <i>Travelers Indem. Co. v. Dingwell</i>, 414 A.2d 220 (Me. 1980), the Supreme Judicial Court of Maine stated in dicta that when a conflict between the insurer and insured arises “the parties may agree that the insurer hire independent counsel for the insured.” <i>Id.</i> at 227.</p>

Jurisdiction	When is Insured Entitled to Independent Counsel?	Relevant Authority
Maryland	When an actual conflict exists between the insurer and the insured, decided on a case by case basis.	<p><b>Caselaw:</b> When an actual conflict of interest exists between the insurer and the insured, the insured is entitled to retain independent counsel and the insurer is required to pay the reasonable costs of defense. <i>Brohawn v. Transamerica Ins. Co.</i>, 347 A.2d 842 (Md. 1975); <i>Allstate Ins. Co. v. Campbell</i>, 639 A.2d 652, 657 (Md. 1994).</p> <p>Applying Maryland law, the Fourth Circuit concluded that “Maryland has rejected a <i>per se</i> rule whereby the insurer is required to pay for the insured's independent counsel any time that the insured's objectives might differ from the objectives of the insurer. However, when an actual conflict of interest does exist, an insurer's duty to defend necessarily involves the duty to pay for the insured's independent counsel.” <i>Driggs Corp. v. Pennsylvania Mfrs. Ass'n Ins. Co.</i>, 181 F.3d 87, *5-6 (4th Cir. 1999) (internal citations omitted). “[A]n actual conflict of interest does not exist merely because an insurer defends its insured subject to a reservation of rights.” <i>Id.</i> (citing <i>Cardin v. Pacific Employees Ins. Co.</i>, 745 F.Supp. 330, 336 (D. Md. 1990)).</p>
Massachusetts	When the insurer issues a reservation of rights (the <i>per se</i> conflict rule).	<p><b>Caselaw:</b> In <i>Herbert A. Sullivan, Inc. v. Utica Mut. Ins. Co.</i>, 788 N.E.2d 522 (Mass. 2003), the Supreme Judicial Court of Massachusetts held that “[w]hen an insurer seeks to defend its insured under a reservation of rights, and the insured is unwilling that the insurer do so, the insured may require the insurer either to relinquish its reservation of rights or relinquish its defense of the insured and reimburse the insured for its defense costs.” <i>Id.</i> at 539.</p> <p>When an insured selects independent counsel the insurer is obligated to pay the reasonable charges of the insured’s retained counsel. <i>N. Sec. Ins. Co. v. R.H. Realty Trust</i>, 941 N.E.2d 688, 692 (Mass. App. Ct. 2011). What constitutes the retained counsel’s “reasonable charges” is an issue of fact left to the jury, but there is caselaw supporting the conclusion that fees may be more than the insurance company’s panel rates. <i>Id.</i> (fee of \$225 an hour was reasonable even though the panel rate was \$140 per hour).</p>
Michigan	When an actual conflict exists between the insurer and the insured, decided on a case by case basis.	<p><b>Caselaw:</b> The leading cases on this issue in Michigan are from the federal district courts. In <i>Central Mich. Bd. of Trustees v. Employers Reinsur. Corp.</i>, 117 F. Supp. 2d 627, 633-35 (E.D. Mich. 2000), the District Court explained: “[U]nder Michigan law an insurer complies with its duty to defend when, after it has reserved its rights to contest its obligation to indemnify, it fully informs the insured of the nature of the conflict and selects independent counsel to represent the insured in the underlying litigation. The insured has no absolute right to select the attorney himself, as long as the insurer exercises good faith in its selection and the attorney selected is truly independent.” The District Court’s holding in <i>Central Michigan</i> is based on an attorney’s duty to his or her client, who is the insured and not the insurer. If the insurer fails to provide independent counsel, the insured may retain its own defense counsel, and the insurer is liable for that attorney’s reasonable fees. <i>Fireman’s Fund Ins. Companies v. Ex-Cell-O Corp.</i>, 790 F.Supp. 1339, 1346 (E.D. Mich. 1992).</p>
Minnesota	When an actual conflict exists between the insurer and the insured, decided on a case by case basis.	<p><b>Caselaw:</b> Under Minnesota law, an insurer that issues a reservation of rights retains the right to appoint counsel unless there is a showing of “actual conflict.” <i>Mut. Serv. Cas. Ins. Co. v. Luetmer</i>, 474 N.W.2d 365, 368 (Minn. Ct. App. 1991) (rejecting the rule that a reservation of rights creates a <i>per se</i> conflict of interest that allows the insured to retain independent counsel). When an actual conflict is shown, the insurer must pay the reasonable attorney’s fees for the independent defense counsel selected by the insured. <i>Prahn v. Rupp Const. Co.</i>, 277 N.W.2d 389, 390 (Minn. 1979).</p>

Jurisdiction	When is Insured Entitled to Independent Counsel?	Relevant Authority
Mississippi	When the insurer issues a reservation of rights (the per se conflict rule).	<b>Caselaw:</b> Mississippi follows the rule that a reservation of rights creates a per se conflict of interest between the insurer and the insured. <i>Moeller v. Am. Guarantee v. Liab. Ins. Co.</i> , 707 So.2d 1062, 1071 (Miss. 1996).
Missouri	When the insurer issues a reservation of rights (the per se conflict rule).	<p><b>Caselaw:</b> In <i>Truck Ins. Exch. v. Prairie Framing, LLC</i>, 162 S.W.3d 64 (Mo. Ct. App. 2005), the Missouri Court of Appeals stated the following:</p> <p>Upon proper notice to the insured, Missouri law permits an insurer to defend its insured but reserve the right to later disclaim coverage. The insured then has the option of either accepting the insurer’s defense under a reservation of rights or refusing such defense. If the fully-notified insured accepts, the insurer's defense under a reservation of rights will not be considered a denial of coverage. But, the decision is the insured's, and insurers cannot force insureds to accept a reservation of rights defense. Should the insured reject the defense, the insurer then has one of three options: (1) It may represent the insured without a reservation of rights defense; (2) it may withdraw from representing the insured altogether; or (3) it may file a declaratory judgment action to determine the scope of [the] policy's coverage.”</p> <p><i>Id.</i> at 88 (internal citations and quotations omitted). If the insurer chooses (1), i.e. to defend without reservation, the insurer has the opportunity to control the litigation. If, however, the insurer chooses (2) or (3), then it relinquishes control of the defense to the insured. <i>Id.</i></p> <p>In <i>Howard v. Russell Stover Candies, Inc.</i>, 649 F.2d 620, 625 (8th Cir. 1981), the Eighth Circuit concluded that when a complaint alleged alternative grounds for relief – one which was covered and one which provided a basis to deny coverage – the insurer “must either provide an independent attorney to represent the insured or pay the costs incurred by the insured in hiring counsel of its own choice.”</p>
Montana	Unclear, but it appears Montana follows the per se conflict rule.	<p><b>Caselaw:</b> There is not much guidance on this issue under Montana law. In <i>St. Paul Fire &amp; Marine Ins. Co. v. Thompson</i>, 433 P.2d 795, 799 (Mont. 1967), the Montana Supreme Court held that an insurer has a duty to provide independent counsel when inconsistent and antagonistic positions have developed between the insurer and insured. The Court did not, however, address when a potential conflict was sufficiently antagonistic to trigger an insurer’s duty to provide independent counsel.</p> <p>In <i>Safeco Ins. Co. v. Liss</i>, 2005 WL 7137967 (Mont. Dist. Mar. 11, 2005), a Montana Trial Court assessed the issue of whether a conflict between an insurer and insured required independent counsel, and stated: “[I]f the issue were before the Montana Supreme Court, that Court would hold that when an insurer has a duty to defend but sends a reservation of rights letter to its insured on a coverage issue, the inherent conflict of interest between the insurer and the insured affords the insured the opportunity to choose counsel of his or her own choice at the insurer's expense.” <i>Id.</i> at *13.</p>

Jurisdiction	When is Insured Entitled to Independent Counsel?	Relevant Authority
Nebraska	Unclear	<b>Caselaw:</b> There is not much guidance on this issue under Nebraska law. The closest case on this issue is <i>Hawkeye Cas. Co. v. Stoker</i> , 48 N.W.2d 623 (Neb. 1951), in which the Nebraska Supreme Court concluded that an insurer may defend an action under a reservation of rights with the consent of its insured, but the insurer may not continue to defend the insured if the insurer denies coverage or initiates a declaratory judgment action; in such cases the insured is freed from any obligation under the policy to allow the insurer to continue with the defense of the action. <i>Id.</i> at 632.
Nevada	When an actual conflict exists between the insurer and the insured, decided on a case by case basis.	<b>Caselaw:</b> The leading cases on this issue in Nevada are from the federal district courts. In <i>Hansen v. State Farm Mut. Auto. Ins. Co.</i> , 2012 WL 6205722 (D. Nev. Dec. 12, 2012), the Nevada District Court did a national survey and concluded that California’s <i>Cumis</i> requirement is in accord with Nevada law. <i>Id.</i> at *8. The Court further declined to adopt the rule that a per se conflict exists when there is a reservation of rights, and opted for a case by case assessment of conflicts, stating: “The Court determines that a reservation of rights letter can create a conflict of interest, but that Nevada courts would determine the question on a case by case basis. This is because insurers almost always defend under a reservation of rights, and defending under a reservation of rights always creates at least a theoretical conflict of interest.” <i>Id.</i> at *10.
New Hampshire	Unclear. Appears to be when an actual conflict exists between the insurer and the insured, decided on a case by case basis.	<b>Caselaw:</b> In <i>White Mountain Cable Constr. Co., Inc. v. Transamerica Ins Co.</i> , 631 A.2d 907 (N.H. 1993), the New Hampshire Supreme Court held that when there is a conflict between the insurer and the insured, the insurer is not relieved from its duty to defend, may not control the defense, and would have to hire independent counsel. <i>Id.</i> at 913.

Jurisdiction	When is Insured Entitled to Independent Counsel?	Relevant Authority
New Jersey	When an actual conflict exists between the insurer and the insured, decided on a case by case basis.	<p><b>Caselaw:</b> The U.S. District Court for the District of New Jersey summarized New Jersey law on this issue in <i>Szelc v. Stranger</i>, 2010 WL 2925847 (D. N.J. July. 21, 2010), as follows:</p> <p>An insurer who owes its insured a duty to defend is not permitted to control the defense if there is a conflict of interest between the two parties. <i>See, e.g., Schmidt v. Smith</i>, 294 N.J.Super. 569, 590, 684 A.2d 66 (App.Div.1996) (citing <i>Burd v. Sussex Mutual Ins. Co.</i>, 56 N.J. 383, 389, 267 A.2d 7 (1970)). In such a situation, some method must be devised for the insurer to fulfill its duty other than by retaining its own counsel to represent the insured. <i>Morrone v. Harleysville Mut. Ins. Co.</i>, 283 N.J.Super. 411, 421, 662 A.2d 562 (App.Div.1995) (citing cases). <i>Burd</i> and subsequent cases indicate that the usual course of action is for the insured to select its own attorney and for the insurer to reimburse the insured. <i>See, e.g., Morton Int'l, Inc. v. Gen. Accident Ins. Co. of Am.</i>, 266 N.J.Super. 300, 341–43, 629 A.2d 895 (App.Div.1991). Of course, this does not mean that the insurer is required to pay whatever fee the insured's retained attorney happens to charge; rather, the insured is required to pay a reasonable fee for those services reasonably related to the defense of any covered claims. <i>Acquino v. State Farm Ins. Co.</i>, 349 N.J.Super. 402, 415–16, 793 A.2d 824 (App.Div.2002).</p> <p><i>Id.</i> at *2.</p>
New Mexico	When there is the appearance of a conflict of interest.	<p><b>Caselaw:</b> There is not much New Mexico caselaw on this issue. In <i>Am. Employers Ins. Co. v. Crawford</i>, 533 P.2d 1203 (N.M. 1975), the Supreme Court of New Mexico held that when an insurer perceives a conflict of interest between the insurer and the insured, the insured could hire independent counsel or the insurer could hire two sets of attorneys—one to represent the insurer and one to represent the insured.</p>
New York	When an actual conflict exists between the insurer and the insured, decided on a case by case basis.	<p><b>Caselaw:</b> In <i>Pub. Serv. Mut. Ins. Co. v. Goldfarb</i>, 425 N.E.2d 810 (1981), the New York Court of Appeals held that in a case involving some covered and some uncovered claims, the insured is entitled to defense by an attorney of his own choosing, whose reasonable fee is to be paid by the insurer. <i>Id.</i> at 815. In a footnote in <i>Goldfarb</i>, the Court made clear that independent counsel is not always necessary, stating:</p> <p>Independent counsel is only necessary in cases where the defense attorney's duty to the insured would require that he defeat liability on any ground and his duty to the insurer would require that he defeat liability only upon grounds which would render the insurer liable. When such a conflict is apparent, the insured must be free to choose his own counsel whose reasonable fee is to be paid by the insurer.</p> <p><i>Id.</i> If a situation like the one in <i>Goldfarb</i> is present, then the insurer's failure to inform the insured of the right to independent counsel is a deceptive business practice in violation of New York law. <i>Elacqua v. Physician's Reciprocal Insurers</i>, 860 N.Y.S.2d 299, 231-32 (N.Y. App. Div. 2008).</p>

Jurisdiction	When is Insured Entitled to Independent Counsel?	Relevant Authority
North Carolina	Unclear	There is no instructive authority on this issue.
North Dakota	Unclear	<b>Caselaw:</b> The only instructive case on this issue in North Dakota is <i>Fetch v. Quam</i> , 530 N.W.2d 337 (N.D. 1995). In that case, the North Dakota Supreme Court stated that when there is a conflict of interest between the insurer and the insured the trial court may require the insurer to “furnish independent counsel to represent the insured on the insurer’s claims and defenses, or by requiring reimbursement of the insured’s reasonable attorney fees for those services.” <i>Id.</i> at 340.
Ohio	When an actual conflict exists between the insurer and the insured.	<b>Caselaw:</b> In <i>Red Head Brass, Inc. v. Buckeye Union Ins.</i> , 735 M.E.2d 48 (Ohio Ct. App. 1999) the Ohio Appeals Court declined to adopt the rule that a reservation of rights creates a per se conflict of interest that requires the insurer to pay for the insured’s independent counsel. The Court in <i>Red Head Brass</i> held that “an insurer in Ohio may proceed to defend the insured so long as the situation does not arise that the insurer’s defense of the insured and its defense of its own interests are mutually exclusive. In such a case, the insurer, still bound in its duty to defend the insured, would have to pay the cost of the insured’s private counsel.” <i>Id.</i> at 55.
Oklahoma	When an actual conflict exists between the insurer and the insured.	<b>Caselaw:</b> In <i>Nisson v. Am. Home Assurance Co.</i> , 917 P.2d 488 (Okla. Civ. App. 1996), the Court of Appeals of Oklahoma surveyed cases nationally, and concluded that “not every perceived or potential conflict of interest automatically gives rise to a duty on the part of the insurer to pay for the insured’s choice of independent counsel.” <i>Id.</i> at 490. The <i>Nisson</i> Court adopting the New York Court of Appeals’ ruling in <i>Goldfarb</i> , such that retention of independent counsel is needed only when there is a threat of divided loyalty between the insured and the insurer. <i>Id.</i>
Oregon	There is no requirement for an insurer to provide independent counsel, even if there is a conflict of interest.	<b>Caselaw:</b> Under Oregon law, there is no requirement for the insurer to provide an insured with independent counsel, even if there is a clear conflict of interest. The Supreme Court of Oregon addressed the conflict issue by concluding that the judgment in an underlying action is not binding on the insurer or the insured in a subsequent coverage action if there was a conflict of interest between the insurer and insured in the underlying action. <i>Ferguson v. Birmingham Fire Ins. Co.</i> , 460 P.2d 342, 349 (Or. 1969). The Supreme Court reasoned that the risk to an insurer as a defendant in the insured’s subsequent coverage action is sufficient to prevent the insurer from relaxing its efforts defending the underlying action. <i>Id.</i>  <b>Statute:</b> OR. REV. STAT. § 465.483 concerns the defense of environmental claims. It requires that an insurer who defends the insured under a reservation of rights shall provide independent counsel to defend the insured.

Jurisdiction	When is Insured Entitled to Independent Counsel?	Relevant Authority
Pennsylvania	Pennsylvania appears to require independent counsel when an actual conflict exists between the insurer and the insured.	<p><b>Caselaw:</b> Pennsylvania’s federal courts have provided guidance on this issue. In <i>Rector, Wardens and Vestryman of St. Peters Church v. Am. Nat’l Fire Ins.</i>, 2002 WL 59333 (E.D. Pa. Jan. 14, 2002), the Court stated that it is settled law that “where conflicts of interest between an insurer and its insured arise, such that a question as to the loyalty of the insurer's counsel to that insured is raised, the insured is entitled to select its counsel, whose reasonable fee is to be paid by the insurer.” <i>Id.</i> at *10. The Court concluded that there was an actual conflict of interest where the underlying liability could rest on two causes of action, one that was covered under the policy and one that was not. <i>Id.</i></p> <p>The Superior Court of Pennsylvania addressed this issue in <i>Babcock &amp; Wilcox CO. v. Am. Nuclear Insurers</i>, 76 A.3d 1 (Pa. Super. Ct. 2013). In <i>Babcock</i> the court held as a matter of first impression that when an insurer defends under a reservation of rights, the insured may choose to accept the defense or decline the insurer’s tender of a qualified defense and furnish its own counsel. Should the insured choose to furnish its own defense, and should coverage be found, the insured may recover from the insurer the insured’s defense costs to the extent that those costs are deemed reasonable. <i>Id.</i> at 699. The <i>Babcock</i> case was appealed and reversed on other issues. 131 A.3d 445 (Pa. 2015).</p>
Rhode Island	Rhode Island appears to require independent counsel when an actual conflict exists between the insurer and the insured.	<p><b>Caselaw:</b> In <i>Employers’ Fire Ins. Co. v. Beals</i>, 240 A.2d 397 (1968), overruled on other grounds by <i>Peerless Ins. Co. v. Viegas</i>, 667 A.2d 785 (R.I. 1995), the Supreme Court of Rhode Island concluded:</p> <p style="padding-left: 40px;">If, however, an insured, after having been apprised of the conflicting interests existing between him and his insurer, declines to be represented by the insurer’s attorney, we have a different situation. Concerned as we are that the public’s trust in the judicial processes be maintained, this court cannot stand idly by in such circumstances. We are as conscious of an insurer’s concern that it control the defense of any action brought against one of its insureds as we are of an insured’s expectations that his rights will be properly protected. In our opinion, however, an insured, when faced with the quandary posed by the facts of the instant case, has a legitimate right to refuse to accept the offer of a defense counsel appointed by the insurance company; and when an insured elects to exercise this prerogative, the insurer’s desire to control the defense must yield to its obligation to defend its policyholder.</p> <p><i>Beals</i>, 240 A.2d at 403. The Supreme Court recently re-affirmed <i>Beals</i> and stated that “[i]n face of the clear conflict, this Court required the insurer to provide the insured with an independent attorney in the tort action and held that ‘insurer’s desire to control the defense must yield to its obligation to defend its policyholder.’” <i>Labonte v. National Grange Mut. Ins. Co.</i>, 810 A.2d 250, 254 (R.I. 2002).</p>
South Carolina	When an actual conflict exists between the insurer and the insured.	<p><b>Caselaw:</b> In <i>Twin City Fire Ins. Co. v. Ben Arnold-Sunbelt Beverage Co. of S.C., LP</i>, 433 F.3d 365 (4th Cir. 2004), the Fourth Circuit, interpreting South Carolina law, concluded that a case defended under an insured’s reservation of rights only gives rise to a potential conflict, and does not mean that an insured has an automatic right to choose independent counsel at the insurer’s expense. <i>Id.</i> at 373. The Fourth Circuit concluded that the Rules of Professional Conduct, the risk of sanctions for their violation, and the threat of malpractice provided incentive for attorneys hired by the insurer to comply with their ethical obligations.</p>

Jurisdiction	When is Insured Entitled to Independent Counsel?	Relevant Authority
South Dakota	A conflict of interest is avoided if the parties will not be estopped from litigating coverage issues in a later proceeding.	<b>Caselaw:</b> In <i>St. Paul Fire &amp; Marine Ins. Co. v. Engelmann</i> , 639 N.W.2d 192 (S.D. 2002), the Supreme Court of South Dakota concluded that a conflict of interest is avoided when an insurer defends under a reservation of rights because the parties are not estopped from litigating coverage issues in a later proceeding. <i>Id.</i> at 200.
Tennessee	Unclear	<b>Caselaw:</b> Tennessee has yet to provide any instructive authority on the right to independent counsel. The Tennessee Supreme Court has recognized that an insurer’s defense under a reservation of rights may create a conflict of interest between the insured and insurer. <i>Petition of Youngblood</i> , 895 S.W.2d 322, 328 (Tenn. 1995). In <i>Youngblood</i> the court rejected the argument that the insurer’s use of staff counsel created a per se conflict of interest. <i>Id.</i> at 328-29.
Texas	When an actual conflict exists between the insurer and the insured.	<p><b>Caselaw:</b> Under Texas law, when an insurer defends an insured under a reservation of rights, if “when the facts to be adjudicated in the liability lawsuit are the same facts upon which coverage depends, the conflict of interest will prevent the insurer from conducting the defense.” <i>N. County Mut. Ins. Co. v. Davalos</i>, 140 S.W.3d 685, 689 (Tex. 2004). In such circumstances, the insurer loses the right to control the defense, but remains obligated to pay for it. The <i>Davalos</i> Court further listed types of conflicts that may justify an insured’s refusal of an offered defense, including: “(1) when the defense tendered is not a complete defense under circumstances in which it should have been, (2) when the attorney hired by the carrier acts unethically and, at the insurer’s direction, advances the insurer’s interests at the expense of the insured’s, (3) when the defense would not, under the governing law, satisfy the insurer’s duty to defend, and (4) when, though the defense is otherwise proper, the insurer attempts to obtain some type of concession from the insured before it will defend.” <i>Id.</i> (internal citation and quotations omitted).</p> <p>A reservation of rights does not necessarily create a conflict of interest that gives the insured the right to choose independent counsel. “A conflict of interest does not arise unless the outcome of the coverage issue can be controlled by counsel retained by the insurer for the defense of the underlying claim.” <i>Rx.com, Inc. v. Hartford Fire Ins. Co.</i>, 426 F. Supp. 2d 546, 559 (S.D. Tex. 2006).</p> <p>It appears unlikely that a Texas Court would require independent counsel to be compensated by the insurer at panel rates. <i>Kirby v. Hartford Cas. Ins. Co.</i>, 2003 WL 23676809, at *2 (N.D. Tex. June 9, 2003); <i>Housing Auth. of the City of Dallas, Texas v. Northland Ins. Co.</i>, 333 F. Supp. 2d 595 (N.D. Tex. 2004).</p>
Utah	Unclear, but Utah appears to require independent counsel when an actual conflict exists between the insurer and the insured on a case by case basis.	<b>Caselaw:</b> In <i>U.S. Fid. &amp; Guar. Co. v. Louis A. Roser Co.</i> , 585 F.2d 932 (8th Cir. 1978), the Eighth Circuit, applying Utah law, concluded that when a conflict of interest exists between the insurer and insured, an insurer must provide independent counsel to its insured. The Eighth Circuit strongly suggested that it felt a conflict of interest, even if in the form of unconscious bias, would exist when the attorney employed by the insurance company is defending a case under a reservation of rights. <i>Id.</i> at 938 n.5. The court, however, stopped short of adopting the per se conflict rule and decided the issue based on the specific facts. <i>Id.</i> at 939.

Jurisdiction	When is Insured Entitled to Independent Counsel?	Relevant Authority
Vermont	Unclear	<p><b>Caselaw:</b> Under Vermont law, a unilateral reservation of rights by an insurer is ineffective. <i>Am. Fidelity Co. v. Kerr</i>, 426 A.2d 163, 165 (Vt. 1980). The Vermont courts have not specifically addressed the issue of an insured’s right to independent counsel. The closest case on point is <i>Northern Security Insurance Co. v. Pratt</i>, 2011 WL 8472930 (Vt. Super. May 19, 2011) (Crawford, J.). In <i>Pratt</i> the court concluded that the lack of an insured’s assent to a reservation of rights appears sufficient to require the insurer to relinquish control of the defense and appoint defense counsel. In the decision the court determined that the insurer has the right to select independent defense counsel.</p>
Virginia	<p>There is no requirement for an insurer to provide independent counsel, even if there is a conflict of interest.</p> <p>It appears that the insurer retains the right to appoint counsel.</p>	<p><b>Caselaw:</b> The Virginia Supreme Court has concluded that independent counsel is not necessary because the insured and insurer can relitigate issues that bear on coverage in a subsequent action. <i>State Farm Fire &amp; Cas. Co. v. Mabry</i>, 497 S.E.2d 844, 846 (Va. 1998). In <i>Mabry</i> the issue was whether the insured intentionally or accidentally fired a gun. The court reasoned that the insurer could not assert the insured’s conduct was intentional because the insurer was not a party to the underlying action. <i>Id.</i></p> <p>It appears that under Virginia law the insurer retains the right to appoint counsel for the insured, even if there is a conflict. In <i>Norman v. Insurance Co. of North America</i>, 239 S.E.2d 902 (Va. 1978), the insured claimed that the attorney appointed by the insurer had a possible conflict of interest. Assessing the issue, the Court stated: “No one questions the fact that the standards of the legal profession require undeviating fidelity of a lawyer to his client, and no exceptions can be tolerated. A client may presume that his attorney has no interest which will interfere with his devotion to the cause confided in him. And an insurer’s attorney, employed to represent an insured, is bound by the same high standards which govern all attorneys, and owes the insured the same duty as if he were privately retained by the insured.” <i>Id.</i> at 907.</p>

Jurisdiction	When is Insured Entitled to Independent Counsel?	Relevant Authority
Washington	The insurer retains the right to appoint counsel, and the appointed counsel owes the insured an “enhanced obligation of fairness.”	<p><b>Caselaw:</b> The Court of Appeals of Washington has rejected the claim that an insurer’s reservation of rights automatically creates a conflict of interest that requires the insurer to pay for independent counsel. <i>Johnson v. Cont’l Cas. Co.</i>, 788 P.2d 598, 601 (1990). In <i>Weinstein &amp; Riley, P.S. v. Westport Ins. Corp.</i>, 2011 WL 887552 (W.D. Wash. Mar. 11, 2011), the federal district court summarized Washington law on this issue as follows:</p> <p style="padding-left: 40px;">Washington does not recognize an entitlement to “independent counsel” as it is understood under the <i>Cumis</i> model. In Washington, an insured is not entitled by law to choose independent counsel to represent it where there is a potential conflict with the insurer in a reservation of rights situation. Instead, the insured is entitled to a defense provided by a lawyer selected by the insurer, and the appointed lawyer owes an enhanced obligation of fairness to the insured. Thus, in contrast to <i>Cumis</i>, any breach of the ‘enhanced obligation of fairness’ in a reservation of rights situation might lead to <i>after-the-fact</i> liability of the insurer, retained defense counsel, or both.</p> <p><i>Weinstein &amp; Riley</i>, at *19 (internal citations and quotations omitted) (citing to <i>Johnson v. Cont’l Cas. Co.</i>, 788 P.2d 598, 601 (1990) and <i>Tank v. State Farm Fire &amp; Cas. Co.</i>, 715 P.2d 1133 (Wash. 1986)).</p> <p>In <i>Tank v. State Farm Fire &amp; Cas. Co.</i>, 715 P.2d 1133 (Wash. 1986), the Washington Supreme Court set forth specific criteria an insurer must meet to fulfill its “enhanced obligation of fairness” when defending under a reservation of rights. The insurer must: (1) thoroughly investigate the claim; (2) retain competent counsel for the insured and both the retained counsel and the insurer must understand that <i>only</i> the insured is the client; (3) inform the insured of the reservation of rights and all developments relevant to policy coverage and progress of the lawsuit; and (4) refrain from any activity that would show a greater concern for its monetary interests than for insured’s financial risk. <i>Id.</i> at 1137. Moreover, retained counsel must: (1) represent the insured and not the insurer; (2) disclose all conflicts of interest; (3) disclose all information relevant to the defense; and (4) disclose all settlement offers as they are presented. <i>Id.</i></p>
West Virginia	Unclear	<p><b>Caselaw:</b> The West Virginia courts have not addressed an insured’s right to independent counsel. It is clear, however, that under West Virginia law, counsel hired by an insurer to represent an insured owes a duty of loyalty to the insured under the tri-partite relationship. <i>Barefield v. DPIC Cos., Inc.</i>, 600 S.E.2d 256, 270 (W. Va. 2004) (holding that an insurer may not be held liable under West Virginia’s Unfair Trade Practices Act for actions of the insurer employed defense counsel.</p>

Jurisdiction	When is Insured Entitled to Independent Counsel?	Relevant Authority
Wisconsin	<p>It appears Wisconsin follows the per se conflict rule, and allows the insured independent counsel when a reservation of rights is issued.</p> <p>There is a split of authority on whether the insured or the insurer is allowed to select the independent counsel.</p>	<p><b>Caselaw:</b> In <i>Grube v. Daun</i>, 496 N.W.2d 106, 123 (Wis. Ct. App. 1992), overruled on other grounds by <i>Marks v. Houston Cas. Co.</i>, 881 N.W.2d 309 (Wis. 2016), the Wisconsin Court of Appeals described the procedures an insurer may follow to retain its right to challenge coverage while not breaching its duty to defend: (1) the insurer and the insured could enter into a nonwaiver agreement whereby the insurer agrees to defend and the insured acknowledges the right of the insurer to contest coverage; (2) the insurer may request a bifurcated trial or declaratory judgment in order to have the coverage issue separately addressed by the court; or (3) the insurer may provide the insured notice of its intent to reserve the right to contest coverage, at which point “the insured can pursue his own defense not subject to the control of the insurer, but the insurer still would be liable for legal fees incurred.” <i>Grube</i>, 496 N.W.2d at 123. See also <i>Jacob v. West Bend Mut. Ins. Co.</i>, 553 N.W.2d 800, 805 (Wis. Ct. App. 1996) (if the insurer notices the insured of the intent to reserve its coverage rights, the insured is allowed the opportunity “to a defense not subject to the control of the insurer although the insurer remains liable for the legal fees incurred.”).</p> <p>It appears that Wisconsin Supreme Court has not addressed an insured’s right to independent counsel. The federal district courts in Wisconsin have addressed this issue and there is a split of authority regarding whether the insurer or insured has the right to choose independent counsel.</p> <p>In <i>Nowacki v. Federated Realty Group, Inc.</i>, 36 F.Supp. 2d 1099 (E.D. Wis. 1999), the U.S. District Court for the Eastern District of Wisconsin held that an insured has the right to choose counsel when the insurer provides a defense under a reservation of rights. <i>Id.</i> at 1108-09 (citing <i>Grube v. Daun</i>, 496 N.W.2d 106, 123 (Wis. Ct. App. 1992) and <i>Jacob v. West Bend Mut. Ins. Co.</i>, 553 N.W.2d 800, 805 (Wis. Ct. App. 1996)).</p> <p>In contrast, in <i>HK Systems v. Admiral Ins. Co.</i>, 2005 WL 1563340 (E.D. Wis. 2005) (unpublished), the U.S. District Court for the Eastern District of Wisconsin stated that when there is a conflict of interest the insurer may still be entitled to appoint defense counsel if the appointed counsel were truly independent. <i>Id.</i> at *16.</p>
Wyoming	Unclear	There is no instructive authority on this issue under Wyoming law.

**Appendix B**

**REQUEST FOR PROPOSAL**

ABC Co Servicing LLC<sup>1</sup> (“ABC Co” or “we” or “our”) has issued this Request for Proposal (“RFP”) to the Company identified below (“Company” or “you” or “your”). The RFP process is governed by the provisions of that certain Confidentiality and Non-Disclosure Agreement entered into by ABC Co<sup>2</sup> and Company<sup>3</sup> effective date<sup>4</sup> (“NDA”).

Company: Company name: \_\_\_\_\_

Company address: \_\_\_\_\_

Title of RFP Project: \_\_\_\_\_

Date of RFP Issuance: \_\_\_\_\_

Proposal Submission Deadline: \_\_\_\_\_

Please submit your response (“Proposal”) no later than the Proposal Submission Deadline set forth above (the Proposal must be received in our office by that deadline). Please reference the title of this RFP Project and the Date of RFP Issuance in the preamble of your Proposal or in a cover memo attached to your Proposal. Any questions related to this RFP should be directed to the attention of name, title, at phone # or email address. Please submit your Proposal to the attention of:

ABC Co Servicing LLC<sup>5</sup>  
Attn: name & title  
3980 East Mexico Avenue, Suite 200  
Alamos, TN 80210  
Email address: email address<sup>6</sup>

The following formats are acceptable for the submission of the Proposal:

- List formats – e.g., hard copy or email or flash drive or CD, etc.

Please be advised that the following terms and conditions apply to ABC Co and Company and to the RFP process. Do not submit a Proposal unless you agree to these terms and conditions.

1. Each party will be solely responsible for its own costs incurred in issuing this RFP, submitting a Proposal and any further discussions related thereto.
  2. ABC Co reserves the right, in its sole discretion, to terminate the RFP process at any time, or extend or shorten any deadlines in connection with the RFP process, with respect to any or all participants in the RFP process. ABC Co may, in its sole discretion, engage any vendor that ABC Co may select at any time regardless of whether that vendor has participated in the RFP process. Neither Company nor ABC Co will be obligated to enter into any further business relationship as a result of this RFP process unless the parties elect to sign a subsequent written agreement documenting such a relationship. Neither party will be precluded from entering into any other vendor relationships or lines of business as a result of information exchanged during the RFP process, although each party must comply with the provisions of the NDA.
- 

<sup>1</sup> Insert name of appropriate ABC Co entity.

<sup>2</sup> Make sure the NDA is in the name of the same ABC Co entity or that it covers affiliates and insert appropriate ABC Co entity name here.

<sup>3</sup> Make sure the NDA is in the name of the same vendor entity or that it covers affiliates and insert appropriate vendor entity name here.

<sup>4</sup> Insert NDA effective date here.

<sup>5</sup> Insert name of appropriate ABC Co entity.

<sup>6</sup> Insert appropriate email address, or delete this line if email is not an acceptable submission format.

What services are required? How will services be used? Indicators of success (e.g., response times).

This Request for Proposal is comprised of the following Sections:

- I. Introduction to ABC Co and RFP Project
- II. Vendor Instructions
- III. Criteria to be Evaluated
- IV. Questions to Vendors

Your Proposal should address the questions set forth in Sections II through IV as well as any other information that you wish to share.

**I. Introduction to ABC Co and RFP Project. [the following bullets set forth content the RBU may wish to include to educate the vendor]**

- A. Provide a history of company and brand. Consider including information such as a brief history, industry background, company size, number of employees, web address, etc.
- B. Provide backgrounds of key personnel and of the individuals that will use [service].
- C. Outline for vendors the business reasons for pursuing a [service] solution. What problems or challenges do we face? What opportunities do we want to capitalize on? How do we foresee [service] helping us to achieve these goals? E.g., “Current sales training efforts are too costly because sales representatives are spread across the country. An e-learning version of the sales training program will result in more timely training that is less expensive to deliver than current training approaches.”
- D. Briefly outline the solution sought, e.g.:
  - i. [exclusive?] vendor for [service].
  - ii. web-based, vendor-hosted solution.
  - iii. Scalable platform capable of supporting \_\_\_ users.
  - iv. 24x7 access.
  - v. Integration/connectivity with \_\_\_\_\_ (existing legacy system(s))
- E. The timeline for this RFP project is as follows:
  - i. RFP distributed to vendors: [date]
  - ii. Deadline for RFP responses: [date]
  - iii. Invitations for formal presentations to be sent: [date] (delete this line if no formal presentations are anticipated)
  - iv. Vendor presentations to be given at ABC Corporate office: [date] (delete this line if no formal presentations are anticipated)

**II. Vendor Instructions**

- A. Please include the following in your Proposal:
  - i. the name and title of the individual(s) we should contact to follow up regarding your Proposal;
  - ii. a list of any subcontractors or other third parties to whom you anticipate subcontracting or outsourcing any work;
  - iii. a list of any third party service providers that are integral to the services you provide (e.g., third party hosting companies);
  - iv. a list of any third parties who own any intellectual property that is integral to the services you provide (e.g., third party software or data providers);
  - v. proof of insurance; and

- vi. three to five references of current users that we may contact as references (include the company names, addresses, phone numbers and contact persons).

**III. Criteria to be Evaluated. [examples follow; replace with appropriate bullet point list]**

- A. Technical capability
- B. Software capability
- C. Functionality
- D. Vendor support, responsiveness and follow-up
- E. Ease of use
- F. Flexibility and ease of product implementation
- G. Implementation plan and support
- H. Pricing
- I. Form of contract and any applicable SLAs
- J. Timely and complete response to RFP
- K. Vendor client references
- L. Results of requested demonstrations and presentations

**IV. Questions to Vendors.**

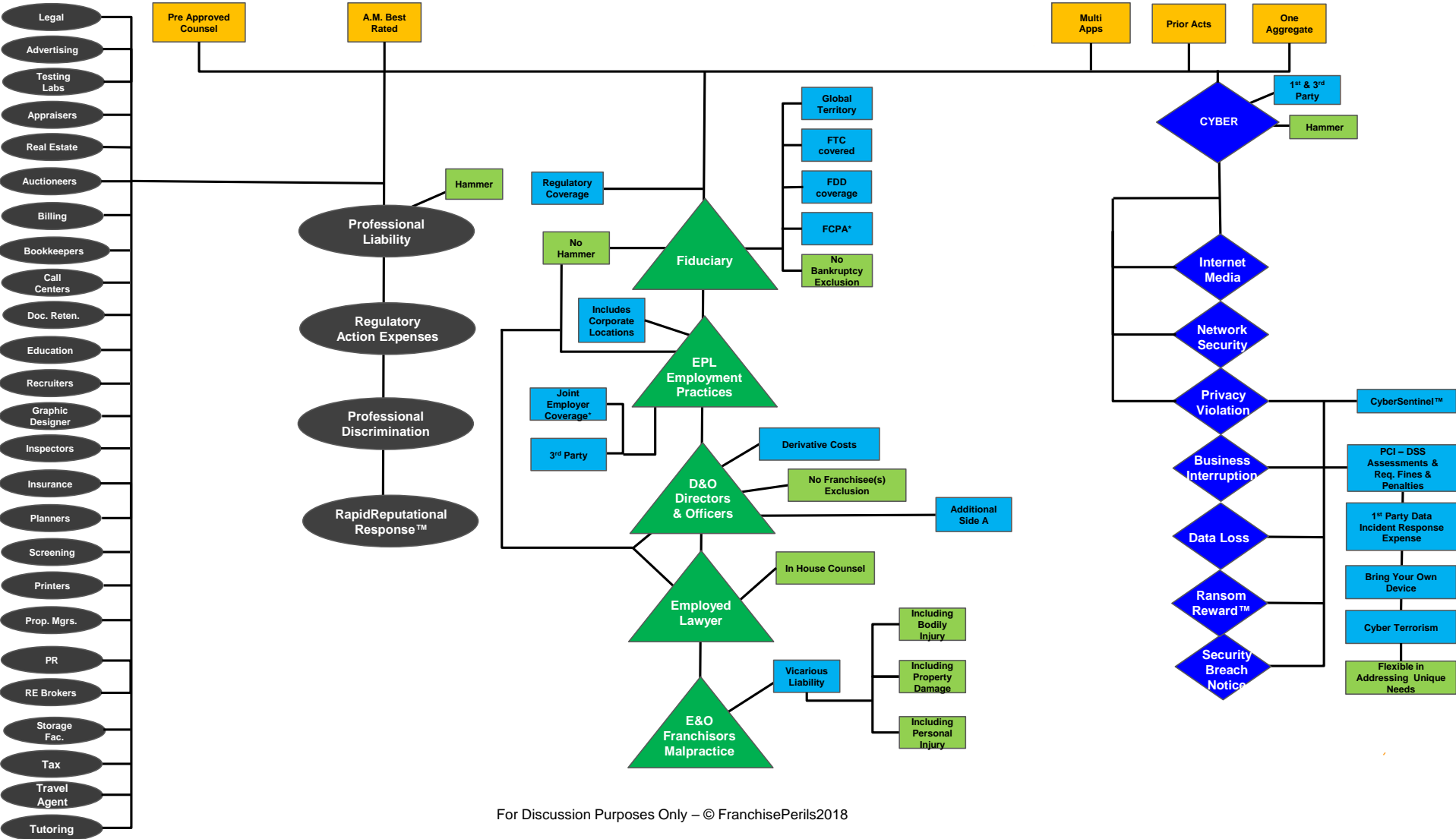
- A. Company Overview – please address the following questions about your organization:
  - i. Provide contact information for the principle individual(s) to be contacted regarding the information in this RFP.
  - ii. Provide a brief history of your company and the location of corporate headquarters and offices.
  - iii. How long have you been in business? How long have you been providing [service]?
  - iv. Are you a private or publicly traded company? If public, provide your ticker symbol and a copy of your company’s latest Annual Report. If private, how did the business start, and who funded the start-up? Provide evidence of your company’s financial stability and projected longevity.
  - v. Indicate the total number of employees by location (if appropriate) and function (e.g., product development, sales & marketing, customer service, technical support, etc.).
  - vi. Describe your core product and service lines.
  - vii. How many current [service] clients do you have?
  - viii. Describe what differentiates your organization from your competitors.
  - ix. List any awards or industry recognition your company has received, especially as related to [service].
- B. Service Overview – please address the following questions about the services covered by this RFP: (examples below – modify as appropriate)
  - i. Scalability & Reliability
    - 1. Summarize how you address scaling up the system for enterprise-wide use.
    - 2. Summarize the actions taken to ensure the reliability and robustness of your system.
    - 3. What makes your system superior to other platforms in terms of technology platform?
  - ii. Customer Service & Technical Support
    - 1. Describe your technical and customer support services.

2. How do you track technical support requests, problems, fixes, etc?
  3. How do you ensure communication and feedback from users?
  4. Describe the system training provided to administrative staff upon system launch.
  5. Describe any promotional services and programs you can provide to ensure the successful launch of services for Smashburger.
- iii. Reporting (optional section)
1. Describe the types of reports that are standard within your system. Do you provide an on-line dashboard to access these reports?
  2. How can we produce, download and/or manipulate standard reports?
  3. Describe the process for developing custom reports upon our request.
- C. Implementation Time & Process (optional section)
- i. What is the average implementation time for a system similar to the solution being requested?
  - ii. Describe the implementation, project management and quality assurance process.
  - iii. What planning and project management tools do you employ?
  - iv. What is your standard project review cycle?
  - v. How do you provide clients with up-to-date information on a project's progress?
  - vi. Provide an overview of the people involved in an implementation.
  - vii. Provide a short synopsis of how the [service] solution will be implemented. For example, you may break the full implementation down into phases:
    1. Phase #1: Pilot Program with \_\_\_\_\_ restaurants.
    2. Phase #2: System-wide launch.
- D. Contracting & Pricing
- i. Provide a breakdown of the pricing for your proposed solution for 1-, 2- and 3-year terms.
  - ii. Which items are optional and/or can be added at a later date?
  - iii. What costs can the customer control?
  - iv. Are there any suggestions you can make to reduce the overall cost?
  - v. Identify any multi-year, volume or other discounts available?
  - vi. Outline proposed payment terms, identifying any up-front "set-up" payments, one-time costs, annual leases, etc.
  - vii. Please summarize any pricing and options available for training services, implementation, extended technical support, etc.
  - viii. How do you bill for your services (monthly, quarterly, annually, etc.)?
  - ix. How are bills itemized? What level of cost detail do you provide?
  - x. Are there standard contract durations for your services? What are the associated terms and conditions?
  - xi. Please attach a sample contract and/or lease agreement as well as any applicable SLAs.
  - xii. Are there any back-end costs after completing the contract? Describe.

V. Availability of Features and Functions (optional – see examples below)

Feature/Function	Existing Capability (Y/N)	Planned Availability Date	Comments
Ability to customize the user interface			
24x7 user/technical support			
Integrated e-commerce capability for third party purchasers			
Web-based access to administrative features, data and reporting			

# Appendix C



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