

2018 IFA

LEGAL SYMPOSIUM

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

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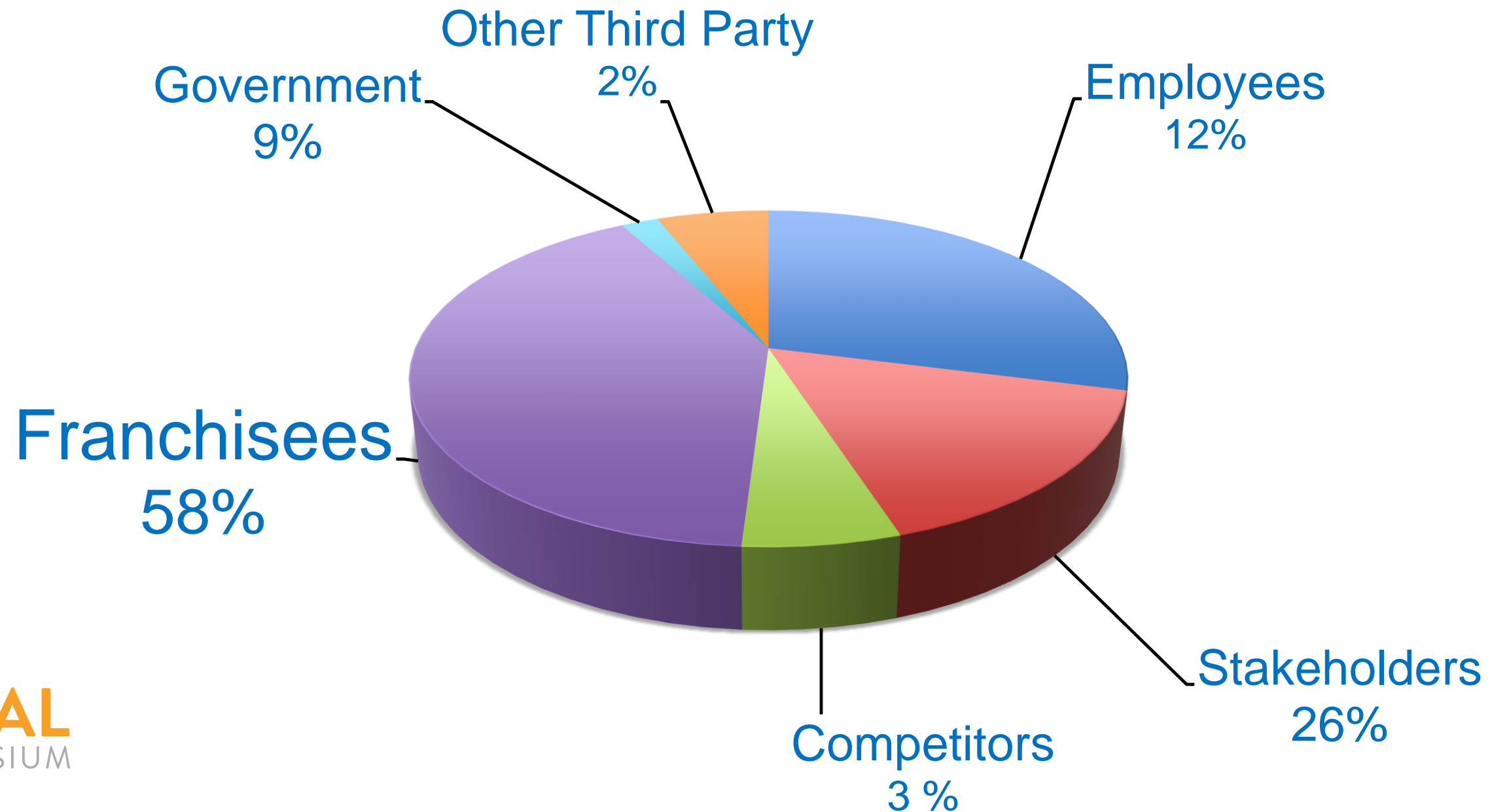
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Disclaimer

- Please see policies for exact terms, conditions and exclusions
- Every insurance policy is different and the advice of counsel is encouraged
- Today's presentation is for discussion purposes only

D&O/ Franchisors' Malpractice *Claims by Claimant*



Franchisors' Malpractice (E&O)

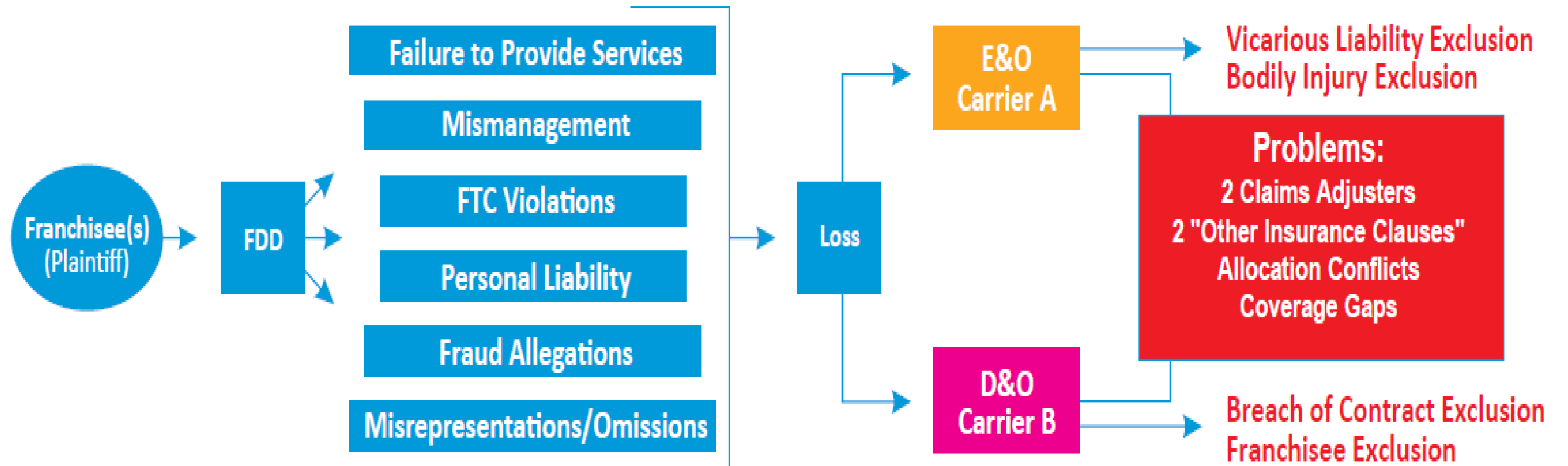
- Failure to render **Franchisor Services**:
 - Marketing, solicitation activities connected to the offer to sell franchises (FDD/ Franchise agreement)
 - Preparation, registration, amendment to FDD/ Franchise Agreement
 - Duties, obligations or other responsibilities of Zor to Zee
 - Per FDD/ Franchise Agreement

Franchisor Vicarious Liability

- The **Insurer** shall pay **Loss** on behalf of an **Insured** resulting from any **Claim** first made against such **Insured** during the **Policy Period** or **Extended Reporting Period**, if applicable arising out of any actions of a **Franchisee** committed on or after the **Retroactive Date**

FRANCHISOR CLAIMS SCENARIO

Traditional Structure



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Employment Practices Liability

Joint Employer

- **People and Customer Protection**
- **Discrimination**
- **Retaliation**
- **Wrongful Termination**
- **Wage & Hour**

Little Difference = Big Problems

- Criminal, dishonest, fraudulent, or knowingly or intentionally **Wrongful Acts** or omissions committed by or
- At the direction of any **Insured** or which were ratified or acquiesced in by any **Insured**.
- of an **Insured** arising from, based upon, or attributable to any deliberately fraudulent or criminal act or omission or any willful violation of law by such **Insureds** **if established by a final non-appealable adjudication** adverse to such **Insured** other than in a proceeding initiated by the **Insurer**

Trade Secrets

- **Same Insurer for D&O and Franchisors' Malpractice**
- **Vicarious Liability Coverage (BI, PD, PI)**
- **NO franchisee(s) Exclusion on D&O**
- **3rd Party and Joint Employer on EPL**
- **Full Regulatory Coverage**
- **Full FDD/Franchise Agreement Coverage**

Creating Effective Programs for Franchisors & Franchisees

DISCUSSION TOPICS

- Managing Risk
 - Risk Assessment
 - Risk Philosophy & Appetite
 - Risk Responses
 - Brokers & Insurance Policies
- Developing Risk & Insurance Programs
 - Insurance Requirements for Franchisees
 - Crisis Management for Franchisees

Risk Assessment – Identify Areas of Vulnerability

- **General Business Risks**
 - Economic & market forces
 - Accidents & natural events
 - Technological breakdowns
- **Industry Specific Risks**
 - Financial services
 - Packaged goods
 - Restaurants
- **Special Risks For Franchised Brands**
 - Independently owned & operated units = unique operational & compliance risks
 - System-wide marketing efforts = prominent consumer brands

Establish Risk Philosophy & Assessment

- Determine General Tolerance For Risk
 - Consider investments to manage & mitigate
 - Conduct cost benefit analysis
- Determine Probability Of Each Risk Actually Occurring
 - Consider empirical data
 - Consider experiences of competitors in same/similar sector
 - Consider individual conception & unpredictability of human behavior
- Determine The Potential Severity Of Any Such Risk Should It Materialize
 - Consider possible penalties, damages & other consequences
 - Consider various worst case-scenarios

Implement Risk Response Strategies

Impact vs. Probability

- **High Risk: Impact & Probability = High**
 - Avoid product
 - Drop product
 - Price for the risk
- **Medium Risk: Impact = Low, Probability = High OR Impact = High, Probability = Low**
 - Mitigate & control
 - Shift risk through insurance, outsourcing, joint ventures or exiting altogether
- **Low Risk: Impact & Probability = Low**
 - Accept risk
 - Absorb consequence

Insurance Requirements For Franchisees

TOP 5 BEST PRACTICES

- 1: Treat insurance requirements as franchise system standards
- 2: Consult with various internal & external resources to set such requirements
- 3: Mandate customary types/amounts of insurance, such as property, professional liability & general liability insurance, and consider mandating supplemental insurance products such as those tailored to provide protection for information security risks
- 4: Require that all such policies (a) name the franchisor & its affiliates as additional insureds, (b) notify the franchisor of cancellation, and (c) contain a waiver of subrogation rights
- 5: Develop tools to audit, track & enforce franchisee compliance w/ insurance requirements

Brokers & Insurance Policies

- Brokers
 - Support for companies w/o readily available experienced resources
 - Internal counsel vs. readily available external counsel
 - Insurance policy nuances; claims reporting & management process
 - Various levels of broker services can be procured through an RFP or other less structured process
 - Coverage need & policy assessment vs. price negotiator
 - The broker agreement – review & negotiate it!
- Insurance Policies
 - Can be meaningful risk management tools if properly procured & vetted
 - Complex contracts that should be treated as such
 - Ensure the policies cover intended losses and exposures
 - Understand exclusions that may limit or eliminate coverage
 - Standard forms vs. manuscript provisions
 - Initial coverage vs. excess coverage
 - Consult with subject matter experts to ensure policies align with risk assessment & appetite
 - Legal counsel role vs. broker role; importance of both
 - Application and disclosures

Crisis Management For Franchisees

- Develop A Written Contingency Plan
 - Address crisis management preparedness throughout system (HQ, corporate locations & franchise locations)
 - Consider w/ specificity the coordination of franchisees w/ the franchisor when during any crisis
 - Media calls; other front line issues
 - Minimize negative consequences & help return to normal operations quickly
- Develop A Crisis Training Program
 - Determine which franchisee stakeholders & employees to train
 - Managing owners
 - Unit-level employees
 - Consider how & when they should be trained
 - Annually
 - As changes are made
 - Onboarding
 - Create a summary crisis guide
 - User friendly & easy to follow
 - Prominently housed in all franchised locations
 - Serves as the initial response blueprint in the acute, initial stages of the crisis

Risk Management Strategy & Liability Insurance

- Risk Assessment
- Selection of Counsel
- Control Over Litigation
- Attorney's Fees & Costs
- Litigation Outcome Scenarios

Risk Assessment

- Litigation Assessment
 - Strategy
 - Outcome
 - Damages
 - Costs
- Insurance Tender & Coverage

Selection of Counsel

- Insurance Company Appointment of Counsel
- Franchisors Right to Independent Counsel
 - Common Law Right to Select Counsel
 - Statutory Right to Select Counsel

Control Over Litigation

- Litigation Strategy
- Funding Defense of Claims
- Duty to Cooperate in Litigation
- Control of Decision to Settle Covered Claims.

Attorney's Fees & Costs

- Expense of Litigation
- Recovery of Attorney's Fees & Costs
 - American Rule
 - English Rule
 - Statutory/Contractual Right to Recovery

Litigation Outcome Scenarios

- Best Case Scenario
 - Liability Insurance Covers the Cost of Litigation
 - Franchisor Prevails at Trial
- Worst Case Scenario
 - Challenging Public Relations Battle
 - Self-fund an Expensive Legal Battle
 - Self-fund an Unbudgeted & Unfavorable Judgment

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Panel Discussion

Moderator:

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Thank You