

BLOGS
Insurance

Insurer Coverage Denial for Contractual Exclusion in Franchise Dispute Is Upheld

A federal district court in Wisconsin granted partial summary judgment to a franchisor's directors and officers (D&O) insurance carrier following its denial of liability coverage based on key policy exclusions. In *Cousins Submarines, Inc. v. Federal Ins. Co.*, 2013 U.S. Dist. LEXIS 17306 (E.D. Wis. Feb. 8, 2013), citing the corporate liability coverage that supplemented its standard D&O liability coverage, a sandwich shop franchisor asked its insurer (Federal) to defend it in an underlying lawsuit. The underlying lawsuit alleged that Cousins and its representatives enticed a group of investors to open franchises in Indiana through arguably illegal means. Federal asserted policy exclusions, primarily an exclusion for liability under any written or oral agreement or contract (except to the extent that an insured organization would have been liable without the agreement), to deny coverage for the claims. Cousins unilaterally settled the underlying lawsuit using its own funds, then filed suit against Federal for breach of contract and bad faith denial of coverage.

In analyzing the contract liability exclusion, the court applied a two-pronged analysis. Under the first prong, it evaluated whether the liability arose from a franchise agreement, and then whether the claim arose from that liability. Federal took the position that a broad standard applied, excluding any claims for liability that would not lie "but for" the existence of a contract. Cousins argued for a more limited scope of the exclusion that would apply strictly to claims based on the contract itself. The court sided with Federal and determined that Cousins' liability stemmed from the existence of a franchise agreement. Under the second prong of the test for liability exclusion, the court considered the extent to which Cousins would have been liable in the absence of the agreement. The court determined that claims for breach of contract, rescission, and various statutory franchise violations were excluded, but that misrepresentation claims could have made Cousins liable in the absence of a franchise agreement. For that reason, the misrepresentation-related claims, including claims for violations of the Indiana Franchise Disclosure Act, were not dismissed. In most states, such claims could not exist in the absence of a contract between Cousins and investors, but the relevant Indiana laws provided for liability for any misrepresentation made in connection with the offer for sale of a franchise. Thus, Cousins could be liable for actions before the formation of the contract, even if a contract was never signed, and the contract liability exclusion did not apply for the pre-contract liability portion of the franchise claims.

Related People

Maisa Frank

Partner

Washington, D.C.

202.295.2209

maisa.frank@lathropgpm.com