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"Supervisor" Hostile Environment Sexual Harassment Claims, Liability Insurance, and the Trend Towards Negligence

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"SUPERVISOR" HOSTILE ENVIRONMENT SEXUAL HARASSMENT CLAIMS, LIABILITY INSURANCE AND THE TREND TOWARDS NEGLIGENCE

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A lack of settled standards for determining liability in supervisor hostile environment sexual harassment lawsuits combined with similar uncertainty in the context of employer liability insurance coverage has resulted in increased litigation in this area. This Note argues that the current predominant standard in the employer liability context, which is based on negligence principles, should be rejected in favor of an apparent authority standard, which more appropriately strikes a balance between encouraging employers to identify harassing behaviors and exonerating them from liability when they do so and take appropriate remedial action. It further argues that in order to develop effective mechanisms for preventing supervisor hostile environment sexual harassment and to adequately compensate victims, courts should consider the cost-shifting effects of employer liability insurance coverage and also the conduct that substantive standards will encourage or discourage.

Sexual harassment lawsuits are front page news.[1] The Anita Hill/Clarence Thomas hearings, and more recently, a record high sexual harassment award against the law firm of Baker & McKenzie[2] and the Equal Employment Opportunity Commission's (EEOC) filing of a large sexual harassment suit against the Mitsubishi Corporation,[3] have provoked unprecedented interest in sexual harassment law, as well as a predictable amount of controversy.[4] The quantifiable increase

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1. *See generally* Allen R. Myerson, *As Federal Bias Cases Drop, Workers Take Up the Fight*, N.Y. TIMES, Jan. 12, 1997, at A1 (documenting the rise in Title VII suits).

2. *See* Weeks v. Baker & McKenzie, 1994 WL 774633 (Cal. Super. Ct. 1994).

3. *See* EEOC v. Mitsubishi Motor Mfg. Of Am., 102 F.3d 869 (7th Cir. 1996).

4. *See* Paul E.B. Glad & Richard V. Rupp, *Employment-Related Liability Claims and Insurance*, *in* EMPLOYMENT LAW LIABILITY CLAIMS: WHAT YOU NEED TO KNOW ABOUT INSURANCE COVERAGE (PLI Comm. Law & Practice Course Handbook Series No. 716 1995) (hereinafter EMPLOYMENT LAW LIABILITY CLAIMS); Joseph P. Monteleone, *Recent Developments in Insurance for Employment Related Litigation*, *in* EMPLOYMENT LAW LIABILITY CLAIMS, *supra*, at 179.

in the number of sexual harassment suits filed in the past four years may also explain at least some of this heightened awareness.[5] The Civil Rights Act of 1991,[6] which expanded the remedies available to sexual harassment plaintiffs under Title VII of the Civil Rights Act of 1964, may be largely responsible for this increase in litigation.[7] Amidst the rising number of claims, two critical areas of sexual harassment law still remain unclear.

First, it is undecided under what circumstances employers may be held legally responsible for the harassing acts of their employees, specifically those employees who hold or have held a supervisory position over the alleged victim of harassment.[8] Second, a significant increase in liability insurance litigation has occurred as corporations seek coverage for defense costs and indemnification for successful sexual harassment awards under their existing insurance policies.[9] The efforts of corporations to recover under commercial general liability (CGL) policies have met with some success in a few jurisdictions.[10] In addition, several insurers have begun to offer a specialized non-uniform insurance product: Employment Practices Liability Insurance (EPLI).[11] This type of insurance is specifically designed to cover employers held liable for wrongful employment practices.[12] Currently, there is no uniform understanding regarding whether, or when, CGL or EPLI policies will cover an

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5. *See* Myerson, *supra* note 1, at A1.

6. 42 U.S.C. § 1981a(a)(1) (1994) (allowing victims of intentional discrimination to recover compensatory and punitive damages).

7. For an analysis of the impact of these additional remedies in sexual harassment litigation, see Robert A. Machson & Joseph P. Monteleone, *Insurance Coverage for Wrongful Employment Practices Claims Under Various Liability Policies*, 49 BUS. LAW. 689, 695–96 (1994). Although the 1991 amendments affected all Title VII plaintiffs, not just those alleging sexual harassment, most of the additional remedies created by the Act were already available to plaintiffs claiming racial discrimination. *See* 42 U.S.C. § 1981 (1994). Therefore, the rise in cases filed has likely been caused by the expansion of remedies available to sexual harassment plaintiffs.

8. *See* Glen Allen Staszewski, *Using Agency Principles for Guidance in Finding Employer Liability for a Supervisor's Hostile Work Environment Sexual Harassment*, 48 VAND. L. REV. 1057, 1061 (1995).

9. *See* James E. Scheuermann, *Insurance Coverage for Employment-Related Claims*, 28 TORT & INS. L.J. 778, 779 (1993); *see also infra* note 84 (discussing the connection between the rise in sexual harassment suits and coverage litigation).

10. *See infra* Part II.

11. For a partial list of insurers and descriptions of EPLI products, see Karen Gordon, *Overview of Employment Practices Liability and EPLI Market Survey*, *in* EMPLOYMENT LAW LIABILITY CLAIMS, *supra* note 4, at 253.

12. *See id.* at 258.

employer/insured for employment practices liability, although there appears to be a growing trend toward allowing coverage.[13]

Part I of this Note provides a broad overview of the law on employer liability for supervisor hostile environment sexual harassment claims and the current standards that determine liability. Part II outlines the factors that determine the extent of a corporate employer's insurance coverage, under both CGL and EPLI policies, for supervisor hostile environment sexual harassment suits.

Part III identifies the growing similarity between the predominant employer liability standard for supervisor hostile environment sexual harassment and the standard most commonly used in coverage disputes between the employer and its insurer. Part III shows how this collapse occurs and argues that, because the convergence in standards is administratively appealing to courts, the trend will continue if not checked.

Part IV considers a normative question: In light of the growing willingness of courts to allow employers to insure against liability for harassing acts of supervisory employees, which substantive employer liability standard works best to fulfill the policy goals of Title VII? Part IV is premised on the belief that, although the negligence standard described in Part III is administratively attractive, it may produce undesirable results, and that other, non-negligence based standards may be preferable.

Most of the discussion regarding the appropriate standard for employer liability in supervisor hostile environment sexual harassment cases includes an analysis of the policy goals of Title VII itself—preventing discriminatory conduct and compensating the victims of such conduct.[14] Courts that deny employers insurance coverage for sexual harassment liability under the employer's CGL often do so on public policy grounds.

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13. Because EPLI policies are new, no significant case law has developed that is specific to these policies. However, many commentators have addressed the policy concerns about EPLI policies by referring to decisions interpreting CGL and other general insurance policies. *See* Joseph P. Monteleone, *Employment Practices Liability Insurance (EPLI) Policies: Who Controls Selection of Defense Counsel*, 18 W. NEW ENG. L. REV. 159, 160 (1996).

14. *See, e.g.*, Ford Motor Co. v. EEOC, 458 U.S. 219, 230 (1981); *see also* Maria M. Carrillo, *Hostile Environment Sexual Harassment by a Supervisor Under Title VII: Reassessment of Employer Liability in Light of the Civil Rights Act of 1991*, 24 COLUM. HUM. RTS. L. REV. 41, 84 (1992–93) (recognizing that holding employers vicariously liable for the harassing acts of their supervisory employees best promotes the goals of Title VII).

Specifically, courts are wary of the danger of moral hazard[15] if employers are allowed to insure against intentional discrimination such as sexual harassment.[16] Therefore, public policy, whether found in common law or statutes, often explicitly or implicitly controls the outcome of both substantive actions and coverage disputes.

Judicial and academic discussion of public policy, however, is often extremely narrow and mechanical. Academics who advocate or oppose employer liability under Title VII rarely consider the implications of the growing availability of insurance for corporate entities. For example, different standards for employer liability may be more or less likely to compromise the compensation goal of Title VII by shifting the costs of discrimination to insurers.[17] Such analyses are precluded, however, when courts and academics refuse to consider the intersection of the fields of employer liability and insurance. Similarly, insurance law scholarship and legislation has developed, especially in the area of employer liability for hostile environment sexual harassment claims, almost entirely without recognition of the unsettled state of employer liability for such claims.[18] This development frustrates a central function of liability insurance—effective risk management.[19] When courts consider the advisability of the various standards for employer liability, or decide whether to allow coverage on such claims, they should attempt to effectuate the policy goals of Title VII with an understanding of the concurrent development in the law of insurance.

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15. The concept of moral hazard reflects the concern that an individual has a greater tendency to act wrongfully or negligently when he or she is insured against personal loss.

16. *See, e.g.*, Coit Drapery Cleaners, Inc. v. Sequoia Ins. Co., 18 Cal. Rptr. 2d 692, 700 (Ct. App. 1993) (arguing that it would be contrary to public policy to allow an employer to shift the loss resulting from intentional, wrongful conduct to its insurer).

17. For example, if an employer is denied coverage, a successful plaintiff may receive nothing because of the bankruptcy of the employer.

18. *But see* Wayne E. Borgeest et al., *Insurance Coverage for Employment Related Claims: Uncertainty and Transition*, *in* EMPLOYMENT LAW LIABILITY CLAIMS, *supra* note 4, at 7, 10 (stating that the law surrounding employer liability is unpredictable).

19. Because of the fluid state of the law, employers cannot accurately estimate their liability exposure for the harassing acts of their employees. Depending on their actual liability, employers may be either inefficiently overinsuring or underinsuring.

I. CURRENT SUPERVISOR HOSTILE ENVIRONMENT SEXUAL HARASSMENT STANDARDS

A plaintiff suing for sexual harassment under Title VII of the Civil Rights Act of 1964 must prove sexual harassment under one of two theories—"quid pro quo" or "hostile environment."[20] Quid pro quo harassment occurs when a supervisor explicitly conditions job advancement or another benefit on acquiescence to sexual relations.[21] Hostile environment sexual harassment occurs when an employer's conduct "'has the purpose or effect of unreasonably interfering with an individual's work performance or creating an intimidating, hostile, or offensive working environment.'"[22]

Historically, the question of employer liability for the conduct of employees has been cited as the crucial element in creating a workable and effective regime of sexual harassment law.[23] Furthermore, the employer liability issue has become increasingly important because several federal courts have eliminated the possibility of individual liability for supervisors who have sexually harassed their subordinates.[24] Because of this limitation on individual supervisory liability, showing that the employer should be held vicariously liable for its employee's acts may be the only route to recovery for plaintiffs.

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20. *See, e.g.*, Meritor Sav. Bank v. Vinson, 477 U.S. 57 (1986).

21. *See* Sparks v. Pilot Freight Carriers, Inc., 830 F.2d 1554, 1564 (11th Cir. 1987); Henson v. City of Dundee, 682 F.2d 897, 908 (11th Cir. 1982).

22. *Meritor*, 477 U.S. at 65 (quoting 29 C.F.R. § 1604.11(a)(3) (1985)).

23. *See, e.g.*, CATHARINE A. MACKINNON, SEXUAL HARASSMENT OF WORKING WOMEN 94 (1979).

24. *See* Wilson v. Wayne County, 856 F. Supp. 1254, 1262 (M.D. Tenn. 1994) *remanded sub nom.* Wilson v. Nutt, 69 F.3d 538 (6th Cir. 1995) (following the great weight of recent authority in holding that there is no individual liability under Title VII, but recognizing that some courts continue to hold to the contrary). Describing the circuit split over individual liability, the court explained:

> Those cases . . . which deny the existence of individual liability have distinguished between an agent's liability in his "official capacity" as agent of the employer and his liability in his "individual capacity." In so doing, they borrow from the jurisprudence of the Civil Rights Act of 1871, 42 U.S.C. § 1983, which construes "official capacity" suits as proceeding against the government entity which the individual defendant serves, rather than against the individual defendant personally in his "individual capacity." These courts assert that the phrase "and any agent" in Title VII's definition of "employer" means agents in their "official capacities" as representatives of employers.

Id. at 1261–62 (citations omitted).

Most federal courts agree that employers should be held strictly liable for the acts of supervisory employees who engage in quid pro quo harassment of other employees.[25] However, the extent of employer liability for the acts of supervisory employees who create a hostile work environment is not yet decided.[26]

Before the Supreme Court's seminal decision in *Meritor Savings Bank v. Vinson*,[27] courts that considered the question of employer liability for a supervisor's creation of a hostile work environment usually decided the issue in one of two ways. Some courts held that, as in cases of quid pro quo harassment, employers should be held strictly liable for the acts of their supervisory employees that created a hostile work environment.[28] Other courts found that employers should only be held liable for supervisor hostile environment claims if the plaintiff shows that the employer had notice of the harassment and failed to take any action in response.[29] This latter standard has commonly been called a "notice" or "negligence" standard.[30] Some courts advocating the notice standard traced their theory of employer liability for supervisor harassment to

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25. *See, e.g.*, Horn v. Duke Homes, Inc., 755 F.2d 599, 604–06 (7th Cir. 1985); Craig v. Y & Y Snacks, Inc., 721 F.2d 77, 80–81 (3d Cir. 1983); Katz v. Dole, 709 F.2d 251, 255 n.6 (4th Cir. 1983); Henson v. City of Dundee, 682 F.2d 897, 910 (11th Cir. 1982).

26. *See Meritor*, 477 U.S. at 72. Because of the imposition of strict liability on employers whose supervisory employees engage in quid pro quo harassment, much of the current litigation revolves around the issue of how to characterize the harassing employee in question—as a supervisor, as a co-worker, or as an authority indistinguishable from the employer because of the powerful position he holds within the company. *See* Swentek v. USAir, Inc., 830 F.2d 552, 557–58 (4th Cir. 1987) (failing to find a supervisory role where a pilot allegedly harassed a flight attendant); *cf. Katz*, 709 F.2d at 255 ("Except in situations where a proprietor, partner or corporate officer participates personally in the harassing behavior, the plaintiff will have the additional responsibility of demonstrating the propriety of holding the employer liable under some theory of *respondeat superior*."); *Henson*, 682 F.2d at 905 n.9 (assuming that the defendant was the plaintiff's supervisor for purposes of discussion). This Note focuses on classic situations of supervisor sexual harassment, in which the harassing employee clearly is in a position of authority over the plaintiff but is not the only person of authority.

27. 477 U.S. 57 (1986).

28. *See, e.g.*, Vinson v. Taylor, 753 F.2d 141, 149–50 (D.C. Cir. 1985) *aff'd and remanded sub nom.* Meritor Sav. Bank, FSB v. Vinson, 477 U.S. 57 (1986) (holding an employer responsible for the acts of its supervisory employees regardless of whether the employer knew or should have known of the acts' occurrence); *Horn*, 755 F.2d at 605–06.

29. *See* Jones v. Flagship Int'l, 793 F.2d 714, 720 (5th Cir. 1986); *Katz*, 709 F.2d at 255; *Henson*, 682 F.2d at 905.

30. *See* Ronald Turner, *Title VII and Hostile Environment Sexual Harassment: Mislabeling the Standard of Employer Liability*, 71 U. DET. MERCY L. REV. 817 (1994) (discussing a number of cases that either directly or indirectly apply such a standard).

the common law tort doctrine of respondeat superior.[31] Other courts vehemently held that the use of respondeat superior doctrine was not appropriate in the Title VII context because Congress enacted Title VII to remedy only intentional discrimination.[32]

In 1986, the Supreme Court explicitly recognized hostile environment sexual harassment as sex discrimination for the first time in *Meritor Savings Bank v. Vinson*.[33] However, the Court refused to state definitively the applicable standard for employer liability for such claims.[34] The Court held that although a specific decision as to employer liability was premature, both of the standards previously imposed by lower courts, strict liability and the notice standard, were inappropriate.[35] The Court held that lower courts should use common-law agency principles, as articulated in the *Restatement of Agency*, to decide the question of employer liability. The Court reasoned that because Title VII's definition of employer includes any agent of the employer, Congress intended to limit employer liability in some respects but did not intend to exonerate employers completely.[36] However, the Court noted that employers cannot always insulate themselves from liability simply by taking formal steps such as establishing a sexual harassment grievance procedure.[37] Arguably, the Court in *Meritor* was attempting to find a middle ground for employer liability in agency law.[38]

The directive of *Meritor* has been interpreted in various ways by lower courts. Many courts have used the framework outlined by the *Restatement (Second) of Agency* section 219, the approach endorsed in *Meritor*, to determine employer

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31. *See Henson*, 682 F.2d at 905; *see also infra* note 68.

32. *See Vinson*, 753 F.2d at 150–51 ("Title VII is a mandate from Congress to cure a perceived evil—certain types of discrimination in employment—in a prescribed fashion. Rules of tort law, on the other hand, have evolved over centuries to meet diverse societal demands by allocating risks of harm and duties of care."); *see also infra* Part IV (discussing the importance of this distinction).

33. 477 U.S. 57, 73 (1986).

34. *See id.* at 72.

35. *See id.*

36. *See id.* (implying that a test for employer liability based on agency law might provide a middle ground between the strict liability test and the notice standard).

37. *See id.*

38. *See* Staszewski, *supra* note 8, at 1068 ("Justice Rehnquist's opinion, therefore, should be viewed as a compromise between the two polar extremes advocated in the proceedings below.").

liability.[39] The *Restatement*'s framework provides, in theory, several routes by which a plaintiff may prove agency liability:

(1) A master is subject to liability for the torts of his servants committed while acting in the scope of their employment.

(2) A master is not subject to liability for the torts of his servants acting outside the scope of their employment, unless:

  (a) the master intended the conduct or the consequences, or

  (b) the master was negligent or reckless, or

  (c) The conduct violated a non-delegable duty of the master, or

  (d) the servant purported to act or to speak on behalf of the principal and there was reliance upon apparent authority, or he was aided in accomplishing the tort by the existence of the agency relation.[40]

The law in the federal circuit courts has coalesced around several of the theories of agency liability outlined in section 219.[41] The three most common standards derived from section 219 are usually referred to as the "knew-or-should-have-known" standard, the apparent authority standard, and the *respondeat superior* standard.[42]

The most prominent standard now in use is the "knew-or-should-have-known" standard, derived from the agency principle enunciated in section 219(2)(b)—that employers may be held liable if they are negligent or reckless—although it is not always described in those terms.[43] Structurally, this

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39. *See, e.g.*, Hirschfeld v. New Mexico Corrections Dep't, 916 F.2d 572 (10th Cir. 1990). For a cogent criticism of the applicability of agency law to sexual harassment, see Rachel E. Lutner, *Employer Liability for Sexual Harassment: The Morass of Agency Principles and Respondeat Superior*, 1993 U. ILL. L. REV. 589.

40. RESTATEMENT (SECOND) OF AGENCY § 219 (1958).

41. For a concise analysis of the state of the law in the federal circuits, see Justin S. Weddle, *Title VII Sexual Harassment: Recognizing an Employer's Non-Delegable Duty to Prevent a Hostile Workplace*, 95 COLUM. L. REV. 724 (1995).

42. *See id.* at 734–35.

43. *See id.* ("The dominant standard in the lower courts is one of direct liability . . . ."). Some courts ignore agency principles altogether and base liability on misguided applications of respondeat superior. *See Hirschfeld*, 916 F.2d at 577 n.5; *see also infra* note 66.

standard resembles the notice standard mentioned in *Meritor* and is often described in terms of negligence.[44] The First,[45] Second,[46] Third,[47] Fourth,[48] Fifth,[49] Seventh,[50] Eighth,[51] Ninth,[52] Tenth,[53] and Eleventh Circuits have applied this standard to determine employer liability.[54] Courts typically formulate the "knew-or-should-have-known" inquiry as a two part test. The plaintiff must first show that the employer knew or should have known of the harassment and then show that the employer failed to take appropriate remedial action when it became aware of the harassment.[55]

A different theory, derived from *Restatement (Second) of Agency* section 219(2)(d), and typically called the apparent authority theory is also in use. Several federal circuits, holding that the "knew-or-should-have-known" standard is not the only way for a plaintiff to establish employer liability under Title VII, have chosen to employ the apparent authority theory as an alternative. The Second,[56] Third,[57] Tenth,[58] Eleventh,[59]

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44. *See Hirschfeld*, 916 F.2d at 577 n.5.

45. *See* Lipsett v. University of P.R., 864 F.2d 881, 901 (1st Cir. 1988) (applying the Title VII standard in the Title IX context).

46. *See* Kotcher v. Rosa & Sullivan Appliance Ctr., Inc., 957 F.2d 59, 63 (2d Cir. 1992) ("[A] plaintiff must prove that the employer either provided no reasonable avenue for complaint or knew of the harassment but did nothing about it.").

47. *See* Bouton v. BMW of N. Am., Inc., 29 F.3d 103, 107 (3d Cir. 1994) ("[U]nder negligence principles, prompt and effective action by the employer will relieve it of liability."); Andrews v. City of Philadelphia, 895 F.2d 1469, 1486 (3d Cir. 1990).

48. *See* Swentek v. USAir, Inc., 830 F.2d 552, 558 (4th Cir. 1987).

49. *See* Nash v. Electrospace Sys., Inc., 9 F.3d 401, 404 (5th Cir. 1993).

50. *See* Juarez v. Ameritech Mobile Communications, Inc., 957 F.2d 317, 320 (7th Cir. 1992).

51. *See* Burns v. McGregor Elec. Indus., Inc., 955 F.2d 559, 564 (8th Cir. 1992).

52. *See* Ellison v. Brady, 924 F.2d 872, 881 (9th Cir. 1991); EEOC v. Hacienda Hotel, 881 F.2d 1504, 1515–16 (9th Cir. 1989).

53. *See* Hirase-Doi v. U.S. West Comm., 61 F.3d 777, 783 (10th Cir. 1995); Hirschfeld v. New Mexico Corrections Dep't, 916 F.2d 572, 577 (10th Cir. 1990).

54. *See* Steele v. Offshore Shipbuilding, Inc., 867 F.2d 1311, 1316 (11th Cir. 1989).

55. *See Juarez*, 957 F.2d at 320 (citing Brooms v. Regal Tube Co., 881 F.2d 412, 421 (7th Cir. 1989)).

56. *See* Karibian v. Columbia Univ., 14 F.3d 773, 780 (2d Cir. 1994) ("[A]n employer is liable for the discriminatorily abusive work environment created by a supervisor if the supervisor uses his actual or apparent authority to further the harassment, or if he was otherwise aided ... by the existence of the agency relationship.").

57. *See* Bouton v. BMW of N. Am., Inc., 29 F.3d 103, 109 (3d Cir. 1994).

58. *See* Bolden v. PRC Inc., 43 F.3d 545, 551–52 n.1 (10th Cir. 1994); Griffith v. Colorado Div. of Youth Servs., 17 F.3d 1323, 1330 (10th Cir. 1994); *Hirschfeld*, 916 F.2d at 579; Hicks v. Gates Rubber Co., 833 F.2d 1406, 1418 (10th Cir. 1987).

59. *See* Sparks v. Pilot Freight Carriers, Inc., 830 F.2d 1554, 1559 (11th Cir. 1987).

and D.C.[60] Circuits impute liability to the employer if a plaintiff can show that her supervisor acted with actual or apparent authority.[61] The EEOC has also recommended this standard.[62] The content of the apparent authority standard varies somewhat between courts, but most courts require the plaintiff to show that it was reasonable for a third party to believe that the supervisor had authority over the plaintiff.[63] This standard is closer in many respects to the strict liability standard advocated by the Court of Appeals in *Vinson* and the concurrence in *Meritor*.[64]

Finally, the Sixth Circuit applies what it calls a respondeat superior test, analyzing whether the harassment occurred within the scope of the supervisor's employment.[65] This doctrine has been widely criticized as misapplied,[66] and does not materially change the argument of this Note. Courts in most other circuits, finding sexual harassment to be outside the scope of employment, have rejected the application of respondeat superior.[67] The Sixth Circuit standard does provide a good example, however, of the confusion that pervades the employer liability question.

When weighing the merits of these standards, scholars occasionally chart them along a spectrum of relative strength, with the strict liability standard advocated by the District of Columbia Circuit in *Vinson* at one end and the lenient notice

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60. *See* Gary v. Long, 59 F.3d 1391, 1397 (D.C. Cir. 1995) (discussing the apparent authority standard but finding it inapplicable to the facts of the case).

61. The First Circuit may also be developing an apparent authority standard. *See* Johnson v. Plastic Packaging, Inc., 892 F. Supp. 25, 29 (D. Mass. 1995).

62. *See* EEOC Policy Guidance on Sexual Harassment (March 19, 1990) ("[A]bsent . . . strong . . . polic[ies] against sexual harassment . . ., employees [may] believe that a harassing supervisor's actions will be ignored, tolerated or condoned . . . . By implementing . . . an effective policy, an employer can divest the supervisor of apparent authority . . . . Failure to prohibit or prevent a hostile work environment would, therefore, be grounds for . . . liability.").

63. *See, e.g.*, Bouton v. BMW of N. Am., Inc., 29 F.3d 103, 109 (3d Cir. 1994).

64. *See* discussion *supra* accompanying notes 28–38.

65. *See* Fleenor v. Hewitt Soap Co., 81 F.3d 48, 49–50 (6th Cir. 1996) (attempting to clarify this standard); *see also* Kauffman v. Allied Signal, Inc., 59 Fair Empl. Prac. Cas. (BNA) 606, 610 (6th Cir. 1992); Yates v. Avco Corp., 819 F.2d 630, 636 (6th Cir. 1987).

66. *See* BARBARA LINDEMANN & DAVID D. KADUE, SEXUAL HARASSMENT IN EMPLOYMENT LAW 226 (1992) ("Under agency principles, liability is imputed to the employer for the torts of its employees committed while acting in the scope of their employment. This doctrine, sometimes referred to as respondeat superior, is almost never suitable in a sexual harassment case."); *see also* Turner, *supra* note 30.

67. *See, e.g.*, *Bouton*, 29 F.3d at 106–07.

standard used by some pre-*Meritor* courts at the other.[68] The apparent authority standard is placed at the strict liability end of the spectrum, while the "knew-or-should-have-known" test is perceived to be more lenient.[69] Given both the Supreme Court's holding in *Meritor* that neither strict liability nor notice liability is appropriate and its advocacy of an intermediate liability for employers, this analysis of relative strictness is not particularly useful. In order to accomplish Title VII's goals of preventing discrimination and compensating its victims, courts must understand what kinds of behavior the application of each standard will prompt in employers.

Courts applying the "knew-or-should-have-known" standard consistently require employers to have actual knowledge of the harassment and are reluctant to consider the possibility of constructive knowledge.[70] Despite the holding in *Meritor* that the plaintiff's failure to file a complaint should not be dispositive, courts often treat this failure as strong evidence that the employer had neither knowledge of the harassment nor reason to know of its occurrence.[71]

In addition, taking effective remedial action may now be an insulating device for employers. There is a growing consensus among commentators that an employer can avoid liability if it

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68. *See, e.g.*, David L. Gregory, *Sex Discrimination: Continuing Clarifications by the Second Circuit*, 61 BROOK. L. REV. 363, 389–90 (1995).

69. *See id.*

70. *See* Faragher v. City of Boca Raton, 76 F.3d 1155, 1167 (11th Cir. 1996) ("[W]e cannot agree with the district court's apparent belief that simply because conduct is pervasive enough to create an abusive work environment the employer should be charged with knowledge of the conduct."); *see also* Nash v. Electrospace Sys., Inc., 9 F.3d 401, 404 (5th Cir. 1993) ("The summary judgment record does not establish that anyone within the company hierarchy was aware of Nash's complaints against Sharp until she went to the personnel department . . . [or] that Sharp's conduct took place in public . . . . It thus appears that the company did not know nor should it have known of Sharp's offensive inquisitiveness about Nash."); Juarez v. Ameritech Mobile Communications, Inc., 957 F.2d 317, 320 (7th Cir. 1992) ("Even if we assume that the vague, second-hand information possessed by Bettendorf [that employees were bothered by the sexual behavior of a supervisor] constituted 'knowledge' on her part that Shkrutz had engaged in sexual harassment, that knowledge cannot be imputed to AMCI [the employer]."). Other courts have held that a plaintiff can demonstrate that her employer had constructive knowledge of the harassment by showing the pervasiveness of the harassment. *See* Waltman v. International Paper Co., 875 F.2d 468, 478 (5th Cir. 1989); Swentek v. USAir, Inc., 830 F.2d 552, 558 (4th Cir. 1987).

71. *See, e.g.*, *Nash*, 9 F.3d at 404 n.2 ("The availability of a formal grievance procedure at ESI [the employer] should be counted strongly in ESI's favor . . . ."); *see also* Michael J. Phillips, *Employer Sexual Harassment Liability Under Agency Principles: A Second Look at* Meritor Savings Bank, FSB v. Vinson, 44 VAND. L. REV. 1229, 1238 (1991) ("Absent her employer's constructive knowledge, a victim who fails to report harassment to some responsible manager or supervisor will have difficulty recovering under the actual-or-constructive-knowledge standard.").

has a clear policy and takes effective remedial actions once it is notified of harassment.[72] Consequently, in assessing an employer's potential liability, courts concentrate almost exclusively on the employer's conduct *after* the act of harassment.[73] By focusing on the corporate employer's post-harassment conduct, courts consistently fail to consider the actual harm of hostile environment sexual harassment—the creation of an interpersonal sexual dynamic in the workplace that is intimidating or offensive.[74] This focus on the employer's behavior is the result of the negligence-oriented approach of the "knew-or-should-have-known" standard. Because courts are comfortable assessing conduct in terms of duty/no duty and breach/no breach, they are drawn to this negligence-based standard.[75]

The "knew-or-should-have-known" standard focuses almost exclusively on the employer's behavior after it has received formal notice of the harassment. Although this standard may give employers powerful incentives to institute formal policies against sexual harassment and to take swift action once given notice, it does not encourage employers to affirmatively monitor dynamics between employees so as to prevent harassment from happening in the first place.

The apparent authority standard used by some courts, either on its own or in conjunction with the "knew-or-should-have-known" standard, requires a different factual analysis. Like the "knew-or-should-have-known" standard, the apparent authority test consists of a two-part test where the plaintiff must show first that her harassing supervisor acted with actual or apparent authority, and second that her employer failed to take remedial action when it knew of the harassment.[76] When applying this test, some courts focus only on whether the supervisor somehow came into contact with the plaintiff through the hierarchy of the organization or

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72. *See, e.g.*, Davis v. Tri-State Mack Distrib., Inc., 981 F.2d 340, 344 (8th Cir. 1992) ("[I]f Tri-State had had an effective sexual harassment policy in place, the results of this case [finding liability] may have been different.").

73. This inquiry occasionally explicitly takes the form of an analysis of the employer's "duty." *See* Hirase-Doi v. U.S. West Comm., Inc., 61 F.3d 777, 783 (10th Cir. 1995) ("In evaluating claims for negligence, proximate cause and foreseeability are typically employed to determine the scope of an employer's duty.").

74. *See* Meritor Sav. Bank v. Vinson, 477 U.S. 57, 65 (1986).

75. *See Hirase-Doi*, 61 F.3d at 783.

76. *See, e.g.*, Steele v. Offshore Shipbuilding, Inc., 867 F.2d 1311, 1316 (11th Cir. 1989).

whether he had the ability to hire, promote or fire her.[77] Other courts use a standard which measures apparent authority by the reasonableness of that authority to a third person.[78]

Once again, in order to analyze the effectiveness of the apparent authority standard in effectuating Title VII's goals, it is important to consider how the standard focuses a court's inquiry. The apparent authority standard concentrates less on the conduct of the employer after formal notice is given, and more on the nature of the relationship between the harassing supervisor and the plaintiff.[79] Unlike the "knew-or-should-have-known" standard, in which the focus is on post-reporting conduct, the apparent authority standard focuses on pre-reporting conduct—the relationship between the harasser and his victim. Because the apparent authority standard more accurately identifies meritorious claims, including claims where the potential plaintiff's workplace is too hostile or intimidating to permit her to give formal notice of harassment, it more effectively meets the goals of Title VII than the "knew-or-should-have-known" standard.

II. LIABILITY INSURANCE COVERAGE FOR EMPLOYER DEFENDANTS

Predictably, employers faced with the possibility of large damage awards and the considerable defense costs associated with sexual harassment suits are likely to have sought coverage under a range of insurance policies—from home-owners' policies to directors and officers (D&O) policies. Also predictably, insurers have asserted vigorous defenses to these coverage claims.[80] This Part focuses only on the coverage afforded by standard Commercial General Liability (CGL) policies and new Employment Practices Liability Insurance

77. *See, e.g.*, Watts v. New York City Police Dep't, 724 F. Supp. 99, 106 n.6 (S.D.N.Y. 1989).

78. *See* Bouton v. BMW of N. Am., Inc., 29 F.3d 103, 109 (3d Cir. 1994) (noting that reasonable belief in an agent's apparent authority is required before principal will be bound).

79. *See id.* at 110 (stating that courts implicitly acknowledge that "the choice whether to permit a grievance procedure to alleviate liability under § 219(2)(d) is a policy decision based on the appropriate amount of deterrence" and that "if employers are liable whenever supervisors harass their subordinates, they have an economic incentive . . . to recruit, train, and supervise their managers to prevent hostile environments").

80. *See* Scheuermann, *supra* note 9, at 784–85.

(EPLI) policies.[81] CGL and EPLI policies are most likely to provide coverage for employer liability in supervisor hostile environment sexual harassment claims, although the issues raised in the consideration of CGL and EPLI policies may be relevant to an analysis of coverage under other policies.

As a general rule, the employer should first consider coverage under any applicable EPLI policy. Insurers are less likely to contest claims made under EPLI policies because these policies are specifically tailored to cover employment practices liability such as wrongful termination and discrimination (including sexual harassment).[82]

The contentious issues that arise in coverage litigation are best described in terms of the defenses an insurer will raise to an employer's claim for coverage stemming from a supervisor hostile environment claim. CGL policies typically provide that the insurer will pay, within applicable limits, those damages for which the insured (the employer/defendant in the underlying sexual harassment suit) becomes legally obligated to pay because of "personal injury, property damage or advertising offense . . . caused by an occurrence" provided that none of the policy exclusions apply.[83]

For the most part, the insurer will not be able to deny coverage based on a lack of bodily injury or property damage because the plaintiff in the underlying action will have

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81. Much of this discussion of CGL and EPLI policies is also relevant to an analysis of other liability insurance products. In fact, many EPLI policies appear as endorsements to D&O policies. For a description of those endorsements, see Machson & Monteleone, *supra* note 7, at 711–12.

82. In addition, EPLI policies are "claims-made" policies; that is, they cover all claims made against an insured during the policy coverage period. *See* Machson & Monteleone, *supra* note 7, at 712. In contrast, CGL policies are "occurrence-based" policies which cover only claims stemming from incidents that occurred during the coverage period. *See id.* at 697–98. Most CGL policies written now contain a specific "employment practices" exclusion that explicitly eliminates coverage for employer liability resulting from sexual harassment. *See id.* at 707; *see also* Western Heritage Ins. Co. v. Magic Years Learning Ctrs. & Child Care, Inc., 45 F.3d 85, 89 (5th Cir. 1995) (denying coverage because of applicable employment practices exclusion). However, older CGL policies, without the employment practices exclusion, may still provide coverage for conduct that occurred within the policy period. This Note considers only policies potentially covering defense costs and indemnifying the employer for compensatory and other non-punitive damages. It does not consider indemnification for punitive damages, which most jurisdictions reject as against public policy. *See* Magnum Foods, Inc. v. Continental Cas. Co., 36 F.3d 1491, 1506 (10th Cir. 1994); Home Ins. Co. v. American Home Prod., 873 F.2d 520 (2d Cir. 1990). *But see* Grant v. North River Ins. Co., 453 F. Supp. 1361, 1370 (N.D. Ind. 1978).

83. Irene A. Sullivan & Adam C. Rosenberg, *Insurance Coverage for Wrongful Termination and Employment Discrimination Claims*, *in* EMPLOYMENT LAW LIABILITY CLAIMS, *supra* note 4 at 191, 195–96.

constructed her pleadings to invoke insurance coverage by claiming those types of injuries.[84] For example, most federal courts have agreed that the bodily injury provision of CGL policies does not provide coverage for purely emotional harms.[85] Therefore, a plaintiff in a sexual harassment action will likely plead that she suffered physical injury in addition to emotional injury in order to trigger coverage under the CGL policy of her employer. By alleging even slight physical manifestations of an emotional injury, such as headaches or insomnia, a plaintiff will trigger coverage under CGL policies in most jurisdictions.[86]

An insurer seeking to avoid coverage may be more successful, however, in arguing that the underlying acts of harassment do not constitute an occurrence under the CGL policy. An "occurrence" is defined by most CGL policies as conduct not expected or intended by the insured.[87] Therefore, accidental or negligent conduct is covered by typical CGL policies while intentional conduct is not.[88] In the context of a coverage dispute over an underlying sexual harassment claim, this negligent/intentional distinction becomes crucial to several aspects of the coverage inquiry.

As an initial matter, the insurer will argue that sexual harassment is intentional conduct, and not an occurrence, so that the policy language on its face prohibits coverage. The insured/employer may respond with two arguments, attempting to cast the employer's conduct as non-intentional in order to trigger coverage.

First, the insured/employer may invoke the "act/injury" exception, arguing that while the harassing conduct itself may

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84. *See* Wayne N. Outten, *Evaluating Plaintiff's Case and Settlement Opportunities: Plaintiff's Perspective*, *in* EMPLOYMENT LAW LIABILITY CLAIMS, *supra* note 4, at 30–31 ("The way you draft the complaint may determine whether your claims are covered by the defendant's insurance.") The typical litigation will involve a "triangular relationship," which may produce incentives for collusion between any two of the parties. This triangular relationship may play out in sexual harassment suits in several forms, the most obvious of which is the collusion between the plaintiff and the defendant in the underlying sexual harassment suit to invoke insurance coverage through pleadings. This procedural incentive alone may account for the growing number of coverage disputes.

85. *See* Jefferson-Pilot Fire & Cas. Co. v. Sunbelt Beer Distribs., Inc., 839 F. Supp. 376, 379 (D.S.C. 1993); Kline v. Kemper Group, 826 F. Supp. 123, 129 (M.D. Pa. 1993). *But see* NPS Corp. v. Insurance Co. of N. Am., 517 A.2d 1211, 1212 (N.J. Super. Ct. App. Div. 1986) (recognizing that "bodily injury" can include purely emotional harm).

86. Michael J. Brady et al., *Insurance Coverage Issues Arising from Workplace Tort Claims*, 62 DEF. COUNS. J. 354, 356 (1995).

87. *See, e.g.*, Machson & Monteleone, *supra* note 7, at 699.

88. *See* Brady et al., *supra* note 86, at 357.

have been intentional, the injurious consequence of that conduct was not.[89] While this exception has been used by courts to allow coverage in the past, its use in the sexual harassment context has been limited.[90] Courts considering coverage for underlying acts of sexual harassment usually have held that the intent to cause injury may be inferred from the intent to act[91] or have ignored the "act/injury" exception altogether.[92]

Second, the insured/employer may argue that while the supervisor's conduct was intentional, the corporate entity's conduct was not intentional and therefore coverage should be allowed for the employer.[93] This latter argument has been persuasive. Several courts have required insurers to defend against and indemnify negligence claims, such as negligent supervision or investigation, even when coverage is barred for the intentional acts of the individual harasser.[94]

In addition to arguing that coverage should be denied because of the occurrence requirement, the insurer will argue that coverage should be barred for underlying acts of sexual harassment because of the strong statutory and judicial policy against insurance coverage for intentional discrimination.[95] In

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89. *See* Mutual Serv. Cas. Ins. Co. v. Co-op Supply, Inc., 699 F. Supp. 1438, 1441 (D. Mont. 1988) ("[U]nintended bodily injury falls within the purview of the definition [of occurrence] regardless of the fact that the operative conduct, *i.e.*, [the insured's] actions in terminating [the employee,] was intentional.").

90. *See* Sullivan & Rosenberg, *supra* note 83, at 220–21.

91. *See, e.g.*, Greenman v. Michigan Mut. Ins. Co., 433 N.W.2d 346, 349 (Mich. Ct. App. 1988) (holding that the "demotion and discharge were intentional acts, and the natural, foreseeable and 'expected' result of those acts was injury to the complainant").

92. *See, e.g.*, Presidential Hotel v. Canal Ins. Co., 373 S.E.2d 671, 673 (Ga. Ct. App. 1988) (ignoring the act/injury distinction).

93. For a discussion of who must expect or intend the resulting injury in order to trigger coverage, see Scheuermann, *supra* note 9, at 788 ("Coverage should be barred by the expected or intended proviso only if the insurer can prove that the policyholder's responsible effective management expected or intended the injuries of which the plaintiff is complaining.").

94. *See* Seminole Point Hosp. Corp. v. Aetna Cas. & Sur. Co., 675 F. Supp. 44, 47 (D.N.H. 1987); *see also* Dart Indus., Inc. v. Liberty Mut. Ins. Co., 484 F.2d 1295, 1297 (9th Cir. 1973) (holding that an insurance policy may indemnify the insured for an intentional act when the insured's liability is vicarious but not when the insured is personally at fault). This formulation has been termed the "innocent co-insured theory," *see* Glad & Rupp, *supra* note 4, at 127–28, and the "'imputed liability' exception to the public policy exclusion." *See* Sean W. Gallagher, Note, *The Public Policy Exclusion and Insurance for Intentional Employment Discrimination*, 92 MICH. L. REV. 1256, 1276 n.93 (1994).

95. *Cf.* Coit Drapery Cleaners, Inc. v. Sequoia Ins. Co., 18 Cal. Rptr. 2d 692 (Ct. App. 1993) (holding that sexual harassment is intentional conduct and an insurer has no duty to defend a policyholder from such a suit).

New York, this policy was originally expressed in a 1963 opinion of the New York Superintendent of Insurance, which stated that insurance coverage for discrimination-based liability "may not lawfully be written under the New York Insurance Law."[96] In California, this policy is evidenced in section 533 of the Insurance Code, which states that an "insurer is not liable for a loss caused by the wilful act of the insured . . . ."[97]

The public policy against insuring for intentional torts is generally grounded in a fear of moral hazard, the danger that insurance may encourage wrongful or negligent behavior. For example, one Arizona state court has noted:

> [W]e conclude that there is no coverage for an insured's intentional acts, wrongful under the law of torts, because contractual intent and public policy coincide to prevent an insured from acting wrongfully knowing his insurance company will pay the damages.[98]

Therefore, both state and federal courts, as well as state legislatures, have invoked the public policy against insuring for intentional conduct. In fact, some courts have explicitly invoked the public policy discussed above with respect to insurance coverage for sexual harassment claims.[99] For example, California courts have interpreted section 533 of the Insurance Code as prohibiting the indemnification of an insured employer against claims of quid pro quo sexual harassment.[100] In *Coit*, which involved quid pro quo harassment by the company president,[101] the California Court of Appeals held that section 533 mandated a reading of the intentional acts exclusion of the employer's CGL policy to bar

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96. Opinion of the New York Superintendent of Insurance (September 26, 1963) (on file with the *University of Michigan Journal of Law Reform*).

97. CAL. INS. CODE § 533 (West 1993).

98. Continental Ins. Co. v. McDaniel, 772 P.2d 6, 9 (Ariz. Ct. App. 1988).

99. *See Coit*, 18 Cal. Rptr. 2d at 700.

100. *See id.*

101. *See id.* at 695–96. The *Coit* court's finding of no coverage is not dispositive of the coverage issue in all future sexual harassment claims in that jurisdiction. Because the underlying defendant in *Coit* was the president of the company, his actions were automatically imputed to the corporate entity because there was no meaningful distinction between the two. *See* Monteleone, *supra* note 13, at 189 n.8.

coverage for the sexual harassment claims of an employee.[102] The *Coit* court held:

> Quite apart from the plain meaning of section 533, and its obvious application to claims of intentional wrongdoing such as those in issue here, the purpose and public policy represented by the section, and the public and statutory policy of this state against sexual harassment of employees, would not be well served by a ruling which would exonerate a perpetrator from payment of damages for his own willful act of sexual gratification, by shifting such liability to an insurer.[103]

The court seems to have recognized that cost shifting in the sexual harassment context is inappropriate both for symbolic reasons and because of potential moral hazard. In addition, other jurisdictions have held sexual harassment to be so inherently harmful that it must be presumed intentional as a matter of law without any consideration of the subjective intent of either the harasser or the employer.[104]

Some courts, however, may require insurers to provide coverage for claims of negligent harassing behavior, on the grounds that such coverage is consistent with the public policy forbidding insurance for intentional conduct.[105] For example, in *Seminole Point Hospital Corp. v. Aetna Casualty & Surety Co.*, the court found that, although the insurer was not obligated to indemnify the insured for claims of intentional harassment, it was obligated to cover claims of negligent supervision.[106] This court's inquiry focused on whether the conduct was intentional, as demonstrated in the record or the pleadings. A plaintiff, therefore, may be able to invoke insurance coverage by alleging negligence on the part of the employer.[107] Notably,

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102. *See id.* at 697. The intentional acts exclusion is substantively the same as the limitation of covered "occurrences" to accidental events. *See* Machson & Monteleone, *supra* note 7, at 699.

103. *Coit*, 18 Cal. Rptr. 2d at 698.

104. *See* Continental Ins. Co. v. McDaniel, 772 P.2d 6, 8 (Ariz. Ct. App. 1988); State Farm Fire & Cas. Co. v. Compupay, Inc., 654 So. 2d 944, 947 (Fla. Dist. Ct. App. 1995).

105 *See* Seminole Point Hosp. Corp. v. Aetna Cas. & Sur. Co., 675 F. Supp. 44, 47 (D.N.H. 1987).

106. *See id.*

107. *See* Outten, *supra* note 84, at 30–31 ("The way you draft the complaint may determine whether your claims are covered by the defendant's insurance. For example, general commercial liability insurance generally will cover negligent, but not intentional, acts . . . .").

some courts refuse to allow the parties to recast intentional conduct as negligence in order to trigger coverage.[108]

There is also evidence that the original public policy disfavoring insuring against intentional conduct is eroding. In 1994, the New York Insurance Department issued a circular letter stating that it had changed its policy:

> [T]he Department has concluded that liability coverage for acts of discrimination, when based solely on either disparate impact (as opposed to disparate treatment) or vicarious liability, would not be against public policy and therefore should be permitted.[109]

In its letter, the Insurance Department stated that the reason for its change in position was the growing recognition that allowing insurance for disparate impact cases and vicarious employer liability cases might not produce the moral hazard concerns that had been associated with allowing insurance in the past.[110] The Circular Letter further stated:

> [T]he strong public policy against discrimination of any kind is, in fact, furthered by permitting coverage of the kinds described. By bringing to employers' attention practices that can potentially result in unlawful discrimination, insurer's loss prevention programs and underwriting standards should discourage such practices.[111]

In summary, the employer/insured may argue under several theories that coverage should be allowed for supervisor hostile environment sexual harassment claims. First, it may argue that the behavior of the employer corporation constituted negligent rather than intentional conduct, notwithstanding any finding that the individual harasser's conduct was intentional.[112] Second, the employer may argue that, even if its conduct is found to be intentional, the erosion of the policy against allowing insurance for intentional conduct stems from

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108. *See Coit*, 18 Cal. Rptr. 2d at 697 ("California law and applicable precedents do not allow the recharacterization of such clearly intentional and willful sexual misconduct as merely negligent or non-willful, so as to trigger insurance coverage.").

109. New York Ins. Dep't Circular Letter No. 6, May 31, 1994 [hereinafter Circular Letter] (on file with the *University of Michigan Journal of Law Reform*).

110. *See id.*

111. *See id.*

112. *See supra* notes 92–93 and accompanying text.

a recognition that insurance companies are increasingly willing to police against moral hazard, and allowing them to do so will preserve the deterrent function of Title VII.[113]

In any hostile environment sexual harassment case, an inquiry into the employer's negligence or intentional behavior will be central to the coverage litigation. Employers may be able to invoke coverage by classifying their conduct as negligent or, if their conduct is deemed intentional, by arguing that insurance companies will police their conduct sufficiently.

III. THE CONVERGENCE ON THE NEGLIGENCE STANDARD

As outlined in Part II, recent decisions and policy changes in the area of employment practices insurance indicate that, in the future, employers may be allowed expanded liability coverage for the harassing acts of supervisory employees. Furthermore, it seems that at least part of the coverage inquiry will focus on whether the employer's conduct was negligent. This evolution in the law of insurance is especially relevant because of the recent debate (discussed in Part I) over the substantive standards of employer liability for supervisor sexual harassment.

As noted in Part I, the most prominent standard in use today for deciding employer liability is the "knew-or-should-have-known" standard commonly drawn from section 219(2)(b) of the *Restatement of Agency*.[114] This Part argues that, as courts considering the substantive law of sexual harassment move toward a negligence-based standard (i.e., "knew-or-should-have-known") for employer liability, courts resolving the subsequent coverage disputes will use the record in the underlying case to find the employer's conduct negligent, thereby allowing coverage under the employer's CGL policies.

The tendency for courts to allow expanded coverage for employers because of the convergence in standards may not be stated explicitly by the courts. Instead, the trend may simply be a function of similarity between the coverage court's analysis and that of the court in the underlying sexual harassment suit. For example, in *Seminole Point Hospital*, the coverage

113. *See supra* notes 109–10 and accompanying text.

114. *See* RESTATEMENT (SECOND) OF AGENCY § 219(2)(b) (1958) (holding the employer liable if it was "negligent or reckless").

court determined, under principles of agency law, that coverage was available to the employer even though the supervisor's conduct was not within the scope of his employment.[115] It is likely that, as the substantive law of employer liability for supervisor sexual harassment develops around negligence principles (as found in the law of agency), other courts will be similarly drawn to negligence principles when determining insurance coverage. This convergence may appear either in the context of the "occurrence" inquiry or in the context of the consideration of the public policy exclusion for intentional acts.[116] This practice may also be prompted by the gradual erosion of the public policy against insuring for intentional discrimination.[117]

Additionally, the substantive findings in a sexual harassment case may actually *control* the outcome in the subsequent coverage litigation.[118] At least one commentator has noted that the inquiry into the insurability of conduct under CGL policies may in fact be determined by the findings of fact regarding intent in the underlying action.[119] According to one commentator:

> Even when a court does not adopt this presumption [that certain types of acts are so inherently dangerous that intent must be inferred as a matter of law], coverage for employment-related liabilities may be barred by a record in the underlying case that establishes that the injuries were intentionally caused, or by a finding by the insurance coverage court that the insured intended the resulting injuries.[120]

Therefore, if the liability court finds the employer liable under a negligence-based theory, a coverage court would be prevented from finding the act intentional.

Scheuermann also argues that the construction of the underlying statute may control the allocation of the amount of settlement if the case settles.[121] Therefore, as it becomes easier for employers to escape substantive liability through the use of

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115. *See* Seminole Point Hosp. v. Aetna Cas. & Sur. Co., 675 F. Supp. 44, 47 (D.N.H. 1987).

116. *See supra* notes 89–111 and accompanying text.

117. *See* Circular Letter, *supra* note 109 (allowing coverage when liability is vicarious, regardless of intent).

118. *See id.*

119. *See* Scheuermann, *supra* note 9, at 787.

120. *Id.*

121. *See id.* at 798.

the lenient "knew-or-should-have-known" standard, it simultaneously becomes easier for employers to shift any liability they do incur to their insurer. Such a shift may even be mandated in situations where the employer is found negligent.[122]

IV. NORMATIVE SUGGESTIONS

Given the erosion of both the common law and statutory policies against allowing liability insurance for intentional acts, as well as the development of policies which specifically insure for intentional acts, many employers will succeed in obtaining insurance coverage for harassment claims. Because of this, the cost of harassment will shift to insurance companies when employers are held liable for the acts of supervisory employees who create hostile work environments. This Part argues that, instead of analyzing the public policy behind employer liability under the false assumption that the employer will actually pay for the defense of the claim and any award, courts deciding questions of employer liability for supervisor hostile environment sexual harassment claims should recognize that employers will shift the cost of those suits to insurers. Part IV critiques the negligence-based standard that is beginning to control both the underlying employer liability inquiry and the subsequent coverage inquiry. It then considers the alternative, non-negligence-based standards for employer liability for supervisor hostile environment sexual harassment suits outlined in Part I.

As mentioned above, the negligence-based "knew-or-should-have-known" standard for employer liability directs a court's fact-finding toward the behavior of the employer only after it is formally notified of the harassment.[123] This standard limits the employer's responsibility to the plaintiff before the

122. This convergence of substantive sexual harassment law and insurance law around the negligent/non-negligent distinction may severely disadvantage the plaintiff. Applicable workers compensation laws may bar a plaintiff from suing her employer on negligence grounds. If a plaintiff can only be sure to invoke insurance coverage by pleading a negligence claim, then she is effectively denied the possibility of reaching the deep pockets of the insurance company. A plaintiff who, because of the workers compensation bar, fails to bring a negligence claim may be ensuring that coverage will be denied. *See* Shaver v. Laborie Food Mart, Inc., 72 Fair Empl. Prac. Cas. (BNA) 330 (E.D. La. 1996); Coit Drapery Cleaners, Inc. v. Sequoia Ins. Co., 18 Cal. Rptr. 2d 692, 699 (Ct. App. 1993).

123. *See supra* notes 70–75 and accompanying text.

harassment. As long as the employer provides individual victims with a means to make a formal complaint and takes appropriate action once they do, the employer has not acted negligently and will not be subject to liability.[124] Consequently, an employer may not be negligent when the acts of its supervisory employees create a hostile environment so intimidating that a potential plaintiff is deterred from filing a complaint.[125]

The "knew-or-should-have-known" standard defines employer conduct as negligent only when the employer does not establish a means for giving notice of the harassment or does not act appropriately once such notice is given. Under the developing practice of allowing employers to shift costs of negligent conduct, employers who do not have complaint procedures, and those who do not take appropriate remedial action, may not have to pay for their negligence because of coverage under their CGL or EPLI policies. This shift in cost will likely exacerbate the problem mentioned above—the injured plaintiff subjected to a hostile environment will be left without a claim against her employer.[126] Furthermore, insurance companies will only police the behavior of employers to the extent that those employers are likely to be held liable in the underlying suit.[127]

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124. This standard may not run directly afoul of the Supreme Court's holding in *Meritor* that an employer may not escape liability simply by having a formal grievance procedure. *See* Meritor Sav. Bank v. Vinson, 477 U.S. 57, 72 (1986). The "knew-or-should-have-known" standard imposes the additional requirement of appropriate remedial action. *See supra* note 72 and accompanying text.

125. Clearly, this critique would not be valid if courts read the "should have known" clause in the standard broadly. However, as established above, courts rarely hold employers liable under the "should have known" provision when an employer has established a grievance procedure. *See supra* note 70. Although plaintiffs litigating under this standard may argue that the complaint procedure was ineffective, courts have been reluctant to consider this argument. *See supra* note 71.

126. Because evidence sufficient to prove hostile environment sexual harassment does not necessarily suffice to establish employer knowledge of such harassment, a plaintiff who is too intimidated to pursue a valid claim against an offending supervisor may lose her claim against the employer due to the stricter negligence standard applied in the employer liability context. *See* Faragher v. City of Boca Raton, 76 F.3d 1155 (11th Cir. 1996). Furthermore, this plaintiff may also be unable to recover from the individual harasser. *See supra* note 24.

127. Although it is a valid argument that defense costs alone may suffice to preserve the policing function of insurers in this context, the growing popularity of the negligence standard may make it easier for employers to win summary judgment motions based on their "non-negligence." Therefore, defense costs may decrease as the standard solidifies, thus lessening insurers' incentives to police lax employer practices.

Given the weak substantive standard, there is an additional problem with allowing cost shifting in the sexual harassment employer liability context. As a regime develops in which employers are allowed to recover under common CGL policies, the cost of sexual harassment may be shifted to the pool of corporations with CGL policies, many of whom actively strive for work environments free of sexual harassment for purely ethical reasons. The cost of sexual harassment suits would thus be distributed among all of the companies who purchase CGL policies for other reasons, from slip-and-fall to products liability. Those companies who allow hostile environments to develop become free-riders.[128]

The concept of cost spreading does provide a valuable tool with which to further critique the negligence-based "knew-or-should-have-known" standard. As mentioned above, the use of this standard results in underprevention of sexual harassment; it does not adequately deter conduct which creates hostile environments.[129] The fact that the employer liability standard does not provide for adequate remedies however, does not mean that those suits will not be brought. Therefore, litigation under this inadequate standard is socially financed. All corporations who maintain CGL policies, and consumers who buy products or services from them, indirectly bear the cost of employers' defense of sexual harassment suits in which sexual harassment may be proven, but for which employers will not be held liable.

There is a final, powerful argument for rejecting the negligence-based "knew-or-should-have-known" standard. As stated strongly by one circuit court:

> Traditional principles of respondeat superior, as they obtain in the field of torts, are not altogether suitable for resolution of questions of Title VII law. The explanation is manifest: Title VII is a mandate from Congress to cure a perceived evil—certain types of discrimination in employment—in a prescribed fashion. Rules of tort law, on the other hand, have evolved over centuries to meet

128. Incidentally, this problem does not occur when insurance for sexual harassment employer liability is allowed in the form of EPLI policies, where the insurance pool is limited to those companies who face such a large exposure that they are willing to pay extremely high premiums for coverage. Notably, however, allowing EPLI coverage for employer liability only addresses the problem of excessive risk spreading; it does not correct the central problem of underprevention identified above.

129. *See supra* Part I.

> diverse societal demands by allocating risks of harm and duties of care. Without clear congressional instruction, we think it unsafe in developing Title VII jurisprudence to rely uncritically on dogma thus begotten.[130]

The *Vinson* court suggested, therefore, that the general policy of risk allocation and management that forms the basis of negligence law is not an appropriate concern when defining standards of employer liability in harassment cases.[131]

The *Vinson* court instead advocated a theory of strict liability for supervisor sexual harassment.[132] The court in *Vinson* also seemed to anticipate the ultimate holding in *Meritor*—that lower courts should apply agency principles to provide a middle position between strict liability and the notice standard.[133] The *Vinson* court noted that some lower courts were using an expanded notion of respondeat superior to broaden the scope of employer liability (much as the use of agency law has expanded employer liability), but stated that "there simply is no need to so confine either the analysis or the solution where Title VII applies."[134] This advocacy of a strict liability standard has power in the context of this analysis, especially in light of the increased shifting of the costs of harassment documented above. It may be that the negligence-based, "tortified" regime that has developed both in the substantive standards and in subsequent coverage litigation cannot adequately address the concerns of Title VII.[135]

Given this critique of the negligence-based "knew-or-should-have known" standard and *Meritor*'s explicit rejection of strict liability, the apparent authority standard emerges as the true middle ground in the employer liability debate. This standard will encourage employers to identify harassing dynamics between their employees but will exonerate them from liability if they do so and take remedial action. The apparent authority standard also avoids the convergence in substantive and coverage standards that exacerbates the problems with the "knew-or-should-have-known" standard. The explicit differences

130. Vinson v. Taylor, 753 F.2d 141, 150–51 (D.C. Cir. 1985) (footnotes omitted).

131. *See id.*

132. *See id.* at 150.

133. *See id.*

134. *Id.* at 151.

135. *See* MACKINNON, *supra* note 23, at 172 ("Tort law compensates individuals for injuries while spreading their costs and perhaps setting examples for foresightful perpetrators; the purpose of discrimination law is to change the society so that this kind of injury need not and does not recur.").

between the substantive and coverage standards will diminish cost-shifting because coverage courts will be unable to rely directly upon the findings of the court in the underlying sexual harassment suit. Furthermore, policing by insurers will increase the power of the apparent authority standard to focus on pre-harassment workplace dynamics. Because insurance companies will have to be concerned with more than merely making sure employers act non-negligently, they may be forced to act affirmatively to *prevent* harassment, better effectuating the goals of Title VII.

CONCLUSION

The current lack of a settled standard in either the substantive or coverage contexts of sexual harassment litigation is extremely costly. The uncertainty resulting from insurance coverage for employer liability for supervisor hostile environment sexual harassment claims has produced a coverage litigation explosion which mirrors the growing number of underlying sexual harassment claims. This social cost presents a very real and underutilized argument for immediate clarification of the substantive employer liability standard in sexual harassment law.

However, the current discussion of the standards for employer liability for supervisor hostile environment sexual harassment and the standards controlling coverage disputes concerning that liability has been too narrow to produce an intelligent system of employer liability. In order to develop an effective preventive and compensatory mechanism for supervisor hostile environment sexual harassment, courts must consider the probable shift of the cost of sexual harassment suits from corporations to insurers. Conversely, in order to effectively prevent moral hazard in the shift of liability from employers to insurers, courts must consider the conduct that substantive standards will encourage or discourage. Such consideration begins with the recognition that an employer liability regime based on negligence does not adequately address the problem of sexual harassment, either by compensating the victims of such harassment or by preventing its occurrence.