Additional-Insured Endorsements Might Not Protect You, Despite what Your Contract and Certificate of Insurance Both Say

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Liability insurance is a critical part of managing business risk, particularly for lessors, construction projects, and industries involving machinery or chemicals, and co-venturers often contract to provide coverage to one another through insurance policy endorsements. But insurance, like contract-drafting, is subtle and complicated, and when business operators misunderstand it, insurance can fail its purpose and expose a business to litigation costs. A recent Federal Court decision[1] involving a workplace injury invalidates assumptions business operators frequently make about the safety of their contractual insurance arrangements – and its lessons about hidden risk are worth paying attention to.

A Philly Pretzel Factory restaurant worker who injured her hand in a pretzel rolling
The machine sued the restaurant franchisor, Soft Pretzel Franchise Systems, Inc., as well as the franchisee and the machine’s manufacturer, for breach of warranty, strict liability, and negligence claims. After some procedural developments, she pressed her lawsuit only against the franchisor. Under their franchise agreement, the franchisee had obtained a liability insurance coverage endorsement naming the franchisor as an additional insured under franchisee’s insurance, “but only with respect to their liability as grantor of the franchise to [franchisee].” The franchisee’s liability coverage obligated the insurer to “pay those sums that the insured becomes legally obligated to pay as damages because of ‘bodily injury’ … or ‘personal and advertising injury’ to which this insurance applies.” The policy also included apparently redundant terms that the insurer had no duty to defend the insured for “‘bodily injury’ … or ‘personal and advertising injury’ to which this insurance does not apply.”

Meanwhile, as per the franchise agreement, the franchisee’s insurance broker issued the franchisor a Certificate of Insurance stating, “Soft Pretzel Franchise Systems, Inc. is named an additional insured with regards to the general liability.” The Certificate of Insurance included a standard disclaimer that “THIS CERTIFICATE IS ISSUED AS A MATTER OF INFORMATION ONLY AND CONFERS NO RIGHTS ON THE CERTIFICATE HOLDER.” We ask the reader to pause and consider, is any part of this arrangement unusual?

The Court acknowledged the expectations of the parties should guide its interpretation of the insurance policy, and that it should construe ambiguous policy terms in favor of providing coverage to the insured[2]. Unfortunately for the franchisor, the Court held that the franchisor was not insured by the policy, because Pennsylvania law gives effect to “clear and unambiguous” policy language stating the franchisor was not insured for the worker’s injury-related claims[3]. Huh?

The Court found the worker’s claims “simply have nothing to do with Pretzel Franchise as grantor of a franchise to Pretzel Factory.” The worker alleged the franchisor “had responsibility for the implementation and enforcement of safety procedures at Philly Pretzel Factory facilities”, and the franchisor “designed and placed in commerce the defective machine and failed to inspect, repair, and maintain it.”[4] Common sense tells us the franchisor did these things in order to fulfill its duties to franchisee, so why did the Court decide coverage did not apply under the endorsement? One explanation is that the Court applied Occam’s razor to the parties’ arguments, and decided the solution requiring the fewest assumptions about the policy language and the policy parties’ intentions was the correct one. The policy insured the franchisor for its liability as grantor of the franchise to the franchisee, and the worker’s claims depended on franchisor’s other acts and omissions, not on whether franchisor granted a franchise to franchisee. In fact, this analysis requires zero assumptions about the policy language or the policy parties’ intentions – and demonstrates judges’ deep-seated respect for properly drafted contracts.

And what about the Certificate of Insurance stating the franchisor was insured for “the general liability”? The Court cited its disclaimer, and that it was issued by the broker and not the insurer, to find it was not part of the policy and the franchisor could not rely on it to expect insurance coverage.[5]
We see several lessons for business operators and their legal counsel:

- The Court’s disregard of the Certificate of Insurance as a representation of coverage is a cold slap to businesses that typically rely on these out of commercial expedience. We do not expect brokers to remove standard-form disclaimers. Clearly, parties cannot rely solely on certificates of insurance to confirm they have insurance coverage.

- When there is significant risk of loss, we advise parties and their counsel to take whatever time is necessary to read the insurance policy and resolve any misapprehensions.

- If this is not practical, parties should clearly communicate their expectations for policy coverage in writing with the insurer, or failing that, the broker. This will document the parties’ intentions and may support their positions in coverage disputes.

- Prepare for unexpected gaps in coverage through proper risk assessment and contract drafting. Intelligent and experienced deal-makers can identify other ways to allocate risk and expense between the parties when insurance coverage fails.

- A business that already has a contractual agreement for another party to provide it with insurance coverage should closely review the insurance policy and the contract to see if they actually cover risk.

The Court may have decided differently if the worker had sued only the franchisee, and the franchisee had in turn sued the franchisor for exposing it to risk by granting it a franchise. But plaintiffs typically sue the party with the most resources and the least likelihood of ducking a judgment lien by filing for bankruptcy. Businesses that rely on contractually-agreed insurance coverage with their venture partners need to closely examine their insurance coverage information—and carefully prepare their contractual agreements—in order to lock all the doors they close on risk.


3 Id.

4 Soft Pretzel Franchise Systems, Inc. at *6.

5 Soft Pretzel Franchise Systems, Inc. at *7.

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