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James E. Scheuermann

John K. Baillie

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# EMPLOYER'S LIABILITY AND ERRORS AND OMISSIONS INSURANCE COVERAGE FOR EMPLOYMENT-RELATED CLAIMS

JAMES E. SCHEUERMANN  
JOHN K. BAILLIE\*

## INTRODUCTION

Today the specter of employment-related claims<sup>1</sup> haunts corporate board rooms throughout the country. The pervasiveness of such claims, and the large awards that have been made to claimants,<sup>2</sup> have led employers of all types to seek insurance coverage for employment-related claims under many different types of liability policies. Corporate policyholders often mistakenly assume that they must bear the full costs of the defense and liabilities of an employment-related suit. In fact, when applying policy language and well-established rules of insurance law, many courts have found insurance coverage for defense costs or liabilities associated with em-

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\* James E. Scheuermann and John K. Baillie are attorneys at the law firm of Kirkpatrick & Lockhart, LLP, in Pittsburgh, Pennsylvania, where they counsel and litigate on behalf of policyholders concerning insurance coverage matters. This Article reflects the views of the authors as to the identification of important issues in third-party liability coverage for employment-related claims but does not necessarily reflect their views as to the resolution of these issues. Moreover, this Article does not necessarily reflect the views of any client of Kirkpatrick & Lockhart, LLP, or the firm itself.

Portions of this chapter previously appeared in James E. Scheuermann, *Insurance Coverage for Employment-Related Claims*, 28 TORT & INS. L. J. 778 (1993), and in James E. Scheuermann & John K. Baillie, *Liability Insurance for Employment-Related Claims*, in 11B THE LAW OF LIABILITY INSURANCE (Rowland H. Long ed. Matthew Bender 1995). Both of these articles comprehensively discuss liability insurance coverage for employment-related claims. The portions that appeared in THE LAW OF LIABILITY INSURANCE are reprinted with the permission of Matthew Bender & Co., Inc. © 1995. All rights reserved.

1. As used in this Article, "employment-related" generically refers to liabilities, acts, or claims arising in connection with employment discrimination, wrongful termination, constructive discharge, sexual harassment, and similar conduct. It does not refer to liabilities and claims for work-related injuries that may be covered under workers' compensation statutes.

2. See, e.g., *Shoney's Inc.: Judge Approves Settlement of Racial Bias Lawsuit*, WALL ST. J., January 26, 1993, at B4 (reporting that a U.S. district court judge approved a \$105 million settlement in a racial discrimination suit against Shoney's, Inc.).

ployment-related claims under liability insurance policies, including commercial general liability ("CGL") insurance policies,<sup>3</sup> employers' liability ("EL policies" or "EL coverages"), as well as errors and omissions ("E&O") insurance policies.

This Article examines the key issues that arise under EL and E&O insurance coverages in the specific context of employment-related claims. The following section focuses on the five principal issues that arise under a typical grant of EL insurance coverage and examines two exclusions that are often included in EL policies and which are of special importance in the employment-related claims context. Section III examines three key issues that arise under E&O policies in the context of employment-related claims.

### I. COVERAGE FOR EMPLOYMENT-RELATED CLAIMS UNDER EMPLOYERS' LIABILITY POLICIES

EL coverages are intended to complement both Workers' Compensation ("WC") coverages<sup>4</sup> and general liability insurance coverages. A classic description of the interlocking and complementary nature of these coverages is found in *Federal Rice Drug Co. v. Queen Insurance Co.*:<sup>5</sup>

The insuring agreements of the Workmen's Compensation and Employer's Liability Policy are designated to meet the situation created by the commonly enacted workmen's compensation statutes. Under most of these statutes an employee has a theoretical election either to be covered by the statute, thereby obtaining the benefit of its absolute liability but accepting its limitations on payment, or to reject coverage and rely on the employer's com-

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3. For an examination and analysis of issues arising in this context under a variety of liability insurance policies, see James E. Scheuermann & John K. Baillie, *Liability Insurance for Employment-Related Claims*, in *THE LAW OF LIABILITY INSURANCE* (Rowland H. Long ed., Matthew Bender 1995).

4. Workers' compensation schemes generally provide cash benefits to eligible employees that are injured accidentally on the job and are unable to work as a result, and to recompense them for their lost wages and medical benefits. Typically, the remedy provided by the applicable workers' compensation scheme is the only remedy that an employee may seek against his employer for injuries that are covered under that scheme. In many states, employers are required or permitted to fund potential workers' compensation liabilities by purchasing Workers' Compensation/Employers' Liability ("WC/EL") insurance policies. 7B J. APPLEMAN, *INSURANCE LAW AND PRACTICE* § 4571 at 4-5 (West 1979 & Supp. 1994). Employees' claims of negligent and intentional infliction of emotional distress are preempted by the workers' compensation system in some states. *E.g.*, *La Jolla Beach & Tennis Club, Inc. v. Industrial Indem. Co.*, 36 Cal. Rptr. 2d 100, 884 P.2d 1048 (1995).

5. 463 F.2d 626 (3d Cir. 1972) (applying Pennsylvania law).

mon law liability. Coverage A of the standard Workmen's Compensation and Employer's Liability Policy insures against liability to those employees who elect for Workmen's Compensation Act coverage . . . Coverage B of the Workmen's Compensation and Employer's Liability Policy insures against liability to employees who would be covered by the Workmen's Compensation Act except for the fact that they elected against coverage. That this is the case is clear from the use of the language "arising out of and in the course of his employment." These words . . . are those used in the workmen's compensation statutes of a majority of the states. The same language is used in exclusion (g) of the insurer's Comprehensive Business Policy, and undoubtedly is intended to have the same meaning. We read exclusion (f) to exclude liability to covered employees electing for workmen's compensation and exclusion (g) to exclude liability to covered employees electing against workmen's compensation and we read the exclusions, therefore as coextensive. Together they are intended to exclude only such claims as would fall within the coverage of a standard Workmen's Compensation and Employer's Liability Policy.<sup>6</sup>

In *Federal Rice*, the estate of a former employee of the insured who, "committed suicide in the insured's place of business by hanging himself" two weeks after his dismissal, sued the employer for wrongful death, alleging that the insured's president had, over the course of three years, harassed and humiliated the deceased employee to such an extent that his emotional distress deprived him of the capacity to govern his own conduct and resist an insane suicidal impulse.<sup>7</sup> The employer sought coverage under its comprehensive business insurance policy, but its insurer denied coverage based on the policy's employers liability exclusion and workers compensation exclusion.<sup>8</sup> The court described the complementary and interlock-

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6. *Id.* at 629-30 (citations omitted).

7. *See id.* at 627-28.

8. *Id.* at 628. The specific grant of coverage at issue in *Federal Rice* provided:

**COVERAGE A - BODILY INJURY LIABILITY:**

To pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury, sickness or disease, including death at any time resulting therefrom, sustained by any person [and caused by accident].

*Id.*

The bracketed language was deleted by an endorsement to the policy. The exclusions at issue in *Federal Rice* barred coverage:

(f) under coverage A, to any obligation for which the insured or any carrier as his insurer may be held liable under any workmen's compensation, unemployment, compensation or disability benefits law, or under any similar law;

(g) under coverage A, except with respect to liability assumed by the insured

ing nature of these coverages<sup>9</sup> and hinged its coverage analysis on whether the underlying claim would be cognizable under the applicable workers' compensation law: "If it would, there is no coverage. If it would not, neither exclusion (f) nor exclusion (g) applies, and there is coverage under Coverage A of the insuring agreements."<sup>10</sup> The court found that exclusions did not bar coverage for the underlying claim because the emotional distress which allegedly caused the employee's suicide was not an "accident," and thus not covered under the applicable workers' compensation law.<sup>11</sup>

#### A. *The Scope of the Coverage Grant*

EL coverage typically provides, "[the insurer will] pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury by accident or disease . . . sustained . . . by any employee of the insured *arising out of and in the course of his employment*."<sup>12</sup> EL policies may also include a defense obligation, created by language such as the following: "We have the right and duty to defend, at our expense any

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under a contract as defined herein, to bodily injury or to sickness, disease or death of any employee of the insured arising out of and in the course of employment by the insured.

*Id.*

9. The *Federal Rice* court reviewed "standard" WC and EL grants of coverage for the purposes of comparison with the WC and employment exclusions in the policy at issue. The "standard" WC grant of coverage quoted by the court provided:

**COVERAGE A - WORKMEN'S COMPENSATION**

To pay promptly when due all compensation and other benefits required of the insured by the workmen's compensation law.

*Id.* at 629 n.2. The "standard" EL grant of coverage quoted by the court provided:

**COVERAGE B - EMPLOYER'S LIABILITY**

To pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury by accident or disease, including death at any time resulting therefrom, sustained in the United States of America, its territories or possessions, or Canada by any employee of the insured arising out of and in the course of his employment by the insured either in operations in a state designated in item 3 of the declarations or in operations necessary or incidental thereto.

*Id.* at 629 n.3.

10. *Id.* at 630.

11. *Id.* at 630-31.

12. See, e.g., *Lumbermens Mut. Casualty Co. v. S-W Indus., Inc.*, 23 F.3d 970, 979 (6th Cir.) (alterations in original) (construing Ohio law), *cert. denied*, 115 S. Ct. 190 (1994); cf. Commercial Union Insurance Company, Workers Compensation and Employers Liability Insurance Policy WC 00 00 00 A at 2 (August 1991) (providing coverage for "bodily injury" that "arise[s] out of and in the course of . . . employment," subject to a number of other terms and conditions) [hereinafter Commercial Union Policy].

claim, proceeding or suit against you for damages payable by this insurance.”<sup>13</sup>

These coverage grants give rise to five principal issues in the context of employment-related claims: (i) what qualifies as “bodily injury”; (ii) whether the acts giving rise to employment-related claims qualify as “accidents”; (iii) whether the amounts assessed against employers as the result of such claims are “damages”; (iv) who qualifies as an employee of the insured; and (v) whether employment-related claims “arise out of and in the course of employment.”

### 1. Bodily Injury Coverage

Sample form EL policies do not define the key policy term “bodily injury.”<sup>14</sup> Accordingly, under hornbook rules of construction, the term should be given its common ordinary meaning, and any vagueness, confusion, or ambiguity arising out of the failure to define the term should be resolved in favor of coverage for the policyholder.<sup>15</sup> Since EL policies use the term “bodily injury” in their coverage grant in a manner similar to that of the standard-form Comprehensive or Commercial General Liability (“CGL”) insurance policies, a review of the issues arising under the “bodily injury” coverage of CGL policies is instructive.

In the 1993 revisions to the standard form CGL insurance policy “bodily injury” is defined as “bodily injury, sickness or disease sustained by a person, including death resulting from any of these at any time.”<sup>16</sup> Many of the allegations of an employment-related complaint typically will not fall within the bodily injury coverage, e.g., allegations of breach of contract. The most common issue under a “bodily injury” coverage provision in employment-related coverage actions is whether emotional or mental distress is within the scope of “bodily injury” when there are no accompanying physical symptoms.

Policyholders in employment-related coverage cases and other

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13. Commercial Union Policy, *supra* note 12, at 3 (August 1991).

14. *Id.*

15. 13 J. APPELMAN, INSURANCE LAW & PRACTICE, §§ 7384 at 70-74, 7401 at 197, 219-27 (West 1976).

16. Insurance Services Office, Inc., Commercial General Liability Coverage Form CG 00 01 10 93 (1993), reprinted in S. MILLER & P. LEFEBVRE, I MILLER'S STANDARD INSURANCE POLICIES ANNOTATED 417 (1986 & Supp. 1994). The definition of “bodily injury” in the 1973 ISO standard form Comprehensive General Liability insurance policy, which is the subject of most of the case law, is materially identical. *See id.* at 451.2.

coverage cases often argue that the bodily injury coverage includes claims for infliction of emotional or mental distress, even if not accompanied by physical symptoms.<sup>17</sup> This strategy may be worth pursuing in an employment-related coverage action, even when emotional or mental distress claims do not represent significant liabilities for a policyholder. The potential for coverage for a claim of emotional or mental distress under the bodily injury coverage will typically activate the policy's broad duty to defend,<sup>18</sup> which may involve coverage for significant defense costs.

Many courts, including the highest courts of New York and South Carolina, have found the policyholders' position persuasive.<sup>19</sup> A slightly greater number of courts have rejected the policyholders' position and have held that purely emotional or mental distress claims are not within the bodily injury coverage.<sup>20</sup>

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17. *E.g.*, *Lavanant v. General Accident Ins. Co. of Am.*, 79 N.Y.2d 623, 595 N.E.2d 819 (1992) (holding that purely emotional injuries sustained by tenants as a result of ceiling collapse were covered under landlord's general liability policy).

18. *See, e.g.*, *EEOC v. Southern Publishing Co.*, 894 F.2d 785, 789 (5th Cir. 1990) (applying Mississippi law and stating that under an EL policy the insurer's duty to defend is triggered if there is any possibility of coverage under the allegations of the complaint against the insured).

19. *Lavanant*, 79 N.Y.2d 623, 595 N.E.2d 819 (1992); *County of Chemung v. Hartford Casualty Ins. Co.*, 496 N.Y.S.2d 933 (N.Y. Super. Ct. 1985); *State Farm Mut. Auto. Ins. Co. v. Ramsey*, 297 S.C. 71, 374 S.E.2d 896 (1988); *Allstate Ins. Co. v. Biggerstaff*, 703 F. Supp. 23 (D.S.C. 1989) (S. Carolina law); *Omark Indus., Inc. v. Safeco Ins. Co. of Am.*, 590 F. Supp. 114 (D. Or. 1984) (Oregon law); *Morrison Assurance Co. v. North Am. Reinsurance Corp.*, 588 F. Supp. 1324 (N.D. Ala. 1984) (Alabama law), *aff'd*, 760 F.2d 279 (11th Cir. 1985); *United Pac. Ins. Co. v. McGuire Co.*, 281 Cal. Rptr. 375 (Cal. Ct. App.), *rev. denied* (1991); *Abellon v. Hartford Ins. Co.*, 212 Cal. Rptr. 852 (Cal. Ct. App.), *rev. denied* (1985); *Bloodworth v. Carroll*, 455 So. 2d 1197 (La. Ct. App. 1984), *rev'd on other grounds*, 463 So. 2d 1313 (La. 1985); *Maine Bonding & Casualty Co. v. Douglas Dynamics, Inc.*, 594 A.2d 1079 (Me. 1991) (finding a duty to defend even though Maine law requires physical symptoms accompanying alleged emotional distress and complaint did not allege accompanying physical symptoms, on grounds that underlying plaintiff may prove such physical symptoms at trial); *Loewenthal v. Security Ins. Co.*, 50 Md. App. 112, 436 A.2d 493 (1981).

20. *United Pac. Ins. Co. v. First Interstate Bancsystems, Inc.*, 690 F. Supp. 917 (D. Mont. 1988) (applying Montana law); *West Am. Ins. Co. v. Bank of Isle of Wight*, 673 F. Supp. 760 (E.D. Va. 1987) (applying Virginia Law); *St. Paul Fire and Marine Ins. Co. v. Campbell County Sch. Dist. No. 1*, 612 F. Supp. 285 (D. Wyo. 1985) (applying Wyoming law); *Rolette County v. Western Casualty & Sur. Co.*, 452 F. Supp. 125 (D.N.D. 1978) (North Dakota law); *Chatton v. National Union Fire Ins. Co.*, 13 Cal. Rptr. 2d 318 (Cal. Ct. App. 1992); *Cotton States Mut. Ins. Co. v. Crosby*, 244 Ga. 456, 260 S.E.2d 860 (1979); *Allstate Ins. Co. v. Diamant*, 401 Mass. 654, 518 N.E.2d 1154 (1988); *Greenman v. Michigan Mut. Ins. Co.*, 173 Mich. App. 88, 433 N.W.2d 346 (1988); *National Ben Franklin Ins. Co. v. Harris*, 161 Mich. App. 86, 409 N.W.2d 733 (1987); *Arctcraft of N.H., Inc. v. Lumberman's [sic] Mut. Casualty Co.*, 126 N.H. 844, 497 A.2d 1195 (1985); *SL Indus., Inc. v. American Motorists Ins. Co.*, 128 N.J. 188, 607 A.2d 1266 (1992) (but holding that ambiguity of "bodily injury" requires a case-by-case analysis of underlying

Perhaps the most striking aspect of the cases holding that "bodily injury" does not encompass emotional or mental distress when unaccompanied by any physical symptoms is that they rewrite the definition of "bodily injury." They equate "bodily" with "physical," and, moreover, read "bodily" as modifying "sickness" and "disease," as well as "injury." "Bodily injury" is thus rewritten to mean "*physical injury, physical sickness, or physical disease.*"<sup>21</sup> The plain language of the definition, however, does not use the term "physical" and uses "bodily" only to modify "injury." As the highest court of New York held, "[w]e decline [the insurer's] invitation to rewrite the contract to add 'bodily sickness' and 'bodily disease' . . . . [The insurer] could itself have specified such limitations in drafting its policy, but it did not do so."<sup>22</sup> Rather, read as plainly written, "[t]he categories 'sickness' and 'disease' in the insurer's definition not only enlarge the term 'bodily injury' but also, to the average reader, may include mental as well as physical sickness and disease."<sup>23</sup>

The same result is required by the plain and ordinary meaning of the terms in the definition of "bodily injury" and well-established rules of insurance policy construction. Common definitions of "sickness" and "disease" are broad enough to encompass purely mental or emotional illnesses or distress and *not* limited to physical sicknesses or diseases. "Sickness" is commonly broadly defined as "illness . . . a weakened and disordered state of anything"<sup>24</sup> or "infirmity . . . indisposition . . . malaise."<sup>25</sup> Similarly, "disease" is commonly defined as "distress . . . any departure from health; illness in general"<sup>26</sup> or "distemper . . . derangement . . . breakdown."<sup>27</sup> Under the well-established rule of construction that undefined policy terms are to be given their common, ordinary meanings,<sup>28</sup> purely emotional distress claims should fall within either "sickness" or "disease" or both.

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facts); *E-Z Loader Boat Trailers, Inc. v. Travelers Indem. Co.*, 106 Wash. 2d 901, 726 P.2d 439 (1986).

21. *E.g.*, *Rolette County*, 452 F. Supp. at 130; *Diamant*, 401 Mass. at 658 n.3, 518 N.E.2d at 1157 n.3; *Artcraft*, 126 N.H. at 846, 497 A.2d at 1196; *E-Z Loader Boat Trailers*, 106 Wash. 2d at 908, 726 P.2d at 443.

22. *Lavanant*, 79 N.Y.2d at 629, 595 N.E.2d at 822.

23. *Id.*

24. WEBSTER'S NEW TWENTIETH CENTURY DICTIONARY 1685 (1983).

25. DOUBLEDAY ROGET'S THESAURUS IN DICTIONARY FORM 638 (rev. ed. 1987).

26. WEBSTER'S NEW TWENTIETH CENTURY DICTIONARY 523 (1983).

27. DOUBLEDAY ROGET'S THESAURUS IN DICTIONARY, FORM 194 (rev. ed. 1987).

28. *E.g.*, APPLEMAN, *supra* note 15, § 7384, at 70-74.



Moreover, it is black-letter insurance law that terms included in grants of coverage are to be interpreted broadly so as to provide the insured with the maximum coverage possible under the policy, and further, that ambiguous policy terms (i.e., those that have more than one reasonable interpretation) are to be construed in favor of coverage and against the insurer-drafter.<sup>29</sup> Accordingly, the term "bodily injury," which is, at best, ambiguously defined in EL policies, should encompass emotional or mental distress even when unaccompanied by physical symptoms.<sup>30</sup>

In addition, the difficulties in distinguishing between physical and mental injuries should weigh the scales heavily in favor of finding coverage. The question of whether an emotional injury is a bodily injury is a question of fact. "It involves a medical or psychological problem of proof rather than purely a question of law."<sup>31</sup> Recognizing just this point, courts otherwise inclined to find "bodily injury" unambiguous have also held that this term may be ambiguous in light of certain facts or allegations and, accordingly, "should be analyzed on a case-by-case basis to determine whether the alleged injuries are sufficiently akin to physical injuries to render the term 'bodily injury' ambiguous."<sup>32</sup>

The case-by-case analysis is especially crucial in determining whether there is a duty to defend. Because this broad duty is activated if there is *any* potential liability covered under the policy,<sup>33</sup> the absence of a well-developed factual record as to the nature and extent of the claimant's alleged "bodily injuries" and the potential ambiguity of "bodily injury" in light of certain facts that may be developed should favor a finding of coverage for defense costs.<sup>34</sup>

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29. See *id.* § 7401, at 197, 219-27; § 7405, at 340; *accord, e.g.*, *Kent v. Middlesex Mut. Assurance Co.*, 226 Conn. 427, 436 n.13, 627 A.2d 1319, 1324 n.13 (1993); *Bateman v. Motorists Mut. Ins. Co.*, 527 Pa. 241, 245, 590 A.2d 281, 283 (1991).

30. If further evidence of the ambiguity of "bodily injury" is needed, one need look no further than the case of *University of Illinois v. Continental Casualty Co.*, 234 Ill. App. 3d 340, 599 N.E.2d 1338 (1992), in which the defendant-insurer argued that claims of mental anguish and emotional distress fell within the policy's definition of "bodily injury" (i.e., "injury, sickness or disease") and accordingly were subject to an exclusion for damages arising from bodily injury. The court rejected this argument and found coverage for employment-related claims. *Id.* at 360-62, 599 N.E.2d at 1351-53.

31. *Abellon v. Hartford Ins. Co.*, 212 Cal. Rptr. 852, 855 (Cal. Ct. App. 1985).

32. *SL Indus., Inc. v. American Motorists Ins. Co.*, 128 N.J. 188, 204, 607 A.2d 1266, 1274 (1992).

33. See, e.g., *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 275, 419 P.2d 168, 174-75 (1966) (en banc).

34. See *State Farm Fire & Casualty Co. v. Westchester Inv. Co.*, 721 F. Supp. 1165, 1167 (C.D. Cal. 1989) (applying California law and denying insurer's motion for summary judgment on duty to defend under bodily injury coverage when evidence of

## 2. "Accident"

EL policies' use of the undefined term "accident" in their grants of coverage raises an important issue that is likely to be coverage-determinative in many cases involving employment-related claims: from whose standpoint is an "accident" determined? As with the undefined term "bodily injury," if any ambiguity or confusion is created by the insurers' failure to define this term under black-letter rules of construction, it should be resolved in favor of coverage.<sup>35</sup>

It is remarkable that this issue should even be the subject of litigation under the EL policy. The confusion as to the relevant perspective or standpoint was one of the factors leading to the 1966 revision of the standard-form CGL policy from an "accident" basis (which also did not specify the relevant standpoint) to an "occurrence" basis (which did specify the relevant standpoint as being that of the insured).<sup>36</sup> Thus, the lesson learned by CGL insurers some thirty years ago appears to have been lost on contemporary EL insurers, dooming them (and their policyholders) to litigation over an ambiguous policy provision that could very easily have been made clear through more careful drafting.

This omission has led to otherwise unnecessary litigation and a split of judicial authority on the issue. In *EEOC v. Southern Publishing Co.*,<sup>37</sup> two former employees of an EL policyholder alleged that another employee "was guilty of 'continued and persistent grabbing and touching of [one of the former employee's] private

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physical manifestations of alleged emotional distress was developed in deposition discovery).

35. See APPLEMAN, *supra* note 15, and accompanying text.

36. See Norman Nachman, *The New Policy Provisions for General Liability Insurance*, 18 THE ANNALS 197, 200 (1965) ("[A] number of cases have held, contrary to intent, that the unexpected nature of the injury is to be determined from the point of view of the injured party."); Lyman J. Baldwin, Jr., (Secretary-Underwriting of the Insurance Company of North America), Address to the American Society of Insurance Management 1, 7 (Oct. 20, 1965) ("To the consternation of underwriters, a number of past court decisions have applie[d] the concept of fortuity from the point of view of the injured party. Such an unintended interpretation of coverage should not result from the new language."); Richard H. Elliott (Secretary of the National Bureau of Casualty Underwriters), *The New Comprehensive General Liability Policy* 1, 3 American Management Association (1966) ("To the consternation of underwriters, a number of past court decisions have applied the concept of fortuity from the point of view of the injured party. Such an unintended interpretation of coverage should not result from the new language."). (Transcripts of these papers are on file with the authors.)

37. 705 F. Supp. 1213 (S.D. Miss. 1988), *aff'd*, 894 F.2d 785 (5th Cir. 1990).

parts” and that he “had committed assault and battery” on them.<sup>38</sup> One of the employees also alleged that the policyholder’s president had told her new employer that “she had sabotaged the office computer.”<sup>39</sup> The Equal Employment Opportunity Commission (“EEOC”) brought claims for sexual harassment resulting in constructive and retaliatory discharge, and the two former employees intervened, alleging claims of slander and assault and battery.<sup>40</sup>

The insured argued that its insurer had a duty to defend the EEOC’s harassment charges and the employees’ tort claims under the terms of an EL policy.<sup>41</sup> The district court noted that the policy did not define the term “accident” and did not define “from whose viewpoint actions claimed to be accidental should be evaluated.”<sup>42</sup> The district court reasoned that “[w]hether or not the alleged assault and battery may be appropriately characterized as an accident so as to bring those claims within the ambit of coverage depends upon from whose standpoint the conduct is viewed.”<sup>43</sup> Citing state case law, and construing the ambiguity created by the policy’s failure to specify from whose viewpoint “accident” was to be determined in favor of coverage for the policyholder, the district court concluded that the determination of whether an injury is “accidental” should be made from the injured person’s perspective. Thus, “[i]f the injury comes to [the victim] through external force, not of [the victim’s] choice or provocation, then as to [the victim] the injury is accidental.”<sup>44</sup>

Applying this rule, the district court in *Southern Publishing* held that, from the victims’ standpoint, their injury from the assault and battery was “accidental” because “the injury was the result of external force,” and the victims did not choose or provoke their injury.<sup>45</sup> Consequently, the court ruled that the EL policy potentially covered the assault and battery claims but not the slander claim<sup>46</sup> and found that the EL insurer had a duty to defend its policyholder against the assault and battery claims. The district court

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38. EEOC v. Southern Pub. Co., Inc., 894 F.2d 785, 787 (5th Cir. 1990) (quoting the former employees’ complaint).

39. *Id.*

40. *Id.*

41. Apparently, the defendant did not argue for insurance coverage of the harassment claim.

42. *Southern Publishing*, 705 F. Supp. at 1217.

43. *Id.*

44. *Id.* (quoting *Georgia Casualty Co. v. Alden Mills*, 127 So. 555 (Miss. 1930)).

45. *Id.* at 1217-18.

46. *Id.* at 1218.

found that there was no possibility of coverage for the slander claim under the policy's EL coverages because "certainly no bodily injury resulted from the alleged slander."<sup>47</sup> The court of appeals reversed the district court's determination and found that the slander claims were covered under the "personal injury and advertising liability coverage" of the policy's general liability coverages. The court further found that the district court had erred in finding that coverage for the slander claim was barred by the policy's exclusion for intentional acts because the claim against the policyholder alleged negligent slander as well as intentional slander.<sup>48</sup>

The district court refused to award the policyholder all of the costs that it incurred in defending the action. Because the former employees' tort claims were determined to have been barred by the statute of limitations, the court was able to prorate the defense costs between those claims and the non-covered harassment claims, and did so.<sup>49</sup>

In *Mary & Alice Ford Nursing Home, Co. v. Fireman's Insurance Co.*<sup>50</sup> a New York appellate court reached a contrary holding on the "accident" issue addressed in *Southern Publishing*. In *Mary & Alice Ford*, the policyholder sought coverage for a discrimination claim based on disability under a general liability policy, an umbrella liability policy, and an EL policy. Although the EL policy's coverage grant was worded similarly to the EL policy language at issue in *Southern Publishing*,<sup>51</sup> the *Mary & Alice Ford* court failed to recognize the ambiguity created by the language's failure to define from whose standpoint the discrimination had to be an "acci-

47. *Id.* at 1219.

48. *EEOC v. Southern Publishing Co., Inc.*, 894 F.2d 785, 790-91 (5th Cir. 1990).

49. *Southern Publishing*, 705 F. Supp. at 1219-20. Most courts have rejected this position. When a legal action against an insured for which the insured seeks a defense includes both covered and excluded claims, the insurer is required to defend the entire lawsuit. *See, e.g.*, *Alert Centre, Inc. v. Alarm Protection Servs., Inc.*, 967 F.2d 161, 163 (5th Cir. 1992) (applying Louisiana law); *Horace Mann Ins. Co. v. Barbara B.*, 17 Cal. Rptr. 2d 210, 213-14, 846 P.2d 792, 795-96, (Cal. 1993); *Ruder & Finn, Inc. v. Seaboard Sur. Co.*, 52 N.Y.2d 663, 669-70, 422 N.E.2d 518, 521 (1981); *see also* *Heffernan & Co. v. Hartford Ins. Co.*, 418 Pa. 326, 331-32, 614 A.2d 295, 298 (1992) (finding that the duty to defend is triggered when the potential for a covered claim being made against the policyholder became apparent, even if the only claims which were actually ever made were excluded from coverage). The "suit" language in the EL policy provision is substantially similar to the duty to defend language in the liability policies at issue in the cases cited above. *See supra* note 12 and accompanying text.

50. 446 N.Y.S.2d 599 (N.Y. App. Div.), *aff'd*, 57 N.Y.2d 656, 439 N.E.2d 883 (1982).

51. *Compare* *Mary & Alice Ford*, 446 N.Y.S.2d at 600 *with* *Southern Publishing*, 705 F. Supp. at 1217.

dent." Despite the fact that the court noted that the "multifaceted term 'accident' is not given a narrow technical definition by the law,"<sup>52</sup> it concluded that the "casualty" should be looked at "from the point of view of the insured, to see whether or not, from his point of view, it was unexpected, unusual, and unforeseen."<sup>53</sup>

The court reasoned that the employee's alleged injuries "were unexpected and unforeseen by . . . the insured" because they flowed "directly" from the insured's "intentional discriminatory practice."<sup>54</sup> Accordingly, the court held that proof of discrimination would "necessarily establish that there was no accident within the meaning of the insurance policies in question," and hence the insurer was not obligated to defend or indemnify the employer.<sup>55</sup>

Although the court's determination of "accident" from the point of view of the EL policyholder in *Mary & Alice Ford* effected a denial of coverage on the facts before the court, such a rule will often promote coverage in the context of employment-related claims. Often, employment-related claims are responses to the alleged discriminatory, harassing, or otherwise tortious acts of fellow employees who are without significant administrative or policymaking authority within the corporate employer and who have acted without authority or the approval of the corporation. If the corporate insured's responsible effective management did not know of, condone, ratify, or consciously adopt such conduct, the conduct would still be an accident from the standpoint of the corporate policyholder.<sup>56</sup> One of the principal reasons policyholders, especially large corporate policyholders, purchase liability insurance is to protect themselves from the unlawful acts of their employees. The fact that an employee acted with the intent to cause injury should not of itself necessarily bar the corporation from coverage. As the United States Court of Appeals for the Ninth Circuit has recognized, precluding a policyholder from coverage whenever it is vicariously liable for an employee's conduct would make "the comprehensive liability policy illusory for corporate purposes."<sup>57</sup>

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52. *Mary & Alice Ford*, 446 N.Y.S.2d at 601 (citation omitted).

53. *Id.* (relying on *Miller v. Continental Ins. Co.*, 40 N.Y.2d 675, 358 N.E.2d 258 (1976); *McGroarty v. Great Am. Ins. Co.*, 36 N.Y.2d 358, 329 N.E.2d 172 (1975)).

54. *Id.*

55. *Id.*

56. *See, e.g.*, *Fireman's Fund Ins. Co. v. City of Turlock*, 216 Cal. Rptr. 796, 804-05 (Cal. Ct. App. 1985); *SL Indus., Inc. v. American Motorists Ins. Co.*, 128 N.J. 188, 213-14, 607 A.2d 1266, 1279 (1992).

57. *Dart Indus., Inc. v. Liberty Mut. Ins. Co.*, 484 F.2d 1295, 1298 (9th Cir. 1973) (applying California law); *cf. Western Heritage Ins. Co. v. Magic Years Learning Ctrs.*

Only when the insured's responsible effective management knows of or condones unlawful discriminatory or harassing conduct should coverage be precluded for want of an "accident." For example, in *Coit Drapery Cleaners, Inc. v. Sequoia Insurance Co.*,<sup>58</sup> no coverage was available for a former employee's claims of sexual harassment and wrongful termination against the policyholder, when the sexual harassment was allegedly perpetrated by the policyholder's president, and the president's "sexual misconduct with female employees was known to, and ratified by, the board of directors."<sup>59</sup>

### 3. "As Damages"

Insurers have attempted to deny coverage for back pay awards to employees by contending that these awards are an equitable remedy and hence that they are not covered "damages," i.e., monetary relief awardable through an action at law triable to a jury. Significantly, insurance companies themselves have rejected this argument when they, as policyholders, have sought coverage for their employment-related liabilities. In *Liberty Mutual Insurance Co. v. Those Certain Underwriters at Lloyd's*,<sup>60</sup> a federal district court, at the urging of the plaintiff, rejected the "hypertechnical distinction between damages and equitable relief" advanced by the defendant-insurers, and determined that the term "damages" should be "construed in accord with the plain meaning of the term and the reasonable expectations of the insured."<sup>61</sup> Accordingly, the court

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and Child Care, Inc., 45 F.3d 85, 89 (5th Cir. 1995) (applying Texas law and determining that an individual employer's sexual harassment of an employee was "neither expected nor intended from the standpoint of the insured" within the meaning of a CGL policy's occurrence definition, even though that individual was one of three named insureds under the policy, because there was "no contention" that either of the other insureds expected or intended to injure the employee); *Seminole Point Hosp. Corp. v. Aetna Casualty & Sur. Co.*, 675 F. Supp. 44, 47 (D.N.H. 1987) (The court held that there was no coverage for the corporation president's intentional sexual harassment of employees. However, the court found that the insurer was liable for defense costs for the president's employer, the hospital, because the president's acts were not authorized by or done for the benefit of the hospital, and the hospital faced independent liability for its negligence.); *Streamline Bar, Inc. v. GRE Am.*, No. C9-93-451, 1993 WL 290276 (Minn. Ct. App. Aug. 3, 1993) (finding coverage for an employer's vicarious liability for its employee's acts of sexual harassment). The drafting history of the "occurrence" language confirms and supports this argument. See Scheuermann & Baillie, *supra* note 3, at § 11B.02[2][a][iii].

58. 18 Cal. Rptr. 2d 692, *review denied*, (Cal. Ct. App. 1993).

59. *Id.* at 699.

60. 650 F. Supp. 1553 (W.D. Pa. 1987) (applying Pennsylvania law).

61. *Id.* at 1560.

found that the general liability insurance policies at issue provided coverage for back pay awards that the policyholder-insurer was required to pay to remedy discriminatory employment practices.<sup>62</sup> This holding is consistent with the vast majority of courts that have addressed the “damages” issue in environmental insurance coverage disputes.<sup>63</sup>

In contrast, a distinct minority of courts have accepted the “hypertechnical distinction” between legal and equitable forms of relief advanced by insurers in the context of employment-related claims. Thus, in *School District of Shorewood v. Wausau Insurance Cos.*,<sup>64</sup> the Supreme Court of Wisconsin employed that distinction to defeat coverage for defense costs incurred in connection with a discrimination claim seeking attorneys’ fees and injunctive relief that would have required the policyholder to reorganize and adopt new hiring practices to remedy past discrimination. Contrary to overwhelming case law,<sup>65</sup> the court reasoned: “[I]n the insurance context, the term ‘damages’ has an accepted technical meaning in law.”<sup>66</sup> Although the court acknowledged that the words in an insurance contract mean “not what the insurer intended the words to mean but what a reasonable person in the position of an insured would have understood the words to mean,”<sup>67</sup> it disregarded that rule in adopting the technical distinction between law and equity.<sup>68</sup>

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62. *Id.* The “as damages” language which was at issue in *Liberty Mutual* is no different than the “as damages” language which typically appears in EL policies. Although there do not appear to be any cases construing such language in the specific context of an EL policy, the language should be construed similarly in favor of coverage regardless of the type of policy it appears in.

63. See, e.g., *AIU Ins. Co. v. Superior Court*, 51 Cal. 3d 807, 799 P.2d 1253 (1990); *Bausch & Lomb Inc. v. Utica Mut. Ins. Co.*, 330 Md. 758, 782, 625 A.2d 1021, 1033 (1993); *Hazen Paper Co. v. United States Fidelity and Guar. Co.*, 407 Mass. 689, 700, 555 N.E.2d 576, 583 (1990); *Boeing Co. v. Aetna Casualty & Sur. Co.*, 113 Wash. 2d 869, 886-87, 784 P.2d 507, 515 (1990); but see, e.g., *Patrons Oxford Mut. Ins. Co. v. Marois*, 573 A.2d 16, 18-19 (Me. 1990) (environmental remediation costs not “damages”).

64. 170 Wis. 2d 347, 488 N.W.2d 82 (1992).

65. *Id.* at 368 n.61 (citations omitted).

66. *Shorewood*, 170 Wis. 2d at 367-68, 488 N.W.2d at 89.

67. *Id.*

68. Another case often cited by insurers to support their argument that “damages” means only “legal damages” in the context of employment-related claims, *Maryland Cup Corp. v. Employers Mutual Liability Insurance Co.*, 81 Md. App. 518, 568 A.2d 1129 (1990), may no longer be good law in light of the opinion of Maryland’s highest court in *Bausch & Lomb Inc. v. Utica Mutual Insurance Co.*, 330 Md. 758, 625 A.2d 1021 (1993). In *Maryland Cup*, the Maryland Court of Special Appeals accepted the technical distinction between legal damages and equitable relief and denied coverage to a policyholder for claims made under Title VII alleging discriminatory employment practices urged on it by the insurer. Subsequently, Maryland’s highest court

#### 4. "Employee of the Insured"

The "employee of the insured" language in the EL coverage grant gives rise to two issues: first, who is an "employee" and second, who is the "insured." EL coverage will be forthcoming only if the underlying claim arises out of an employment relationship between the plaintiff and an insured employer. Courts have rejected EL policyholders' arguments that EL coverage exists for employment claims that arise outside of an employment relationship between an insured employer and its employees. For example, in *Producers' Dairy Delivery Co. v. Sentry Insurance Co.*,<sup>69</sup> the California Supreme Court determined that there was no possibility of coverage under a WC/EL policy that insured Producers Dairy and its subsidiary, LAS Corporation, for a negligence claim brought against Producers Dairy by an LAS employee who was injured on the job.<sup>70</sup> The court reasoned that "Producers' liability to [the LAS employee] was not based on any employment relationship between them, but arose instead from Producers' negligent maintenance of its delivery truck"<sup>71</sup> and explicitly declined to recognize that coverage might be available under the EL policy "when a negligence claim is made against an 'insured' (Producers), by an employee of an 'insured' (LAS)."<sup>72</sup> The court further reasoned: "[A] reasonable person in the position of an officer of Producers would not disregard the fact that legally Producers and LAS were each separate entities, and accordingly that person would not assume coverage existed under Producers' employers' liability policy where the potential plaintiff is not a Producers' employee."<sup>73</sup>

Whether the claimant in the underlying case is an "employee" is a question which often will be determined by state law and statutes.<sup>74</sup> Courts in the various states have identified factors which are used to determine whether an employer-employee relationship exists. In *Savoie v. Fireman's Fund Insurance Co.*,<sup>75</sup> a Louisiana ap-

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effectively, but *sub silentio*, rejected *Maryland Cup's* interpretation of "damages" and held that the equitable remedies that were sought by a state agency against an alleged polluter under the state's environmental laws and regulations were "damages" as that term appeared in the insured's general liability policy. *See id.* at 782, 625 A.2d at 1033.

69. 41 Cal. 3d 903, 718 P.2d 920 (1986).

70. *Id.* at 907, 718 P.2d at 921.

71. *Id.* at 913, 718 P.2d at 926.

72. *Id.* at 911, 718 P.2d at 924.

73. *Id.* at 913, 718 P.2d at 925.

74. *See* 11 RONALD A. ANDERSON, COUCH ON INSURANCE 2D § 44.73, at 252 (rev. ed. 1982 & Supp. 1995).

75. 339 So. 2d 914 (La. Ct. App. 1976), *aff'd*, 347 So. 2d 188 (La. 1977).



pellate court determined that no employment relationship existed between two cousins (who were also neighbors) who frequently helped one another with farm work because neither one had the right to exercise any control over the other's actions; no wages were paid, nor was there any agreement for wages or compensation; and "[t]hey had no definite agreement with respect to what was actually being exchanged by the parties or the value thereof, nor was there any obligation between them in this connection."<sup>76</sup>

Courts have split on the issue of whether unsuccessful job applicants who are injured during the application process or a tryout period are "employees."<sup>77</sup> In jurisdictions where job applicants may be "employees," EL insurance coverage may be available for claims brought by applicants who allege that they have been discriminated against on an impermissible basis in a hiring decision.

##### 5. "Arising Out of and in the Course of His Employment"

For there to be coverage for an employment-related claim under an EL policy, the injury that is the subject of the claim must have arisen out of or occurred in the course of the claimant's employment. The issue created by such ambiguous language is that of determining the causal nexus between the employment and the alleged injury.<sup>78</sup>

Under well-established rules of construction, grants of coverage are to be interpreted broadly and in favor of coverage,<sup>79</sup> while restrictions and exclusions are to be interpreted narrowly and strictly against the insurer.<sup>80</sup> Accordingly, the "arising out of" language in the EL insurance coverage grant should be understood to

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76. *Id.* at 917.

77. Compare *Sellers v. City of Abbeville*, 458 So. 2d 592, 593 (La. Ct. App. 1984) (denying workers' compensation to police officer who lost his job after failing a civil service test and was injured while warming up for an agility test in connection with his application for re-employment, because he was not an "employee" when injured), *writ denied*, 462 So. 2d 1248 (La. 1985) with *Erickson v. Holland*, 295 N.W.2d 576, 579-80 (Minn. 1980) (awarding workers' compensation to truck driver injured while taking a performance test as part of a formal prerequisite for employment with a trucking firm, because the evidence in the record showed that the applicant would be (and was) paid for his time during the test and because he was under the control and supervision of the employer).

78. The Supreme Court of Tennessee has recognized that the policy term "arising out of" is "extremely broad . . . so broad, in fact, that it is difficult to conceive of a rule that draws a justifiable line between coverage and no coverage at any reasonable point." *Allstate Ins. Co. v. Watts*, 811 S.W.2d 883, 887 (Tenn. 1991).

79. See generally *APPLEMAN*, *supra* note 15, § 7401, at 197.

80. See *id.*, § 7405, at 340.

encompass any bodily injury that has any type of causal nexus with the claimant's employment.<sup>81</sup> Thus, while this coverage grant includes relations of proximate causation between the employment and the bodily injury, it is not limited to such causal relationships.<sup>82</sup>

These principles are illustrated by *Forum Insurance Co. v. Allied Security, Inc.*<sup>83</sup> The underlying claim in *Allied Security* was brought against the employer/EL policyholder, Allied Security, by the estate of a former employee who was killed by another employee while both were on assignment for Allied Security.<sup>84</sup> The jury in the underlying action determined that the deceased was killed for personal reasons "not directed against the victim as an employee or because of his employment."<sup>85</sup> Allied Security's general liability insurer, Forum Insurance Company, provided a defense under a reservation of rights, and brought a declaratory judgment action against the employer's EL insurer, Liberty Mutual Insurance Company, to establish Liberty Mutual's obligation to defend and indemnify Allied Security.<sup>86</sup> The existence of EL coverage hinged on whether the slain employee's death "[arose] out of and in the course of his employment by the insured."<sup>87</sup> The court determined that the EL policy language at issue was unambiguous as a matter of law and that "[b]ut for' causation, i.e., a cause and result relationship, is enough to satisfy this provision of the pol-

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81. See, e.g., *Lumbermens Mut. Casualty Co. v. S-W Indus.*, 23 F.3d 970, 979 (6th Cir. 1994).

82. *Id.* at 980. Another aspect of the policy language "arising out of and in the course of employment" also bears mention in the context of insurance coverage for employment-related claims. Applied properly, black-letter rules of policy interpretation would require the "arising out of and in the course of" language as used in the "employment exclusion" and sometimes included in general liability insurance policies to be construed to exclude coverage only when the employment relationship *proximately* causes the employee's claim. See generally Scheuermann & Baillie, *supra* note 3, at § 11B.02[2][i] n.66 and accompanying text. For a number of reasons, proximate causation may not exist in the context of an employment-related claim. *Id.* at 11B-30-31. Accordingly, coverage for an employment-related claim might be provided by both an employer's EL insurance and its general liability insurer, even if the latter is subject to an "employment exclusion." Cf. *Eichelberger v. Warner*, 290 Pa. Super. 269, 434 A.2d 747 (1981) (construing "arising out of" broadly in the context of the grant of coverage of a auto insurance policy and narrowly in the context of an exclusion in a homeowner's policy and finding that coverage for liabilities associated with one accident was available under both policies).

83. 866 F.2d 80 (3d Cir. 1989) (applying Pennsylvania law).

84. *Id.* at 83.

85. *Id.* at 81.

86. *Id.*

87. *Id.* at 81-82.

icy.”<sup>88</sup> Accordingly, the court found that the employee’s death “clearly arose out of his employment . . . since he was killed by a fellow employee while both were on assignment as security guards for their employer”<sup>89</sup> and thus that Liberty Mutual was obligated to bear part of the cost of the defense of the claim against Allied Security, as the claim was potentially covered under Forum’s policy as well as Liberty Mutual’s policy.<sup>90</sup>

The United States Court of Appeals for the Sixth Circuit has held that under the coverage grant of an EL policy even an intentional tort that an employer commits against an employee may “arise out of and in the course of” employment. In *Lumbermens Mutual Casualty Co. v. S-W Industries, Inc.*,<sup>91</sup> a worker, Carl Viock, contracted lung disease as the result of being exposed to toxic fumes and dust on the job. In Viock’s tort action against his employer, the jury determined that the employer had acted with a “presumed intent,” but not a specific intent, to injure Viock.<sup>92</sup> The employer’s EL insurers denied coverage, contending that “an intentional tort by one’s employer cannot possibly ‘arise out of and in the course’ of [one’s] employment.”<sup>93</sup> The Sixth Circuit rejected that contention:

It is undisputed that Viock’s injuries were caused by his long term exposure to toxic chemicals and congestive dusts *at his work*. But for his job, there is no question that Viock would not have sustained these injuries. It strains credulity, therefore, for the appellee-insurers in this case to contend that these injuries did not “arise out of and in the course of” Viock’s employment.<sup>94</sup>

Accordingly, the court found coverage under the EL policies for Viock’s claim.<sup>95</sup>

### B. *Possible Applicable Exclusions*

EL policies may incorporate exclusions that in some circumstances may bar coverage wholly or in part for employment-related

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88. *Id.* at 82 (relying on *McCabe v. Old Republic Ins. Co.*, 228 A.2d 901, 903 (1967)).

89. *Id.* at 83.

90. *Id.* at 85.

91. 23 F.3d 970 (6th Cir.) (applying Ohio law), *cert. denied*, 115 S. Ct. 190 (1994).

92. *Id.* at 973-74.

93. *Id.* at 979.

94. *Id.*

95. *Id.* at 980.

claims. These include the employment exclusion and the contract exclusion.

### 1. The EL Policy's Employment Exclusion

EL policies often contain some form of employment exclusion. For example, an EL policy may contain an exclusion for "damages arising out of the . . . discrimination against any employee in violation of law."<sup>96</sup> The judicial response to such exclusions has been mixed.

Two cases which have found coverage for employment-related claims under EL policies despite such exclusions are worth discussion. In *EEOC v. Southern Publishing Co.*,<sup>97</sup> the United States Court of Appeals for the Fifth Circuit determined that an EL policy provided coverage for claims of assault and battery and "negligent slander" brought against an employer by two employees. The Fifth Circuit found that the allegations of "continued and persistent grabbing," "assault and battery," and "physical pain" that the employees suffered were sufficient to allege "bodily injury" under the policy.<sup>98</sup> The court rejected the insurer's argument that the bodily injury claims were not covered because they were nothing more than evidence of alleged discrimination, and the policy excluded "damages arising out of the discharge of, coercion of, or discrimination against any employee in violation of law."<sup>99</sup> The court ruled that the bodily injury claims were sufficiently distinct from the Title VII claims so as to not fall within this exclusion.<sup>100</sup> With respect to the alleged slander of an employee by the employer, the court determined that the policy provided coverage for slander unless it was intentional.<sup>101</sup> Because the complaint against the employer alleged that the slander may have been "stated with gross and reckless disregard of the truth," the policy provided coverage for the slander

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96. *Ottumwa Hous. Auth. v. State Farm Fire & Casualty Co.*, 495 N.W.2d 723, 729 (Iowa 1993) (quoting the employer's liability policy issued by State Farm) (alterations in original) (determining that such an exclusion barred coverage for claims grounded on unlawful sex discrimination); Commercial Union Policy, *supra* note 12, (containing an exclusion applicable to "damages arising out of coercion, criticism, demotion, evaluation, reassignment, discipline, defamation, harassment, humiliation, discrimination or termination of any employee, or any personnel practices, policies, acts or omissions").

97. 894 F.2d 785 (5th Cir. 1990) (applying Mississippi law).

98. *Id.* at 789.

99. *Id.* (quoting the workers' compensation and employers' liability policy issued by Southern Guaranty).

100. *Id.* at 791.

101. *Id.*

claim.<sup>102</sup>

*Seminole Point Hospital Corp. v. Aetna Casualty & Surety Co.*<sup>103</sup> also provides an example of a court's finding coverage for an employment-related claim under an EL policy. In *Seminole Point*, two employees of the hospital-EL policyholder filed suits against the hospital, two officer-directors of the hospital, and several other hospital employees, alleging failure to supervise by the hospital and sexual harassment by the officer-directors.<sup>104</sup> The court held that no coverage was available to the officer-directors under the hospital's EL policies.<sup>105</sup> One officer-director was denied coverage because he was not a named insured. The court determined that coverage for the other was precluded by the EL policy's exclusion for discriminatory acts and its exclusion for "bodily injury intentionally caused or aggravated by [the policyholder]."<sup>106</sup> The court ruled, however, that coverage was available to the hospital for the employee's claims of failure to supervise. Because the alleged acts of sexual harassment were not authorized by the hospital and not done to benefit the hospital, the officer-directors were acting outside the scope of their authority, and their intent thus could not be imputed to the hospital.<sup>107</sup>

Taking a different direction, the Iowa Supreme Court in *Ottumwa Housing Authority v. State Farm Fire & Casualty Co.*,<sup>108</sup> held that a discrimination exclusion in an EL policy completely barred coverage for claims of sex discrimination, sexual harassment, retaliation, intentional infliction of emotional harm, and breach of the covenant of good faith and fair dealing.<sup>109</sup> The EL policy contained an exclusion for "'damages arising out of the . . . discrimination against any employee in violation of the law.'"<sup>110</sup> The court held, without any discussion or analysis, that because the claimants' theories of recovery "are grounded on sex discrimination in violation of state and federal law," the exclusion "clearly applies."<sup>111</sup> In so holding, in cursory fashion, the court seems to have been influenced

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102. *Id.* at 790-91.

103. 675 F. Supp. 44 (D.N.H. 1987) (applying New Hampshire law).

104. *Id.* at 45.

105. *Id.* at 47.

106. *Id.* at 45 (alteration in original).

107. *Id.* at 47.

108. 495 N.W.2d 723 (Iowa 1993).

109. *Id.* at 727.

110. *Id.* at 729 (quoting the employer's liability policy issued by State Farm) (alteration in original).

111. *Id.*

by its similar finding that the employment exclusion in the policyholder's general liability policy barred coverage for the same claims.

## 2. The Contract Exclusion

EL policies, like most other types of liability insurance policies, usually exclude coverage for amounts that the insured owes pursuant to a contractual obligation.<sup>112</sup> In the context of coverage for employment-related claims, the issue created by such language is whether back pay awards have been made pursuant to a contractual obligation. Again, judicial interpretations of such exclusions are mixed, but the trend is to find coverage for back pay awards, notwithstanding the exclusions. Although there do not appear to be any court decisions construing the EL policy's "contract exclusion," the language of that exclusion is substantially the same as the contract exclusions that appear in other liability policies.

Thus, for example, in *New Madrid County Reorganized School District No. 1, Enlarged v. Continental Casualty Co.*,<sup>113</sup> the United States Court of Appeals for the Eighth Circuit held that an E&O policy's contract exclusion did not bar coverage for back wages awarded in connection with a suit alleging violations of employees' civil rights because the suit was not purely a contract action.<sup>114</sup>

On similar facts, in *School District for City of Royal Oak v. Continental Casualty Co.*,<sup>115</sup> the United States Court of Appeals for the Sixth Circuit recognized that "an exclusion of liability insurance coverage for contractually assumed obligations to third parties is operative only where the insured would not have been liable to the third party absent the insured's agreement to pay."<sup>116</sup> The Sixth Circuit rejected the insurer's argument that the contract exclusion barred coverage because the applicable collective bargaining agreement prohibited certain types of discrimination, the employee did not sue the policyholder for breaching that agreement, and the claims in her complaint against the policyholder did not depend on the agreement.<sup>117</sup>

Similarly, in *Andover Newton Theological School, Inc. v. Conti-*

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112. See, e.g., Commercial Union Policy, *supra* note 12.

113. 904 F.2d 1236 (8th Cir. 1990).

114. *Id.* at 1241.

115. 912 F.2d 844 (6th Cir. 1990) (applying Michigan law).

116. *Id.* at 847.

117. *Id.*

*mental Casualty Co.*,<sup>118</sup> the United States Court of Appeals for the First Circuit determined that the contract exclusion did not bar coverage of liability for age discrimination pursuant to the ADEA, despite a jury's finding that the employee's employment contract was breached. The court ruled that the exclusion was inoperative because the imposition of liability on the policyholder pursuant to the ADEA "did not depend on the existence of an underlying contract, but only on the existence of an ongoing employment relationship."<sup>119</sup>

On the other hand, in *Continental Casualty Co. v. Anne Arundel Community College*,<sup>120</sup> the United States Court of Appeals for the Fourth Circuit upheld a jury's determination that this exclusion barred coverage for a back pay award for civil rights violations, reasoning that although the exclusion's applicability to back pay awards was ambiguous, there was enough extrinsic evidence of the parties' intent in the record to permit the jury's determination.<sup>121</sup> The court of appeals declined to detail the evidence of the parties' intent upon which the jury based its determination.<sup>122</sup>

## II. COVERAGE FOR EMPLOYMENT-RELATED CLAIMS UNDER ERRORS AND OMISSIONS POLICIES (INCLUDING DIRECTORS AND OFFICERS LIABILITY POLICIES)

Like EL policies, there is no standard form E&O policy.<sup>123</sup> Hence, E&O policies include language that differs more or less markedly from insurer to insurer. Nonetheless, because a number of issues recur in E&O coverage litigation, certain generalizations can be made about the employment-related claims coverage afforded by E&O policies. These issues include: (a) who is insured under a policy; (b) what amounts to a claim made against the insured; (c) whether an E&O policy covers claims of intentional discrimination against the insured; (d) whether the insured's liabilities are "damages" under the policy; and (e) whether the E&O policy's "contract exclusion" bars coverage for back pay awards. This sec-

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118. 930 F.2d 89 (1st Cir. 1991) (applying Massachusetts law).

119. *Id.* at 94.

120. 867 F.2d 800 (4th Cir. 1989) (applying Maryland law).

121. *Id.* at 803-04.

122. *Id.* at 804.

123. See *International Risk Management Institute, Inc.*, DIRECTORS AND OFFICERS LIABILITY INSURANCE COVERAGE ANALYSIS X.E.I. (1990) (hereinafter, "IRI, D&O Coverage").

tion discusses each of the first three issues as they arise in the context of coverage for employment-related claims. Issues (d) and (e) above arise under policy language substantially the same as that used in EL and other types of policies, and therefore, should be resolved in a similar manner under E&O policies.<sup>124</sup>

#### A. *The Insured Issue*

A typical insuring agreement in an E&O policy provides:

The Company shall pay on behalf of the Insured Person all loss for which the Insured Person is not indemnified by the Insured Organization and which the Insured Person becomes legally obligated to pay on account of any claim made against him, individually or otherwise . . . for a Wrongful Act committed, attempted, or allegedly committed or attempted, by the Insured Person . . . .<sup>125</sup>

E&O policies also often provide complementary coverage for any losses that an insured organization incurs in indemnifying its directors or officers. The following language is typical of such complementary insuring agreements:

This policy shall reimburse the Company for Loss arising from any claim or claims which are first made against the Directors or Officers . . . for any alleged Wrongful Act in their respective capacities as Directors or Officers of the Company, but only when and to the extent that the Company has indemnified the Directors or Officers for such Loss . . . .<sup>126</sup>

Notably, these insuring agreements provide coverage only for liabilities arising out of claims of wrongful acts made against "insured persons" or "directors and officers." With respect to E&O policies that include such language, a claim against an organization or entity only may not be covered under the policy.

For example, in *Olympic Club v. Those Interested Underwriters at Lloyd's London*,<sup>127</sup> the United States Court of Appeals for the Ninth Circuit affirmed the lower court's determination that under California law and the language of certain E&O policies issued to

124. See *supra* parts I.A.3. and I.B.2 for a discussion of these issues.

125. Chubb Insurance Company, Executive Liability and Indemnification Policy, 14-02-0494 (January 1985), *reprinted in* IRI, D&O Coverage, *supra* note 123, at X.E.2.

126. National Union Fire Insurance Company, Directors and Officers Insurance and Company Reimbursement Policy 47353 (August 1988), *reprinted in* IRI, D&O COVERAGE, *supra* note 123, at X.E.3.

127. 991 F.2d 497 (9th Cir. 1993).



the Olympic Club, there was no coverage for the Club's defense costs associated with suits alleging race and gender discrimination by the Club and fifty unnamed "Doe defendants." The court rejected the Club's argument that a claim of unlawful discrimination against the Club necessarily was a claim against the Club's officers, directors, or employees.<sup>128</sup> The court reasoned that the Club's discriminatory policies could have been carried out by its members rather than its officers, directors, or employees;<sup>129</sup> that neither the complaints against the Club nor the Club's by-laws established who created the Club's allegedly discriminatory policies;<sup>130</sup> and that the complaints were made against the Club itself, not against the Club as principal of its directors, officers, or employees under a theory of imputed liability.<sup>131</sup> The court also rejected the Club's argument that because one of the underlying complaints alleged that the Club's discriminatory acts were performed by the "defendants," including the fifty unnamed "Doe defendants," that complaint gave rise to the insured persons' potential liability for the alleged discriminatory acts.<sup>132</sup>

The court's denial of coverage for defense costs does not rest easily with the well-established California rule that the duty to defend is activated if there is *any* potential for coverage for the allegations in a complaint.<sup>133</sup> The Ninth Circuit apparently ignored that rule when it denied coverage, based in part, on its finding that the complaint's "ambiguous" identification of the "Doe defendants" did not "establish" that those unnamed defendants were the Club's directors, officers, or employees.<sup>134</sup>

The premise underlying the holding in *Olympic Club*—namely, that when an E&O policy provides coverage only for the wrongful acts of an organization's directors, officers, or employees it does not also provide coverage to the organization for its own wrongful acts—may have been correct. However, as the dissent noted, the majority's decision was more likely a reaction to the "Club's unsympathetic stance"<sup>135</sup> as an alleged perpetrator of unlawful discrimina-

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128. *Id.* at 500. By endorsement, the policies at issue covered "losses" from wrongful acts done by the Club's officers, directors, or employees. *Id.* at 499.

129. *Id.* at 500.

130. *Id.*

131. *Id.* at 500-01.

132. *Id.* at 501.

133. *See Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 274, 419 P.2d 168, 174-75 (1966).

134. *Olympic Club*, 991 F.2d at 501.

135. *Id.* at 507 (Reinhart, J., dissenting).

tion, than the product of careful interpretation of the policies, the complaints, and the applicable law.

### B. *The "Claim" or "Suit" Issue*

As indicated by the insuring agreements set forth in the previous subsection, E&O policies typically provide defense or indemnity coverage for "claims" or "suits" against insureds. These terms occasionally are defined in E&O policies. For example, an E&O policy form used by Aetna Casualty and Surety Company defines a "claim" as an "adjudicatory proceeding in a court of law or equity brought against any of the Insured Persons which seeks actual monetary damages or other relief and which may result in a loss under this Policy, including appeal from such adjudicatory proceeding."<sup>136</sup> When the term "claim" or "suit" is not defined by policies, insurers often argue that an informal complaint or the institution of an administrative action against an insured does not constitute a "claim" or a "suit."<sup>137</sup> In such cases, courts have construed those terms consistently with the hornbook rules of policy construction that the undefined terms of an insurance contract are to be given their plain and ordinary meanings<sup>138</sup> and that insuring agreements are to be construed liberally and in favor of coverage.<sup>139</sup>

The implications of this approach are potentially significant. In some cases, coverage is promoted by a finding that an administrative action or other demand is a "claim" or "suit," while in other cases it is not. When the underlying demand, claim, or suit was made or brought and whether the policy is an occurrence or claims-made policy are the principal factors influencing whether policyholders or insurers will argue whether a demand, claim, or suit constitutes a "claim" or "suit" as these terms are found in a policy.

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136. Aetna Casualty and Surety Company, Designated Insured Persons and Company Reimbursement Policy, F-1458-a (November 1986), *reprinted in*, IRI, D&O Coverage, *supra* note 123, at V.E. 34.

137. Virtually the same issue arises dramatically under CGL policies in environmental insurance coverage cases. Courts have overwhelmingly held that potentially responsible party ("PRP") letters, which commence administrative proceedings by federal or state environmental agencies against policyholders, are "suits" which activate the duty to defend. *See, e.g.*, Bausch & Lomb Inc. v. Utica Mut. Ins. Co., 330 Md. 758, 769, 625 A.2d 1021, 1026-27 (1993); Hazen Paper Co. v. United States Fidelity and Guar. Co., 407 Mass. 689, 695, 555 N.E.2d 576, 581 (1990); C.D. Spangler Constr. Co. v. Industrial Crankshaft & Eng'g Co., 326 N.C. 133, 153-54, 388 S.E.2d 557, 570 (1990); *but see, e.g.*, Patrons Oxford Mut. Ins. Co. v. Marois, 573 A.2d 16, 20 (Me. 1990) (determining that a clean-up order issued to a policyholder by a state agency was not a "suit").

138. *See* APPLEMAN, *supra* note 15, § 7384, at 70-74.

139. *Id.*, § 7401, at 197.

Thus, for example, in *Community Unit School District No. 5 Counties of Whiteside and Lee v. Country Mutual Insurance Co.*,<sup>140</sup> an Illinois intermediate appellate court determined that a complaint filed with the ("EEOC") and the Illinois Fair Employment Practice Commission alleging that an E&O policyholder engaged in race and sex discrimination against a disappointed job applicant and seeking money damages and injunctive relief was a "civil suit" within the coverage of an E&O policy.<sup>141</sup> Apparently, the term "civil suit" was not defined in the policy.<sup>142</sup> In reaching its determination, the court recognized that because the terms "claim" and "suit" are both commonly understood to mean "an attempt to gain legal redress or to enforce a right"<sup>143</sup> and because the common meanings of "claim" and "suit" are not restricted to "legal actions in the common law courts,"<sup>144</sup> proceedings before administrative or quasi-judicial tribunals are "claims" or "suits."

In contrast, in *Bensalem Township v. Western World Insurance Co.*,<sup>145</sup> a federal district court, interpreted the undefined policy term "claim" in a claims-made policy and considered whether a letter from the EEOC to an E&O policyholder requesting certain information and notifying the policyholder that a charge of age discrimination had been filed against it was not a "claim" under the E&O policy. The court reasoned that because the EEOC's letter did not demand anything from the policyholder, it was not a "claim," as that term is commonly understood.<sup>146</sup> The EEOC letter and information request was made prior to the inception of the policy at issue.<sup>147</sup> A later, more explicit demand from the EEOC was asserted during the policy period, and the court found that this demand constituted a "claim" within the meaning of the policy.<sup>148</sup> Thus, the court ruled, the policy provided defense coverage for the later "claim."<sup>149</sup>

### C. *Intentional Discrimination*

In the context of employment-related claims, a claim of inten-

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140. 95 Ill. App. 3d 272, 419 N.E.2d 1257 (1981).

141. *Id.* at 279, 419 N.E.2d at 1261-62.

142. *Id.*

143. *Id.* at 279, 419 N.E.2d at 1261.

144. *Id.*

145. 609 F. Supp. 1343 (E.D. Pa. 1985) (applying Pennsylvania law).

146. *Id.* at 1349.

147. *Id.* at 1347.

148. *Id.* at 1349.

149. *See, e.g.,* APPLEMAN, *supra* note 15, § 7401, at 197.

tional discrimination, or "disparate treatment," involves an allegation that an employer intentionally treated an employee less favorably than other employees on the basis of a protected classification, e.g., race, religion, nationality, or sex.<sup>150</sup> Courts have determined that the definition of "Wrongful Act" in E&O policies permits coverage for claims of disparate treatment. "Wrongful Act" is often defined as: "any actual or alleged error, misstatement, misleading statement, act or omission, or neglect or breach of duty by the Directors or Officers in the discharge of their duties solely by reason of their being Directors or Officers of the Company."<sup>151</sup>

Courts finding coverage under this language have reasoned that such language must be enforced as written, and that insurers that do not want to provide coverage for acts of intentional discrimination could have drafted the definition of "Wrongful Act" to state that expressly, or could have excluded such intentional acts from coverage explicitly.<sup>152</sup>

The above-quoted policy language has been distinguished from another typical definition of "Wrongful Act," which provides coverage only for "negligent" acts, errors, omissions, misstatements, or misleading statements. Certain courts interpreting this definition of "Wrongful Act" have determined that such language bars coverage for claims of intentional discrimination.<sup>153</sup>

### III. CONCLUSION

Employers of all types and sizes have faced, and will continue to face, an onslaught of employment-related claims. Traditional

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150. See *International Bhd. of Teamsters v. United States*, 431 U.S. 324, 335-36 n.15 (1977).

151. CNA Insurance Company, *Directors' and Officers' Liability Insurance Policy*, G-11126-4 (October 1983), reprinted in *IRI, D&O COVERAGE*, *supra* note 123, at X.E.4.

The definition of "Wrongful Act" set forth above may not permit coverage for claims made against "directors or officers" by virtue of their conduct outside their capacities as directors and officers. See *Bowie v. Home Ins. Co.*, 923 F.2d 705, 708-09 (9th Cir. 1991) (affirming district court's determination under California law that an E&O insurer had no duty to defend its policyholder's directors in a suit filed against them in connection with their capacities as directors of another company).

152. See, e.g., *New Madrid County Reorganized Sch. Dist. No. 1, Enlarged v. Continental Casualty Co.*, 904 F.2d 1236, 1240-41 (8th Cir. 1990) (applying Missouri law); *Independent Sch. Dist. No. 697, Eveleth v. St. Paul Fire and Marine Ins. Co.*, 515 N.W.2d 576, 580 (Minn. 1994).

153. See, e.g., *Golf Course Superintendents Ass'n v. Underwriters at Lloyd's, London*, 761 F. Supp. 1485, 1489-90 (D. Kan. 1991) (applying Kansas law); *School Dist. No. 1, Multnomah County v. Mission Ins. Co.*, 58 Or. App. 692, 701, 650 P.2d 929, 935-36 (1982).

types of liability insurance purchased by employers, including EL insurance and E&O insurance, often provide coverage for such claims. Employers would do well to ascertain the extent to which their EL and E&O policies may provide coverage for the employment-related claims that have been or might be, made against them before deciding to bear the cost of such claims themselves or purchasing additional (and perhaps unnecessary) insurance to secure such coverage.