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I. INTRODUCTION: USING RISK MANAGEMENT TECHNIQUES TO AVOID AND MINIMIZE EMPLOYMENT DISCRIMINATION LIABILITIES

Employment lawyers have witnessed a virtual revolution in employment relations law during the past thirty years. Traditionally, the employment relationship was regarded as "at will," and thus terminable by the employer or employee at any time, for any reason, or for no reason at all.[1] Although the federal government intervened substantially in private employment relationships in response to the economic catastrophe of the Great Depression,[2] employers remained largely free of regulation until the 1960's, when statutory and common law exploded with new developments. Today, federal statutes affording protections to employees address a wide range of issues and are often supplemented by state legislation. Much of this legislation defines the civil rights of applicants and employees by prohibiting various forms of discrimination.[3] The potential liabilities associated with discrimination in the workplace comprise only part of a much broader exposure that employers face in the changing employment law environment,[4] but discrimina-

1. For discussions of the history and merit of the "at will" rule, see Jay M. Feinman, *The Development of the Employment at Will Rule*, 20 AM. J. LEGAL HIST. 118 (1976); *see also* Deborah A. Ballam, *Exploding the Original Myth Regarding Employment-at-Will: The True Origins of the Doctrine*, 17 BERKELEY J. EMP. & LAB. L. 91 (1996); Richard A. Epstein, *In Defense of the Contract at Will*, 51 U. CHI. L. REV. 947 (1984).

2. *See* National Labor Relations Act of 1935, 29 U.S.C. §§ 151-69 (1994); Federal Old-Age, Survivors, and Disability Insurance Benefits Act (Social Security Act) of 1935, 42 U.S.C. §§ 401-33 (1988); Fair Labor Standards Act of 1938, 29 U.S.C. §§ 201-19 (1988).

3. *See* Civil Rights Act of 1964 (Title VII), 42 U.S.C. § 2000e-1 to e-17 (1994); Civil Rights Act of 1991, Pub. L. No. 102-106, 105 Stat. 1071 (codified as amended at 42 U.S.C. §§ 1987, 2000e (1991)); Age Discrimination in Employment Act, 29 U.S.C. §§ 621-34 (1994); Americans With Disabilities Act, 42 U.S.C. §§ 12101-12213 (1994).

4. Increasingly, Congress has passed legislation which generally regulates the terms and conditions of employment, going far beyond the anti-discrimination principle. *See* Employee Polygraph Protection Act, 29 U.S.C. §§ 2001-2109 (1994); Family and Medical Leave Act, 29 U.S.C. §§ 2601-2654 (1994); Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, 110 Stat. 1936. Additionally, there have been significant developments in the common law of employment relations, including expanded recognition of implied-in-fact contracts premised on oral statements or employee handbooks, promissory estoppel, defamation, and wrongful discharge in contravention of public policy.

tion liabilities remain a preeminent concern for most employers.

For many employers, managing this risk of liability is a vital part of their human resources mission and an important part of their general corporate cost-control program. It would be unrealistic to study the legal liabilities and remedies afforded by anti-discrimination laws without also assessing the risk management strategies undertaken by employers in response to these laws. Stable and effective risk management is sometimes elusive, since the rapidly changing legal landscape and resulting doctrinal uncertainty can render it difficult to assess and minimize the client's exposure with any assurance until the appeals in a particular case have been exhausted. Nevertheless, corporations actively pursue risk management as an important goal in the area of employment discrimination.

The tremendous increase in discrimination suits brought against employers[5] has made risk management of discrimination liabilities particularly important. Because defense expenditures and the potential for judgments or settlements resulting from suits alleging employment discrimination represent significant costs that must be minimized in a competitive economy, risk management is driven by strong financial incentives. In this sense, risk management is the product of a cost-benefit analysis that weighs a significant exposure against the relatively small cost of minimizing liability. Additionally, liability for certain kinds of discriminatory behavior (such as sexual harassment) by supervisors and other employees is assessed against employers if they are unable to establish that the offending employee was acting outside the scope of the agency relationship. Consequently, an employer must adopt proactive anti-discrimination policies to avoid vicarious liability,[6] meaning that risk management is driven directly by the legal requirements of anti-discrimination laws. Finally, a business may wish to avoid the negative consequences of discrimination claims that are not directly legal or

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5. Two commentators report that the employment discrimination caseload in the federal courts grew at the astonishing rate of 2,166% between 1970 and 1989, as compared to an overall increase in the federal caseload of 125%. *See* John J. Donahue, III & Peter Siegelman, *The Changing Nature of Employment Discrimination Litigation*, 43 STAN. L. REV. 983, 985 (1991). The developments in employment discrimination law in the 1990's, coupled with the enormous dislocation of workers by corporate downsizing during this period, have resulted in the growth in employment discrimination cases continuing to exceed the growth in civil filings generally. *See also* Peter Eisler, *Overloaded System Tests New Strategies*, USA TODAY, Aug. 15, 1995, at 10A (reporting that the number of employment discrimination cases filed in federal district court increased a total of 109% between 1990 and 1994); Vince Bielski, *Age Bias Suits Up With Downsizing*, 109 LOS ANGELES DAILY J. 1 (1996).

6. *See* Gary v. Long, 59 F.3d 1391, 1398 (D.C. Cir. 1995) (holding that an employer can absolve itself of vicarious liability from a hostile environment claim if it "has taken energetic measures to discourage sexual harassment in the work place and has established, advertised and enforced effective procedures to deal with it when it does occur.").

financial, including the effect of claims on employee morale, recruitment of new employees, and public perception of the business. This more amorphous interest driving risk management may require the employer to act affirmatively in ways that extend beyond limiting the legal liability and attendant financial costs caused by discriminatory behavior.

Sophisticated employers generally rely on a number of different risk management techniques. These techniques are both proactive and reactive in nature. For example, a risk-averse employer will often formulate corporate policies and procedures designed to ensure that all decisions about the terms and conditions of employment will be nondiscriminatory. Such proactive strategies can run the gamut from educating managers and workers about behavior in the workplace that is proscribed by law, to more ambitious efforts to create a diverse workplace in which all employees feel free of discriminatory animus. Additionally, employers attempt to react to employee grievances in a manner that reduces the potential of suffering the expense and disruption of litigation. For example, many employers now mandate arbitration of employment disputes in accordance with a sophisticated internal grievance procedure in an effort to rapidly settle plausible claims. An important component of most risk management programs is liability insurance, which provides for a legal defense of lawsuits and payment of judgments and settlements within the scope of coverage that the employer might suffer. This article analyzes the increasing reliance by employers on liability insurance to manage the risk of employment discrimination liabilities, and predicts some of the consequences of this emerging trend.

It bears repeating that insurance coverage is only part of the risk management program that should be used to manage the risk arising out of employment-related practices. In light of the expansive motivations and goals of risk management described above, corporate employers likely desire far more than litigation services, since the very presence of discrimination claims signals that a given work site may not be as productive as possible. Moreover, insurance may not even be the most desirable technique for dealing with the threat of litigation. First, insurance coverage will often be a disputed matter, leading to uncertainty and perhaps to increased transaction costs in dealing with employment claims. Additionally, insurance defense counsel retained by the insurance carrier may conduct the litigation in a manner that conflicts with the employer's broader human resources strategy for dealing with employee grievances. This is particularly true when the aggrieved employee is primarily seeking reinstatement with the employer; the employer may desire to settle the matter for a much higher cash payment without reinstatement, while the insurer may be interested in obtaining

the most cost effective resolution of the case. Finally, an insurer's underwriters may refuse to continue coverage for a reasonable price if the employer submits an inordinate number of employment-related claims within a particular period.

On the other hand, insurance coverage might afford far more in terms of risk management than simply defending claims and paying losses. Depending on the importance to the insurer of the employer's account, the employer may be able to secure the insurer's agreement to establish a loss prevention and claim settlement procedure that would allow the employer to participate actively in risk management at every stage. Needless to say, the employer's counsel should work together with the insurer in this regard; if possible, the employer might insist that an on-going risk management committee (composed of counsel and claims and loss control personnel from the insurer and the employer's human resource managers) coordinate the risk management strategies relating to employment practices. Such coordination would involve the employer, rather than subjecting it to an insurer that reacts according to its own interests when problems arise. In so doing, the employer could take advantage of the insurer's risk management expertise and integrate insurance coverage with broader strategies and techniques. These additional "oversight" benefits of insurance coverage have been acknowledged by both courts and regulators.[7] In one case, an Illinois court held that the insured employer could lose claimed coverage by failing to satisfy the notice conditions of the policy, even though the insurer was not obligated under the policy to provide a legal defense of the claim.[8] The court based its ruling on the assumption that the insurer might want to start a loss prevention program with the insured immediately upon receiving notice of the claim in order to reduce the likelihood of any

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7. The New York Department Of Insurance reversed its longstanding prohibition on insurance coverage of discrimination actions and decided to permit coverage of disparate impact liabilities, in part, because the Department believed that public policy would be furthered by the beneficial effects of loss prevention programs. *See* American Management Ass'n v. Atlantic Mut. Ins. Co., 641 N.Y.S.2d 802, 808 (Sup. Ct. 1996). In its holding, the court quotes from the Department's Circular Letter No. 6 (May 31, 1994): "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. Any employer who does not diligently attempt to modify employment procedures accordingly may well be denied insurance coverage." Similarly, in a wrongful discharge case, an Illinois Appellate Court acknowledged that permitting employers to insure against employment-related liabilities would further the public interest in reducing unfair or abusive treatment in the workplace. Dixon Distrib. Co. v. Hanover Ins. Co., 612 N.E.2d 846, 857 (Ill. App. Ct. 1993) ("Having a third party, with an economic interest to protect, oversee the actions of the employer could be very beneficial to the employee and society."), *aff'd*, 641 N.E.2d 395 (Ill. 1994).

8. *See* University of Illinois v. Continental Cas. Co., 599 N.E.2d 1338, 1355 (Ill. App. Ct. 1992).

future claims.[9]

As employment discrimination litigation has become more prevalent and more expensive, many employers have responded by aggressively claiming that their liability insurance provides coverage for these disputes. It is not unusual for employers to seek insurance coverage of these claims, especially since the "first liability insurance policies . . . were purchased by employers as protection against tort liability to employees resulting from work injuries,"[10] prior to the adoption of workers' compensation legislation. Defense counsel, whether in-house counsel supervising litigation or outside counsel retained by the employer to defend the suit, play an important role in assisting clients to identify potential insurance coverage for discrimination claims. Moreover, as the insurance industry reacts to the greatly expanding liabilities it faces in connection with providing coverage for discrimination suits by excluding such suits from coverage under general liability policies, a number of insurers have developed, and are now aggressively marketing, a new liability insurance product designed specifically to provide coverage for these liabilities. Consequently, counsel to the employer should play a role in determining which products best cohere with the employer's broader risk management strategies and human resources philosophies.

This article discusses insurance coverage of employment discrimination claims under both existing policies and emerging Employment Practices Liability Insurance policies: The first part describes the "three

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9. *See id.*

10. ROBERT E. KEETON & ALAN I. WIDISS, INSURANCE LAW § 4.8(a) (student ed. 1988). *See* C. ARTHUR WILLIAMS, JR., INSURANCE ARRANGEMENTS UNDER WORKER'S COMPENSATION 3-4 (1969) (asserting that an 1886 employer's tort liability policy was the first instance of liability insurance in America).

For a good overview of the many issues arising in connection with insurance coverage of employment disputes generally, see Symposium: *Insurance Coverage of Employment Disputes*, 18 W. NEW ENG. L. REV. 1-269 (1996). *See also* WAYNE E. BORGEEST & PATRICK M. KELLY, EMPLOYMENT LAW LIABILITY CLAIMS: WHAT YOU NEED TO KNOW ABOUT INSURANCE COVERAGE (Practicing Law Institute 1995); PAUL E.B. GLAD & RICHARD V. RUPP, EMPLOYMENT-RELATED LIABILITY CLAIMS AND INSURANCE (Practicing Law Institute 1995); Irene A. Sullivan & Adam C. Rosenberg, *Insurance Coverage for Wrongful Termination and Employment Discrimination Claims, in* INSURANCE COVERAGE LITIGATION (Practicing Law Institute 1994); Kearney W. Kilens, *Employer Insurance Coverage for Employment Litigation*, 79 ILL. B.J. 32 (1991); Robert A. Machson & Joseph P. Monteleone, *Insurance Coverage for Wrongful Employment Practices Claims Under Various Liability Policies*, 49 BUS. LAW. 689 (1994); John E. Peer & Ronald E. Mallen, *Insurance Coverage of Employment Discrimination and Wrongful Termination Actions*, 55 DEF. COUNS. J. 12 (1988); Douglas R. Richmond, *Insurance Coverage for Wrongful Employment Practices*, 48 OKLA. L. REV. 1 (1995); David M. Spector & David B. Ritter, *Insurance Coverage of Employee Claims Against Employers*, 5 LAB. LAW. 615 (1989); Richard L. Suter, *Insurance Coverage of Discrimination, Sexual Harassment and Other Employment-Related Claims*, 11 ME. B.J. 82 (1996).

dimensional model" of liability insurance; the second part describes general principles of interpretation as applied by courts to insurance policies; and the third part describes public policy limitations on the interpretation of insurance policies. These first three sections establish the background necessary for analyzing the availability of insurance coverage for employment disputes. The fourth part of the article then analyzes the potential for coverage under standard types of liability insurance, while the fifth part describes the duties which arise in the event of coverage. Finally, the last part describes the relevant considerations that a discrimination claimant may wish to take into account when framing a complaint against the employer. The article concludes by suggesting that the coverage battles of the 1990's may slowly wind down, but that equally interesting and difficult issues may arise under newer policy forms. Additionally, I suggest that the existence of insurance may have a more profound regulative effect on the behavior of employers than the anti-discrimination statutes that create the underlying liability.

II. The "Three Dimensions" of Liability Insurance Coverage

It is impossible to examine the potential for insurance coverage competently without drawing upon a detailed understanding of substantive employment discrimination law and the specifics of the claims being asserted against the employer. Reviewing the relevant insurance policies is complicated by the fact that a number of common liability policies might provide coverage when an employer faces an employment-related claim of discrimination.[11] This section provides a brief overview of the liability policies that potentially afford coverage for claims of employment discrimination.

In order to identify relevant liability insurance policies, employment discrimination lawyers must understand the three-dimensional model of insurance coverage that operates in many cases. First, the employer's liability insurance program has a "width," comprised of a number of different kinds of policies that provide primary insurance coverage. Second, the liability program has a "height," defined by the different economic levels of coverage provided by various insurance products. Finally, the liability program has a "length," consisting of an historical succession of policies owned by the employer during the time period implicated by the allegations in the complaint. To assess the

11. Professor Kenneth Abraham analyzed the general problem in the insurance market of the "heavy reliance on so many different forms of insurance and of the relatively disorganized way in which all this coverage has come into being." Kenneth S. Abraham, Distributing Risk 133-72 (1986).

potential for insurance coverage of a particular claim of employment discrimination, the employment lawyer must fully examine the "three dimensions" of the employer's insurance portfolio. A discussion of each of these "dimensions" of the employer's liability insurance program follows.

A. *Primary Coverages*

1. WORKER'S COMPENSATION AND EMPLOYER'S LIABILITY

The Worker's Compensation and Employer's Liability ("WC\EL") Policy provides primary liability coverage especially designed for employment-related claims of bodily injury. In fact, this product is a combination of two distinct types of coverage.[12] Under the policy, the worker's compensation coverage promises to pay all benefits due from the employer pursuant to the governing worker's compensation scheme. Worker's compensation statutes vary from state to state, sometimes to a significant degree.[13] Generally, these statutory schemes impose no-fault liability on employers to pay death benefits, medical and rehabilitation expenses, and/or lost wages to employees suffering injuries that arise out of, or occur during, the course of their employment. In exchange, the statutes insulate the employer from what would often be more expansive tort liability.[14] The Employer's Liability coverage, in contrast, promises to pay on behalf of employers certain liabilities incurred to employees that fall outside the scope of the worker's compensation statutes.

Most states adopt the standard form Worker's Compensation and

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12. As one court recently summarized:

> [E]mployers' liability insurance is traditionally written in conjunction with workers' compensation policies, and is intended to serve as a "gap-filler," providing protection to the employer in those situations where the employee has a right to bring a tort action despite the provisions of the workers' compensation statute or the employee is not subject to the workers' compensation law. Generally, these two kinds of coverage are mutually exclusive.

Producers Dairy Delivery Co. v. Sentry Ins. Co., 718 P.2d 920, 927 (Cal. 1986) (citations omitted); *see also* Ottumwa Hous. Auth. v. State Farm Fire & Cas. Co., 495 N.W.2d 723, 729 (Iowa 1993) (noting that "[e]mployers' liability insurance protects an employer against common-law liabilities for injuries resulting to employees. In contrast, workers' compensation insurance protects the employer against liability imposed by the worker's compensation acts.").

13. Several states still make the worker's compensation scheme elective for both employer and employee, a carryover from the necessity to avoid constitutional challenge earlier this century. *See* ARTHUR LARSON, WORKMEN'S COMPENSATION § 5.20 (1988).

14. *See* Suckow v. NEOWA FS, Inc., 445 N.W.2d 776, 779 (Iowa 1989) (noting that "[an] employer's immunity is the quid pro quo by which the employer gives up his normal defenses and assumes automatic liability, while the employee gives up his right to common law verdicts.") (citation omitted); LARSON, *supra* note 12, at § 1.10; *see also* Richard A. Epstein, *The Historical Origins and Economic Structure of Workers' Compensation Law*, 16 GA. L. REV. 775, 800-03 (1982) (offering an economic justification of the quid pro quo embodied in worker's compensation acts).

Employer's Liability Policy developed and maintained by the National Council on Compensation Insurance.[15] Part One of the policy provides worker's compensation insurance, and covers the insured employer for obligations to injured workers arising under a state's worker's compensation and occupational disease laws.[16] The policy specifically refers to the worker's compensation statutes in effect for the jurisdiction and promises to pay all wage loss and medical benefits that the injured worker is entitled to receive under these statutes.[17]

Under the policy, the insurance company has the right and duty to defend the insured employer in the event of suit, or other action by the employee, to collect on a disputed claim.[18] By reserving a right to defend, the insurance company maintains its ability to provide the insured employer with effective defense counsel and to ensure that a potential covered settlement or judgment is minimized. In turn, the insurance company's duty to defend provides the insured an important protection against the costs of litigating claims for benefits. This duty to defend is an obligation equal in importance to the insurance company's duty to pay the loss on behalf of the insured employer.

Not every claim involving injury to an employee will be covered under Part One. Part Two, Employer's Liability, covers the insured employer for accidents or disease which cause an employee's injury, but which are not compensable under the state's worker's compensation statute.[19] Ordinarily, when the employee is injured, workers compensation benefits will be the exclusive remedy for the injury.[20] One type of claim that falls outside the scope of the worker's compensation statutes is injury or loss to the employee's spouse, including loss of consortium, arising out the employee's injury.[21] Claims asserted against the employer by the spouse of an injured employee will be covered under the Employer's Liability part of the policy.[22] These claims are asserted in ordinary civil proceedings, as contrasted with claims for worker's

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15. The National Council on Compensation Insurance (NCCI) is an organization that services the insurance industry by developing and filing policy language, rules, and rates with state regulatory authorities.

16. *See* JOHN A. APPLEMAN, INSURANCE LAW AND PRACTICE §§ 4571, 4625 (Berdal ed., 1979)

17. *See* JOHN A. APPLEMAN & JEAN APPLEMAN, INSURANCE LAW AND PRACTICE § 7051 (1981); LEE R. RUSS & THOMAS F. SEGALLA, COUCH ON INSURANCE § 1:36 (3d ed. 1995); GEORGE J. COUCH, III, CYCLOPEDIA OF INSURANCE LAW §§ 44:13, 56:51 (Ronald A. Anderson et al. eds., 1982).

18. *See* COUCH, *supra* note 17, § 56.51.

19. *See* APPLEMAN, *supra* note 16.

20. *See id.* § 4571.

21. *See id.*

22. *See id.*

compensation benefits that are ordinarily adjudicated in an administrative forum.

Insurance policies, including the Worker's Compensation and Employer's Liability Policy, contain exclusions which are designed to bar recovery in some situations. Exclusions in these policies limit recovery if there have been illegal or willful acts by the insured employer. These policies also impose duties and conditions on both the insured employer and the insurance company. While the insurance company has the duty to defend, the insured employer is responsible for notifying the insurance company of a loss and for cooperating in the settlement of the loss.[23]

2. COMMERCIAL GENERAL LIABILITY

The Commercial General Liability ("CGL") Policy provides basic liability insurance coverage for various business entities and governmental units. The CGL policy serves as a general-purpose foundation for the insured's liability coverage, much like the typical homeowner's policy provides individuals with their basic liability coverage. For purposes of employment-related claims, the CGL policy is fairly described as promising to pay, on behalf of the employer, the liabilities associated with bodily injuries and property damage for which the insured is liable.[24]

The Insurance Services Office's ("ISO")[25] CGL policy, adopted in October of 1993, follows a straightforward format. Section I sets forth the coverages provided by the policy. Each coverage is stated in terms of an "insuring agreement" that defines the grant of coverage and exclusions that limit the scope of the insuring agreement. Section II defines the persons and entities who are insured under the policy. Section III defines the limits of insurance, as expressed in the dollar amounts set forth on the "Declarations" page of the policy. Section IV sets forth conditions of the insurance contract, including rights and duties of both the insurer and the insured. Finally, and of great importance, Section V provides definitions of the key terms used throughout the policy.

The CGL policy covers a wide range of liability exposures facing

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23. *See generally* DONALD S. MALECKI ET AL., COMMERCIAL LIABILITY INSURANCE AND RISK MANAGEMENT (3d ed. 1996). The authors have prepared this two volume text as reading for the course of study leading to the Chartered Property Casualty Underwriter (CPCU) designation. CPCU is a widely recognized symbol of professional achievement in the insurance industry. *See also supra* notes 16-17.

24. *See* Richard J. Fitzgerald, *The ISO's General Liability Policy*, J. Mo. B., Sept. 1987, at 383.

25. Insurance Services Office, Inc. is a national insurance industry service organization that develops and files coverage forms, promulgates advisory loss costs, and performs other services for and on behalf of its member companies. *See* Fitzgerald, *supra* note 24, at 383, 387.

businesses and other organizations, including "slip and fall" injuries suffered by visitors to the insured's business premises, injuries caused by the insured's products and completed work, and injuries resulting from certain intentional acts of the insured's agents, such as libel and slander.[26] The CGL policy contains three grants of coverage: Coverage A, Bodily Injury and Property Damage Liability; Coverage B, Personal and Advertising Injury Liability; and Coverage C, Medical Payments.[27] These coverages are subject to exclusions barring recovery in certain situations,[28] and limiting liability to a maximum dollar amount for each occurrence.[29] The coverages are capped by an aggregate limit for all losses paid during any annual period.[30]

Coverage A is an agreement by the insurance company to pay damages to an injured third party on behalf of the insured for those "occurrences" (defined as "accidents") that trigger the policy and result in "bodily injury" or "property damage" during the policy period. In addition to this occurrence "trigger," a "claims-made trigger" is available, but only provides coverage if the claim for bodily injury or property damage was first made during the policy period.[31] Coverage A also provides that the insurance company has a duty to defend the insured in actions brought by the third-party claimant. Because defense costs may be a substantial portion of the insurance company's payout on a given claim, this duty is an important feature of the coverage.

Coverage B provides coverage to the insured for certain intentional torts it commits against others.[32] These offenses typically include libel, slander, and wrongful entry. Again, the policy pays judgments and claims against the insured and defends the insured against actions brought by third parties.

Coverage C provides a no-fault response to an occurrence for which the insured may or may not be liable.[33] Typically, this coverage will pay the medical bills of someone who has suffered bodily injury in connection with the insured's premises or business operations.[34]

One important caveat is in order. The ISO regularly amends its

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26. MALECKI, *supra* note 23, Ch. 3, 4.

27. *See* James T. Hendrick & James P. Wiezel, *The New Commercial General Liability Forms—An Introduction and Critique*, 36 FED'N INS. & CORP. COUNS. Q. 319, 322 (1986).

28. *See id.* at 343-68.

29. *See* Fitzgerald, *supra* note 24, at 386; Hendrick & Wiezel, *supra* note 27, at 335.

30. *See* Fitzgerald, *supra* note 24, at 384; Hendrick & Wiezel, *supra* note 27, at 333, 335.

31. *See* Fitzgerald, *supra* note 24, at 383-85; Hendrick & Wiezel, *supra* note 27, at 332, 336.

32. *See* Fitzgerald, *supra* note 24; Hendrick & Wiezel, *supra* note 27.

33. *See id.* Fitzgerald, *supra* note 24; Hendrick & Wiezel, *supra* note 27.

34. For additional insight into the design and content of the CGL policy, see Phil Watkins, *General Liability Insurance: What it Covers*, 52 TEX. B.J. 898 (1989); Hal G. Block, *Professional and General Liability Insurance Coverage*, 13 BARRISTER 31 (1986).

standard policy forms and usually creates optional endorsements. Additionally, insurance carriers may draft their own policies or endorsements that differ from the current ISO forms. Although the foundational legal principles discussed in this article are unlikely to change in the near future, the specific policy language used as examples may very well differ from the terms contained in a particular CGL policy. The growing body of case law interpreting the availability of coverage for employment-related disputes must be reviewed carefully, since the decisions in many of these cases—even cases only several years old—are predicated on policy language no longer used by many insurance carriers. When analyzing a contract, painstaking attention must always be paid to the precise terms of the contract before researching applicable legal precedent.

3. DIRECTORS AND OFFICERS

Another primary liability policy that may provide coverage for an employment discrimination claim is Directors & Officers ("D&O") Liability Insurance.[35] In some cases, claims made against a business by a disgruntled or former employee will also include separate claims against individual corporate officials.[36] A D&O policy generally indemnifies a company for any settlements, judgments, and expenses incurred resulting from claims premised on wrongful acts committed by its directors and officers acting in their official capacity.[37] These wrongful acts include bad decisions, error, and neglect in corporate matters that cause third persons to suffer harm, particularly financial harm, but may also include intentional acts.[38] D&O policies may also insure the directors and officers personally.[39]

Although there is no standard industry D&O policy form, most insurance companies' forms follow a similar format. Coverage A extends coverage to directors and officers for damages that they are personally obligated to pay due to their wrongful acts. Coverage B, called "corporate reimbursement coverage," reimburses the corporation for its costs in defending or settling claims against its officers and directors.[40] Coverage is activated by a "claims-made trigger," and defense costs, if

35. *See* COUCH, *supra* note 17, § 44:397.

36. *See id.*

37. *See id.*

38. *See* MALECKI, *supra* note 23, Ch. 11; *see also* COUCH, *supra* note 17, § 44:397; Carol A. Noer, *Selected Cases on Directors' and Officers' Liability Insurance Law*, *in* SECURITIES LITIGATION 1994 (Dan L. Goldwasser ed., 1994).

39. *See* COUCH, *supra* note 17, § 44:397.

40. *Id.*

covered, are included within the policy limit.[41] Most insurance companies' forms do not include a duty to defend, and some forms do not provide coverage for defense costs. The policy usually is subject to a deductible and contains exclusions which bar recovery for certain wrongful acts such as fraud.

4. ERRORS AND OMISSIONS

Errors and Omissions coverage protects accountants, architects, engineers, lawyers, and other non-medical professionals for acts, errors, or omissions arising from their professional duties. There is no industry-wide standard policy, but most insurance companies provide coverage for the insured's legal obligation to pay damages arising out of the rendering of, or the failure to render, professional services. Defense costs are covered within policy limits, and exclusions bar recovery for certain acts, including those better covered elsewhere under CGL, Auto, or Employer's Liability policies.[42]

5. EMPLOYMENT-RELATED PRACTICES LIABILITY

It is now general insurance industry practice to exclude liability for employment-related acts, such as wrongful termination, discrimination, and sexual harassment, from standard CGL and Employer's Liability policies; nevertheless, an increasing number of insurance companies are willing to write this coverage by special endorsement or separate policy. There is no standard coverage form, but Employment-Related Practices Liability ("EPLI") policies generally cover liability arising out of employment-related offenses committed by an insured employer against its employees.[43] Coverage is usually on a claims-made basis, and includes the cost of judgments or settlements plus defense costs. Some carriers, however, are writing the policies as "litigation insurance" which only provides coverage for defense costs incurred in employment litigation.[44] Exclusions may bar coverage for acts involving fraud and bodily injury other than emotional distress, mental anguish, or humiliation.[45]

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41. *Id.*

42. *See* MALECKI, *supra* note 23, at Ch. 10; *see also* APPLEMAN & APPLEMAN, *supra* note 17, § 5256; COUCH, *supra* note 17, § 48:166; DAVID W. ICHEL, PROFESSIONAL LIABILITY COVERAGE PROBLEMS OF ATTORNEYS, ACCOUNTANTS, AND INSURANCE BROKERS (1984) (PLI Litig. & Admin. Practice Course Handbook Series No. 260, 1984).

43. *See* MALECKI, *supra* note 23, Ch. 11; *see also* Karen Gordon, *Overview of Employment Practices Liability and EPLI Market Survey*, *in* EMPLOYMENT LAW LIABILITY CLAIMS 253, 258 (Wayne E. Borgeest & Patrick M. Kelly eds., 1995).

44. *See id.*

45. *See id.*

6. ADDITIONAL COVERAGES

Certain risks, such as liability incurred by a business on account of the negligent operation of its automobiles, are covered by separate policies premised on different underwriting and pricing. The Business Auto Policy covers insured employers for their liability and defense costs arising out of the use of a covered automobile.[46] Should liability be imputed to an employer for sexual harassment of an employee carried out by the use of a company car, coverage under this kind of policy is potentially triggered.[47] Even more specific is Pension and Welfare Fund Fiduciary Liability Insurance, which insures pension and welfare benefit plans, administrators, and trustees against suits alleging wrongful acts in connection with the operation of such plans. However, the narrow remedies afforded to plan beneficiaries under ERISA,[48] and the Supreme Court's interpretation of such remedies,[49] make it unlikely that a discrimination suit would trigger coverage under this kind of policy.[50] Finally, most individuals have homeowners' policies that afford personal liability coverage. When a discrimination plaintiff alleges counts against individual agents and employees of the employer, it is prudent for these individuals to assess potential coverage under their personal liability products. However, because homeowners' policies generally exclude liabilities incurred by the individual in the course of business pursuits, there is often no potential for coverage.[51]

In summary, a number of different policies or endorsements provid-

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46. *See* MALECKI, *supra* note 23, Ch. 5; *see also* APPLEMAN & APPLEMAN, *supra* note 17, §§ 4311, 4451, 4452, 7049; COUCH, *supra* note 17, § 45:1.

47. *See, e.g.*, Edquist v. Insurance Co. of N. Am., No. C6-95-1111, 1995 WL 635179, at *2-3 (Minn. Ct. App., Oct. 31, 1995) (rejecting the insured's argument that a claim filed by a female employee, that its area manager sexually assaulted and harassed her in a company car, triggered coverage under its company auto policy because there was no "occurrence" as required by the policy).

48. Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. §§ 1001-1461 (1994). An employee will often only be awarded wrongfully withheld benefits, *see* Massachusetts Mut. Life Ins. Co. v. Russell, 473 U.S. 134, 146-48 (1985), and its developing progeny, and these payments would be outside the scope of covered losses.

49. *See* Massachusetts Mut. Life Ins., 473 U.S. at 146-48.

50. *See, e.g.*, Fieldcrest Cannon, Inc. v. Fireman's Fund Ins. Co., 477 S.E.2d 59, 67 (N.C. Ct. App. 1996) (defining "personal injury" to include discrimination in the Employee Benefits Liability Insurance section of the Broad form policy did not afford coverage for employment discrimination claims under this section); Lapeka, Inc. v. Security Nat'l. Ins. Co., 814 F. Supp. 1540, 1551 (D. Kan. 1993) (granting summary judgment to an insurer facing a claim for coverage by an employer sued for discriminatory termination, because the employee benefit program liability endorsement coverage provided coverage only for negligent administration of the plan, not for discriminatory termination).

51. *See* Greenman v. Michigan Mut. Ins. Co., 433 N.W.2d 346, 349 (Mich. Ct. App. 1988) (denying defendant coverage under his homeowner's policy when he was sued for sexual harassment and intentional infliction of emotional distress, since the allegations fell within the "business pursuit liability" exclusion).

ing primary liability insurance will potentially provide coverage for claims of employment discrimination. Counsel assisting an employer in reviewing its liability coverage must fully review the applicable "width" of the employer's primary insurance protection.

B. *Excess Coverages*

There are two principle kinds of excess coverage: "umbrella" excess coverage and "follow form" excess coverage. Both products are designed to add "height" to an insured's liability program by extending coverage above the limits provided in the underlying primary coverages. The underwriting involved in these products is distinct, since the primary coverages will usually be sufficient to handle claims brought against the insured. Consequently, excess policies are often purchased from a separate insurer that is competing aggressively in the excess market.

The umbrella policy serves two purposes: to extend coverage above the limits of insurance provided in the underlying primary policies, and to offer coverage not available in the underlying policies. Although there is no standard umbrella coverage form, most insurance companies write this coverage for their commercial insureds. Most policies afford defense coverage in addition to a comprehensive grant of liability coverage that will pay the portion of judgments and settlements in excess of amounts paid by the underlying policies. Umbrella policies cover damages for which the insured is liable on account of bodily injury, property damage, personal injury, and advertising injury arising out of an occurrence. Coverage is also available with a claims-made "trigger." Some standard exclusions appearing in CGL and other underlying policies are omitted from umbrella policies, or made less restrictive, in order to broaden the umbrella coverage to fill coverage gaps in the underlying policies. If an umbrella policy covers an occurrence not covered by the underlying policies, the umbrella policy will "drop down" and provide primary coverage for the claim, including a defense of the action.[52] In these circumstances, the policy generally will provide coverage only over a "retained limit" or "self-insured retention," which is equivalent to a deductible.[53] Because the insurance carriers participating in this market have developed their own policy forms, any umbrella policy must be reviewed carefully to determine if this "drop down" coverage exists,

52. *See Dixon Distrib. Co.*, 612 N.E.2d at 849-50 (court described the "unique and special coverage" afforded by an umbrella policy by noting that "under certain circumstances, the policy acts as primary insurance, where there is coverage under the [umbrella] policy but not under any other regular primary policy issued" to the employer).

53. MALECKI, *supra* note 23, Ch. 13; *see* APPLEMAN & APPLEMAN, *supra* note 17, § 4909.85; COUCH, *supra* note 17, § 51:36.

especially if no potential coverage exists under the employer's primary liability insurance policies.[54]

"Follow Form" Excess Liability Policies generally provide coverage under the same terms as the primary policy for liability in excess of those policy limits. The typical Excess Policy will use, or refer to, the same policy language as that in the underlying CGL, Business Auto, Employers Liability or other primary policy. Some Excess Policies, however, may contain their own self-contained policy language modifying or deleting defense costs and other coverages contained in the standard underlying policies.[55] As with umbrella policies, there is no standard coverage form.

Many businesses purchase one or more levels of coverage to supplement their primary liability coverages. These levels of coverages and their inter-relationship are best illustrated with an example. Assume that a company has purchased a CGL policy that includes a $25,000 deductible and a policy limit of $500,000, excess coverage for liability between $500,000 and $1 million, and umbrella coverage up to a limit of $10 million. If an employee recovers a $2 million verdict, all of which is covered under each of these liability policies, the employer would pay the $25,000 deductible, the CGL carrier would pay $475,000, the excess carrier would pay $500,000, and the umbrella carrier would pay $1 million. Because discrimination claims may result in large verdicts, and because an umbrella policy may provide coverage of a suit outside the scope of the primary liability policies, it is important to investigate the full "height" of the employer's insurance coverage.

C. *Time Dimension of Coverages*

Collecting and reviewing the relevant policies that potentially provide coverage for employment discrimination claims is further complicated if the employee alleges continuing discriminatory acts by the employer over a period of several years. Because policy forms change with some frequency, it is necessary to gather all policies potentially triggered by the allegations and examine them closely for differences in

54. In a number of cases employers have sought coverage for employment disputes from their umbrella carrier. *See, e.g.*, Jostens Inc. v. Northfield Ins. Co., 527 N.W.2d 116 (Minn. Ct. App. 1995); *Dixon Distrib. Co.*, 641 N.E.2d at 397-98; Teague Motor Co. v. Federated Serv. Ins. Co., 869 P.2d 1130, 1131 (Wash. Ct. App. 1994); Clark-Peterson Co. v. Independent Ins. Assoc. Ltd., 492 N.W.2d 675 (Iowa 1992). Although umbrella policies are often sold by a different carrier than the carrier providing the relevant primary coverage (reflecting the different underwriting and marketing involved), umbrella coverage sometimes is added to the underlying policy as an endorsement. *See* American Management Ass'n v. Atlantic Mut. Ins. Co., 641 N.Y.S.2d 802, 804 (Sup. Ct. 1996) (interpreting a general liability policy with a drop-down umbrella endorsement).

55. *See* MALECKI, *supra* note 23, Ch. 13.

the coverage they each provide. One substantial difference that may exist between coverages is the so-called "trigger" of coverage. Some policies insure against liability arising as a result of events that cause injury during the policy period; these policies are known as "occurrence"-based insurance. In contrast, other policies insure against claims that are made during the policy period; these policies are known as "claims-made" insurance.

Under standard occurrence coverage policies, each and every policy in force at the time that covered injuries occur potentially provides coverage for the claim. Therefore, it is important to identify the time periods during which the alleged injuries occurred and to review all liability policies in force during this period, regardless of whether different policies are in force at the time the claim for coverage is asserted. In response to the long "tail" of liability facing carriers utilizing occurrence coverage, some insurers recently began issuing liability policies that provide only claims-made coverage.[56] In its pure form, the coverage trigger for this more restrictive policy is a claim made against the insured, during the policy term for an occurrence, taking place during the policy term. Generally, however, coverage is expanded to include claims arising out of occurrences taking place on or after the "retroactive date" specified in the policy. Additionally, many policies provide coverage for claims made during an "extended reporting period," which extends beyond the normal expiration of the policy.

A simple example illustrates the distinction between occurrence and claims-made coverage. Assume that an employer is sued in 1994 for discriminatory behavior allegedly occurring since 1992, as can be the case when an employee asserts a "hostile environment" claim only after a number of years of enduring a discriminatory work place.[57] The employer should investigate potential coverage under any occurrence policies in effect during 1992, 1993, and 1994, as well as under any

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56. *See* KEETON & WIDISS, *supra* note 10, § 5.10(d)(3) (noting that in recent years "most liability insurers have sought to expand dramatically the use of 'claims made' policies to liability risks beyond the professional liability areas in which these coverages came to be used extensively in the 1970s," but also noting the resistance to this move expected in the market). In fact, CGL "occurrence" policies continue to dominate the standard market, notwithstanding the availability, since 1985, of an Insurance Services Office "claims made" CGL policy. However, specialty products, such as fiduciary insurance for pension plan administrators, are more likely to be written on a "claims made" basis. *See, e.g.*, Gulf Resources & Chem. Corp. v. Gavine, 763 F. Supp. 1073 (D. Idaho 1991), *aff'd*, 980 F.2d 737 (9th Cir. 1992). Although Employment Practices Liability Insurance policies are still relatively new to the market and, therefore, still developing in response to consumer demand, it is apparent that these policies will be written almost exclusively on a "claims made" basis.

57. *See, e.g.*, Maine State Academy of Hair Design, Inc. v. Comm'l Union Ins. Co., 699 A.2d 1153, 1155 (Me. 1997) (plaintiff alleged discriminatory acts and a hostile work environment during her ten years of employment prior to being fired).

claims-made policies in effect during 1994. As discussed below, claims-made policies present especially difficult issues in connection with employment discrimination liabilities because the policies often do not define the term "claim," leaving it to the courts to determine if an EEOC/state agency charge, a finding of probable cause, or the commencement of a civil action is necessary before allegations of discrimination are regarded as a claim.

D. *An Example of the Three Dimensions of Coverage*

The following hypothetical demonstrates the significance of the three dimensional model of insurance protection. Assume that an employee alleges that she was subjected to harassment and discrimination by her supervisors and management since 1993. The alleged pattern of harassment includes numerous derogatory statements made about her in front of co-workers and customers, numerous instances of offensive touching, and the maintenance of offensive working conditions in which women felt devalued and ridiculed. The alleged harassment continued until it reached an intensity that compelled the employee to resign in order to escape the intolerable working conditions. At this point, the employee alleges that she has suffered severe emotional distress that manifested in a number of ways, including sleeplessness, weight loss, chronic headaches, and fatigue. Upon resigning in February of 1996, the employee requested severance payments under the employer's welfare benefit plan on the ground that she had effectively been fired from employment without cause. The plan administrator then denied severance based on a company policy formulated by officers of the company. In 1997, the employee brings an action alleging that she was constructively discharged due to the pervasive harassment, discrimination, and defamation, and that she was wrongfully denied severance benefits.

If the employer purchased a reasonable complement of liability coverages, this claim may extend across the full "width" of this insurance portfolio by triggering the basic Commercial General Liability, Employer's Liability, Directors' and Officers' Liability, and Pension Fund Fiduciary Liability policies. Because more recent CGL policies are likely to exclude discrimination and other employment-related practices from coverage with specific language, and because the other policies probably will not afford coverage in many instances, the employer may be left without a plausible claim for coverage, unless it has purchased an EPLI policy.

If the employer purchased a CGL occurrence policy from Company A for two consecutive years beginning January 1, 1993, an occurrence policy from Company B for the policy year beginning January 1, 1995,

and a claims-made policy from Company C each year since January of 1996, there is potential coverage for occurrences under the policies of Company A and B, and for the claims-made policy of Company C. The "length" of insurance may then extend from the first occurrence in 1993 to the date of the claim in 1997. Every CGL policy during that span is potentially involved.

If the basic underlying coverages fail to cover the claim, or are inadequate to pay the full damages, the employer's insurance portfolio will likely include excess coverage in the form of an umbrella policy. The umbrella will supply the "height" in the three dimensional model by providing limits of insurance in excess of those offered by the underlying liability coverages. Additionally, if the underlying policies fail to cover the claim, the umbrella may drop down to provide coverage to fill the gap in the underlying portfolio of coverages, and offer the "height" needed to meet the claim, even without the benefit of underlying limits.

Consequently, in this hypothetical case, it would be necessary to review a number of insurance policies to assess potential coverage for the claims asserted by the plaintiff.[58] This careful review is critical, especially in cases where the alleged occurrences reach back a number of years and therefore may trigger older policies that do not contain effective employment-related practices exclusions.

III. PRINCIPLES OF INTERPRETATION: THE PUBLIC POLICY IN FAVOR OF COVERAGE

Coverage is determined not only by interpreting the terms of the insurance contract as written, but also by applying judicially-created doctrines that may expand the insured's rights beyond a strict reading of the policy language. As one leading commentator summarized, "[j]udges in insurance cases not only make insurance law; sometimes they also make insurance."[59] This section provides an overview of the key principles that govern interpretation of the terms of an insurance contract.

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58. *Cf.* Lumbermen's Mut. Cas. Co. v. S-W Indus., Inc., 39 F.3d 1324 (6th Cir. 1994) (seeking coverage against seven insurers who provided a variety of policies during the relevant period that the employee allegedly suffered injury); Fidelity & Guar. Ins. Underwriters, Inc. v. Everett I. Brown Co., 25 F.3d 484 (7th Cir. 1994) (seeking coverage under a liability package which included a primary liability policy, an excess policy, and a worker's compensation and employer's liability policy); *Dixon Distrib. Co.*, 641 N.E.2d at 395 (claims for coverage under four policies comprising a comprehensive commercial insurance package, including a primary liability policy, an umbrella policy, and a workers' compensation and employers' liability policy).

59. ABRAHAM, *supra* note 11, at 101.

A. *Reading Against the Drafter ("Contra Proferentem")*

If a written contract contains an ambiguity, it is a well-settled maxim that the courts generally prefer an interpretation favoring the party who did not draft the language in question.[60] Although not limited to cases involving adhesion contracts, the maxim *contra proferentem* is followed more rigorously when a significant disparity of bargaining power exists between the parties, and the stronger party supplies all of the terms of the written contract. This, of course, is the situation in the typical insurance transaction, even in the case of a business entity purchasing commercial insurance.[61] Consequently, an employer asserting coverage should prevail if it can demonstrate that one reasonable reading of the policy provides coverage, even if the employer's interpretation is not the only, or even the most, reasonable manner in which to construe the policy language.[62]

This rule of interpretation provides one of the justifications for the universal judicial practice of reading coverage provisions broadly and reading exclusions narrowly. Courts uniformly read Insuring Agreements broadly, reasoning that the insurance company has unilaterally drafted the policy from a position of far greater sophistication and understanding of the underwriting process than the average insured. The following quote is representative of the boilerplate analysis used by courts in assessing coverage: "Contract terms should be read as a reasonable person in the insured's position would have understood

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60. The maxim, *omnia praesumuntur contra proferentem*, is widely cited and is embodied in RESTATEMENT (SECOND) OF CONTRACTS § 206 (1981).

61. *See* Continental Cas. Co. v. Canadian Universal Ins. Co., 924 F.2d 370, 374 n.4 (1st Cir. 1991) (rejecting the argument that the University of Massachusetts is a sophisticated insured that should not be permitted to invoke the maxim). Very large commercial entities (including, of course, insurance companies) are sometimes able to negotiate insurance coverage in a manner that more closely resembles contract negotiation between two parties having equal competence, expertise, and bargaining power, in which case the maxim will have no application. *See, e.g.*, Falmouth Nat'l Bank v. Ticor Title Ins. Co., 920 F.2d 1058, 1061-62 (1st Cir. 1990) (general rules of construction regarding insurance policies do not apply to a case involving a sophisticated insured that had negotiated specific terms in the policy tailored to a particular risk).

62. *See* KEETON & WIDISS, *supra* note 10, § 6.3(a)(2). (noting that "[t]here are literally thousands of judicial opinions resolving insurance coverage disputes in favor of claimants on the basis that a provision of the insurance policy at issue was ambiguous and therefore should be construed against the insurer"); *see also* Western Heritage Ins. Co. v. Magic Years Learning Ctr. & Child Care, Inc., 45 F.3d 85, 88 (5th Cir. 1995) (holding that a policy provides coverage for a claim of sexual harassment when a "physical abuse" coverage endorsement renders later exclusions ambiguous, since the court must adopt the construction of the policy urged by the insured so long as it is not unreasonable); Trustees, Missoula County Sch. Dist. No. 1 v. Pacific Employer's Ins. Co., 866 P.2d 1118, 1124 (Mont. 1993) (holding that a policy exclusion of damages paid for sums owed pursuant to a contract was ambiguous with regard to the employee's statutory claims for bad faith termination and recovery of lost wages and must be read in favor of the employer).

them. . . . The insurer has an affirmative duty to define coverage limitations in clear and explicit terms. . . . An insurance contract is generally liberally construed against the insurer."[63]

Insurers regularly define the scope of coverage in relatively inclusive terms, and then set forth specific limitations on this broad grant of coverage to tailor the risk assumed under the policy. Consequently, coverage disputes often amount to a fight over the correct interpretation of exclusionary language. Exclusions may be generally classified as serving one or more of the following interests: (1) designating certain risks as better covered elsewhere, i.e., with a different insurance product; (2) designating certain risks as insurable only upon the payment of an additional premium; and (3) designating certain risks as uninsurable in the standard market, or in some cases, uninsurable in the insurance market as a whole. Because an exclusion works to "take back" a grant of coverage, courts narrowly construe the language of the exclusion and may shift the burden of proof to the insurer to prove that the otherwise covered risk has been excluded.[64]

Although in many cases the court struggles to find an "ambiguity" that can be interpreted in favor of the insured, the maxim does not empower the court to rewrite the policy terms. For example, in response to an insured's argument that an ambiguity was created when the endorsement to the umbrella policy that specifically excluded coverage for discrimination inadvertently was not signed by the insurer in the relevant year, a Kansas court concluded that the policy terms were clear in light of the intent of the parties.[65] The court concluded: "The general rule that when an insurance contract is open to different interpretations the interpretation most favorable to the insured must be adopted 'does not authorize a perversion of the language, or the exercise of inventive powers for the purpose of creating an ambiguity where none exists.'"[66] Under the *contra proferentem* maxim, there is no basis for overriding the plainly expressed agreement of the parties, as set forth in the policy.

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63. *Lapeka*, 814 F. Supp. at 1544-45 (determining that unintentional discrimination may be an "occurrence," but that the plaintiffs did not suffer "bodily injury" as a result) (citations omitted).

64. *See Western Heritage*, 45 F.3d at 88 (noting that under Texas law, exclusions are construed even more strictly against the insurer than coverage provisions); *Lapeka*, 814 F. Supp. at 1545 (noting that the distinction between coverage and exclusionary provisions is determinative of the burden of proof under Kansas law); Motor Panels, Inc. v. Birmingham Fire Ins. Co., No. 91-CV-7198, 1991 WL 516545, at *2 (N.D. Ohio Nov. 27, 1991), *aff'd*, 955 F.2d 1067 (6th Cir. 1993).

65. Topeka Tent & Awning Co. v. Glen Falls Ins. Co., 774 P.2d 984, 986-87 (Kan. Ct. App. 1989).

66. *Id.* at 987 (citation omitted).

B. *Protecting Reasonable Expectations*

Twenty-five years ago, commentators began to recognize that the courts were interpreting insurance contracts in a manner that could not be explained solely by the *contra proferentem* maxim. In a path-breaking article, then Professor Robert Keeton articulated the "doctrine of reasonable expectations" to explain the interpretive approach increasingly taken by courts since the early 1960's.[67] Judge Keeton summarizes the doctrine in his treatise as follows: "In general, courts will protect the reasonable expectations of applicants, insureds, and intended beneficiaries regarding the coverage afforded by insurance contracts even though a careful examination of the policy provisions indicates that such expectations are contrary to the expressed intention of the insurer."[68] In other words, even when the policy language unambiguously precludes coverage, under certain circumstances, courts will hold that coverage exists.[69]

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67. Robert Keeton, *Insurance Law Rights at Variance With Policy Provisions*, 83 HARV. L. REV. 961, 967 (1970).

68. KEETON & WIDISS, *supra* note 10, § 6.3(a)(3). For commentary on the doctrine, see Kenneth S. Abraham, *Judge-Made Law and Judge-Made Insurance: Honoring the Reasonable Expectations of the Insured*, 67 VA. L. REV. 1151 (1981); Roger C. Henderson, *The Doctrine of Reasonable Expectations in Insurance Law After Two Decades*, 51 OHIO ST. L.J. 823 (1990) (providing a detailed historical account of the doctrine and asserting that the doctrine is principled and can be applied within justiciable guidelines); William A. Mayhew, *Reasonable Expectations: Seeking a Principled Application*, 13 PEPP. L. REV. 267, 287-96 (1986) (formulating standards for applying the doctrine); Mark C. Rahdert, *Reasonable Expectations Reconsidered*, 18 CONN. L. REV. 323, 392 (1986) (arguing for refinements to the doctrine in response to the fading appeal that the doctrine holds for courts and commentators and contending that courts should "discard their unfortunate tendency to speak the platitudes of reasonable expectations without undertaking a careful and systematic analysis"); Laurie Kindel Fett, Note, *The Reasonable Expectations Doctrine: An Alternative to Bending and Stretching Traditional Tools of Contract Interpretation*, 18 WM. MITCHELL L. REV. 1113 (1992) (student note exploring the doctrine under Minnesota law); Scott B. Krider, Note, *The Reconstruction of Insurance Contracts Under the Doctrine of Reasonable Expectations*, 18 J. MARSHALL L. REV. 155 (1984) (student note arguing that regulatory efforts address the underlying problems in the insurance industry in a manner superior to judicial use of reasonable expectations); William Mark Lashner, Note, *A Common Law Alternative to the Doctrine of Reasonable Expectations in the Construction of Insurance Contracts*, 57 N.Y.U. L. REV. 1175, 1208 (1982) (student note arguing that "any provision which undercuts the bargained-for insurance coverage must . . . [be] specifically explained to the insured" to be enforceable); Stephen J. Ware, Note, *A Critique of the Reasonable Expectations Doctrine*, 56 U. CHI. L. REV. 1461 (1989) (student note providing a "law and economics" critique of the doctrine).

69. Courts traditionally invoke *contra proferentem* with the caveat that the doctrine is not a license for courts to rewrite the insurance contract between the parties. *See Lapeka*, 814 F. Supp. at 1545 (explaining that a court may not "torture words in order to import ambiguity" into the policy, nor may the court "make another contract for the parties. Its function is to enforce the contract as made"). The doctrine of reasonable expectations breaks with this traditional limitation on the scope of contract interpretation. As Professor Henderson correctly states, decisions that rely on the doctrine of reasonable expectations "solely to construe policy language do not support a new principle at all. . . . [T]he doctrine of reasonable expectations, if it involves a new principle

Professor Kenneth Abraham has organized the "reasonable expectations" line of cases in a persuasive manner by suggesting that there are two distinct applications of the doctrine.[70] In "misleading impression" cases, the courts find that the insurer has influenced the insured in some manner to believe that coverage exists despite the precise terms of the policy. These cases represent a logical extension of the *contra proferentem* maxim by acknowledging that in some instances it may be unjust to enforce even unambiguous policy terms, given the nature of the bargaining process and relative bargaining strength of the parties.[71]

In "mandated coverage" cases, by contrast, courts determine that coverage is desirable and will be imposed, despite the policy terms, in order to effectuate a general goal of broader risk spreading. These latter cases stand "as criticism of the insurance market as a whole,"[72] rather than an indictment of the insurer for misleading behavior and are best regarded as judicial creation of insurance.

A good example of a court using the "misleading impression" application of the doctrine of reasonable expectations is found in *Clark-Peterson Co., Inc. v. Independent Insurance Associates, Ltd.*[73] Clark-Peterson suffered a substantial judgment in a suit brought by an employee alleging a discriminatory termination on the basis of his alcoholism. The policy provided coverage for "personal injury," defined to include "[d]iscrimination or humiliation";[74] however, the policy also limited this coverage to accidents which unintentionally cause such injury, and later in the policy excluded liability for discrimination "committed by or at [Clark-Peterson's] direction."[75] The Iowa Supreme Court agreed with the trial court's finding that the employee's suit was "not covered under the precise wording of the policy," since the discriminatory termination in this case was an intentional act committed by

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at all, may apply without regard to any ambiguity. It may affect the substantive provisions of the policy, regardless of how the policy is drafted." Henderson, *supra* note 67, at 827.

70. ABRAHAM, *supra* note 11, at 104.

71. *See* KEETON & WIDISS, *supra* note 10, § 6.3(a)(4) (noting that Judge Keeton lists five "pragmatic reasons why coverage limitations that conflict with reasonable expectations ought not to be enforced even when the limitations are both explicit and unambiguous in policy forms," all of which support the "misleading impression" cases). The reasons offered are: (1) insurance contracts are complex documents that the average insured finds difficult to understand, (2) the insured receives a copy of the policy only after purchasing it, when the motivation to read the policy is minimal, (3) the insurer is able to exercise its expertise and superior bargaining power by inserting specific limitations in the policy that work an unconscionable advantage over the insured, (4) general marketing techniques engender expectations of comprehensive coverage, and (5) the insurance policy is titled and structured to emphasize coverage and downplay exclusions. *Id.*

72. ABRAHAM, *supra* note 11, at 109.

73. 492 N.W.2d 675 (Iowa 1992) (en banc).

74. *Id.* at 676 n.3.

75. *Id.*

Clark-Peterson.[76] Nevertheless, the court found that the insurer must provide coverage on the basis of the reasonable expectations doctrine.

In order to invoke the reasonable expectations doctrine under Iowa law, an insured must first demonstrate either that the policy is "such that an ordinary layperson would misunderstand its coverage"[77] or that the insured's coverage expectations were fostered by "circumstances attributable to the insurer."[78] The court found that the ordinary layperson could reasonably expect coverage for such "an unusual and controversial liability, liability which no doubt came as a shock" to Clark-Peterson, given that the policy provided coverage for personal injury resulting from discrimination.[79] The court distinguished intentional racial or sexual discrimination—conduct as to which no reasonable employer could expect coverage—from intentional discrimination on the basis of alcoholism, the conduct giving rise to liability in this case.[80]

Nevertheless, the court emphasized that the doctrine is limited in scope, to the extent that bare reasonable expectations of coverage are not sufficient, in themselves, to override policy terms.[81] Although acknowledging that the reasonable expectations doctrine "has become a vital part of our law interpreting insurance policies,"[82] the court stressed that the doctrine "does not contemplate the expansion of insurance coverage on a general equitable basis. The doctrine is carefully circumscribed; it can only be invoked where an exclusion '(1) is bizarre or oppressive, (2) eviscerates terms explicitly agreed to, or (3) eliminates the dominant purpose of the transaction.'"[83] The court held that Clark-Peterson was able to satisfy the second test because the clear grant of coverage for

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76. *Id.* at 677.

77. *Id.*

78. *Id.*

79. *Id.* at 678.

80. *Id.* at 678 n.6. The court expressed some sympathy for an employer who may have bona fide business reasons to fire an alcoholic employee, albeit illegal and discriminatory reasons. *Id.*

81. *See id.* at 678.

82. *Id.* at 677.

83. *Id.* (citation omitted). The "misleading impression" cases probably encompass the more extreme cases in which an insured argues that the policy is "unconscionable" or provides "illusory coverage" for the premium charged. In *Clark-Peterson*, the court applied a test that sensibly combined the interest in upholding reasonable expectations with the interest in precluding the insurer from obtaining unconscionable advantages. Professor Keeton suggests that in order to avoid claims based on either reasonable expectations or unconscionability:

> [T]he insurer should be required to adopt measures which guarantee (1) either that the purchaser has actual expectations consistent with described coverage because the purchaser was made aware of the limitations during the marketing transaction, or that it would be unreasonable for an insured to have expectations that are not consistent with the insurance policy provisions, and (2) that the premium charged appropriately reflects the actual scope of risk that the policy provisions define.

KEETON & WIDISS, *supra* note 10, § 613(c)(1).

claims relating to injuries resulting from discrimination was later eviscerated, even if not entirely eliminated, by other sections of the policy.[84] The court's rationale was premised on the quasi-deceptive (even if benign) structure of the policy and the difference in expertise and bargaining power between the parties.

> To deny discrimination coverage in the present case would be to withdraw with the policy's left hand what is given with its right. In a fundamental sense, of course, this is the proper function of any exclusion clause in an insurance policy. The reasonable expectations doctrine does no violence to this proper function by its limited intrusion into it. The doctrine means only that when, within its metes and bounds definition, an exclusion acts in technical ways to withdraw a promised coverage, it must do so forthrightly, with words that are, if not flashing, at least sufficient to assure that a reasonable policy purchaser will not be caught unawares.
>
> The reasonable expectations doctrine is a recognition that insurance policies are sold on the basis of the coverage they promise. When later exclusions work to eat up all, or even substantially all, of a vital coverage, they cannot rest on technical wording, obscure to the average insurance purchaser. At some point fairness demands that the coverage clause itself be self-limiting.[85]

Although the court rejected a purely equitable approach, the "fairness" of extending coverage beyond the policy terms was premised on the court's belief that the insurer engendered reasonable expectations with its policy format.[86]

It is useful to compare *Clark-Peterson* with *Jostens, Inc. v. Northfield Insurance Co.*[87] In *Jostens*, the Minnesota Court of Appeals rejected the employer's argument that coverage should be afforded under the doctrine of reasonable expectations, based on its finding that the discrimination "coverage" provided by the umbrella policy was effectively negated immediately in the insuring agreement itself.[88] The

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84. *Clark-Peterson*, 492 N.W.2d at 678-79.

85. *Id.* at 679. *See also* North Bank v. Cincinnati Ins. Cos., 1997 WL 599910, at *2-4 (6th Cir. Oct. 1, 1997):

> The umbrella policy contains a studied ambiguity written into the policy by the defendant. Under Michigan law, ambiguous insurance policy provisions are to be construed against the drafter and in favor of coverage . . . . [The employer] reasonably expected that the Shellenbarger discrimination claim would be covered by the umbrella policy . . . . [As in *Clark-Peterson*,] we are persuaded that the defendant insurance company should not be permitted to sell [the employer] a policy covering discrimination claims and then to refuse to cover garden variety discrimination claims.

86. *See id.*

87. 527 N.W.2d 116 (Minn. Ct. App. 1995).

88. *See id.* at 118.

Jostens court held that the employer could have no reasonable expectation of coverage for discriminatory employment practices arising from the insurance market generally, nor from the terms of the policy, since the exclusionary language was included as part of the definition of "discrimination" in the insuring provision.[89] In short, the court refused to create insurance since the insurer did not contribute to any mistaken beliefs that an employer reasonably could have held about the scope of coverage under the umbrella policy.

A more traditional approach was adopted by the District Court of Pennsylvania in *Duff Supply Co. v. Crum & Forster Insurance Co.*[90] Although the umbrella policy at issue defined "personal injury" to include "discrimination," a later exclusion withdrew coverage for any personal injury arising on the basis of "race, creed, color, sex, age, national origin," or "termination of employment."[91] The court rejected the employer's argument that the exclusion should not be given effect because it defeated the employer's reasonable expectations, and enforced the "clear and unambiguous" language of the policy.[92] The court held that clear and unambiguous policy language in these circumstances would be disregarded "where there exists evidence which demonstrates that the insurer has either passively or actively misled that

89. *Id.* The court stated that:

> [W]e believe that the policy's "except for" language immediately negated any legitimate expectation engendered. Jostens could not have been under more than a momentary delusion that the policy afforded coverage for the costs at issue, given the juxtaposition of the exclusions to the policy's mention of discrimination; thus, the reasonable expectations doctrine does not provide coverage.

Id. The court also rejected the separate claim by the employer that the policy provided only illusory coverage for discrimination, holding that "the doctrine of illusory coverage is best applied . . . where part of the premium is specifically allocated to a particular type or period of coverage and that coverage turns out to be functionally nonexistent," or where the employer reasonably believes that "some specific part of its premium was allocated to discrimination coverage." *Id.* at 119. The policy terms were enforced as written, because Jostens did not pay a separate premium for the extremely limited discrimination coverage and because the limited nature of the coverage was expressed in a manner that defeated any reasonable expectations that Jostens might hold to the contrary. *Id. Cf.* Horace Mann Ins. Co. v. Peters, 21 Colo. 661 (Colo. Ct. App. 1997) (finding that Educators Liability policy that extended coverage to allegations of civil rights violations, but excluded coverage for intentional wrongdoing, did not violate public policy by providing only illusory coverage since the policy specifically provided coverage for intentional corporeal punishment that gives rise to allegations of civil rights violations); Fidelity & Guar. Ins. Underwriters, Inc. v. Everett I. Brown Co., 25 F.3d 484, 490 (7th Cir. 1994) (finding that the Indiana law of "illusory coverage"—limited to cases where a premium was paid for coverage that will not provide benefits under any set of reasonably expected circumstances—is inapplicable when the employer is covered for many potential claims under the terms of the policy); Wayne Township Bd. of Sch. Comm. v. Indiana Ins. Co., 650 N.E.2d 1205 (Ind. Ct. App. 1995).

90. No. 96-8481, 1997 WL 255483 (E.D. Pa. May 8, 1997).

91. *Id.* at *10.

92. *Id.* at *12.

insured as to the scope of coverage provided by the policy,"[93] thereby counteracting the clear terms of the policy language.[94] The court in *Duff Supply* appeared unwilling to consider the issue raised in *Clark-Peterson* and *Jostens*: whether the very structure of the policy language can be misleading to an insured even though the language used is apparently unambiguous. With respect to this question, the result in *Duff Supply* is at least questionable, since a later exclusion virtually eviscerated the grant of coverage for discrimination.

These cases make clear that the developing doctrine of reasonable expectations remains fluid. Consequently, courts in different jurisdictions adopt differing approaches that can leave insurers and insureds uncertain about the scope of coverage until the case has been litigated and appealed. Although the "misleading impression" application of the reasonable expectations doctrine provides employers with a powerful tool to avoid a strict reading of the policy terms, this theory is not unbounded. If the policy language and marketing techniques employed by the insurer scrupulously avoid engendering expectations on the part of the reasonable employer that the dispute in question is covered by the policy, then the insurance contract most likely will be enforced as written.

A more dramatic application of the reasonable expectations doctrine occurs when the court finds coverage despite the absence of any misleading conduct attributable to the insurer. Professor Abraham contends that the tremendous expansion of the insurer's duty to provide a legal defense to the insured is an example of the "mandated coverage" application of the doctrine of reasonable expectations.[95] The duty to defend assumed by insurers in many liability policies is fully discussed later in this article, but this duty provides a good illustration, for present purposes, of the broad implications of the "mandated coverage" application of the reasonable expectations doctrine and the struggle of courts to constrain the doctrine within reasonable limits.

In recent years, the California Supreme Court has held that civil claims for bodily injuries resulting from the termination of employment, including emotional distress that does not result in a physical disability, are preempted by the exclusive remedy provided under workers' compensation law.[96] On the basis of these cases, a California Court of Appeal decided that, when an employee sues for wrongful discharge and

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93. *Id.*

94. *See id.*

95. *See* ABRAHAM, *supra* note 11, at 110-12 (discussing the seminal case in this area, *Gray v. Zurich Ins. Co.*, 419 P.2d 168 (Cal. 1966)).

96. *See* Livitsanos v. Superior Court, 828 P.2d 1195, 1197 (Cal. 1992); Shoemaker v. Myers, 801 P.2d 1054, 1056 (Cal. 1990).

claims damages for emotional distress caused by the termination, the employer is entitled to a defense of the civil action by its workers' compensation carrier.[97] The court reasoned that the employer "could reasonably have expected [the insurer] to assert the bar of workers' compensation as an affirmative defense in the underlying case."[98] Because it is questionable that a reasonable employer would expect its workers' compensation carrier to defend a civil suit in which the employee makes no claim for benefits under the workers' compensation laws, this case is best understood as mandating a specific kind of coverage not otherwise available in the insurance market—protection against the costs of defending claims in civil suits that seek recovery for injuries compensable only under the workers' compensation statutes.[99] This case represented a dramatic expansion of the duty to defend provision in workers' compensation policies.

The scope of the duty to defend under a worker's compensation policy was finally resolved by the California Supreme Court in *La Jolla Beach & Tennis Club, Inc. v. Industrial Indemnity Co.*[100] An employee of La Jolla filed suit alleging a racially discriminatory termination that also amounted to an intentional infliction of emotional distress. La Jolla tendered defense of the case to its workers' compensation carrier, which refused to defend the action. La Jolla pleaded the exclusivity of the workers' compensation remedy as an affirmative defense, settled the lawsuit with its employee before the issues were adjudicated, and then sought recovery from its insurer for breach of its duty to defend and for indemnification. The trial court entered summary judgment for the insurer, but the court of appeal reversed this judgment and found that the employer was entitled to a defense.[101] The appeals court expressed its reluctance to impose additional burdens on the workers' compensation system, but, nevertheless, found that the "wide-ranging obligation" of the duty to defend compelled the result it reached since the claimed injury of emotional distress "had the potential of coming within the scope of the Workers' Compensation Act [and] this potential would in turn give rise to a duty to defend."[102] The court reasoned that if the employer successfully established that it did not discriminate against its employee, but the employee nevertheless established that he suffered

97. Wong v. State Compensation Ins. Fund, 16 Cal. Rptr. 2d 1, 6 (Cal. Ct. App. 1993), *overruled by* La Jolla Beach & Tennis Club, Inc. v. Industrial Indem. Co., 884 P.2d 1048 (Cal. 1995) (en banc).

98. *Id.* at 6.

99. *Cf.* ABRAHAM, *supra* note 11, at 111.

100. 884 P.2d 1048 (Cal. 1995) (en banc).

101. *See* 23 Cal. Rptr. 2d 656 (Cal. Ct. App. 1994), *rev'd*, 884 P.2d 1048 (Cal. 1995) (en banc).

102. *La Jolla*, 23 Cal. Rptr. 2d at 659, 661 (relying on *Wong*, 16 Cal. Rptr. 2d at 1).

emotional distress as a result of the termination, the employee's suit eventually would be reduced to a claim for benefits under the workers' compensation statutes.[103] Thus, the civil action raised the possibility that the employee ultimately would be asserting a claim for benefits that would be covered under the workers' compensation insurance policy.[104]

The California Supreme Court, *en banc*, reversed the court of appeal and found that no duty to defend existed on these facts.[105] In its opinion, the court distinguished the different applications of the reasonable expectations doctrine regarding an insurer's duty to defend. First, the court acknowledged as a general matter that the reasonable expectations of the insured will be respected when the policy is "ambiguous" due to the language used or its placement in the policy.[106] The court found that the policy unambiguously promised only to defend any claim, proceeding, or suit for benefits under the workers' compensation law, and that the underlying suit did not seek such benefits.[107] In short, the court found that the case did not fall within the "misleading impression" application of the doctrine of reasonable expectations.

The employer explicitly urged the court to employ a broader test of reasonable expectations by arguing that employers who purchase liability insurance packages (including CGL and workers' compensation policies) are entitled to receive the "seamless insurance protection" that they reasonably expect.[108] This more expansive claim amounts to a request that the courts mandate coverage to "fill the gaps" in the insurance package, an invitation that the supreme court refused in this case.[109] The court found that the employer could not reasonably expect seamless coverage, especially since, by purchasing several different policies, the employer manifested its understanding that each policy was limited in scope.[110] The court further found that the underlying suit raised no potential for a covered judgment, since workers' compensation benefits may be awarded only through the administrative process established by the workers' compensation law.[111] To hold otherwise, the court reasoned, would amount to converting the duty to defend in a workers' compensation policy into an unlimited litigation insurance policy:

> There is always some possibility that facts alleged in one forum

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103. *See id.* at 662.
104. *See id.*
105. *La Jolla*, 884 P.2d 1048, 1049 (Cal. 1995) (en banc).
106. *See id.* at 1054.
107. *See id.* at 1057.
108. *Id.*
109. *See id.*
110. *See id.*
111. *See id.*

> could, in the future, form the basis for a covered claim in a different action. Were this the test, however, any judicial or administrative action involving an employer-employee relationship could be characterized as a "predecessor" claim for workers' compensation benefits.
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> . . . .
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> Rather, the test is whether the underlying action for which defense and indemnity is sought potentially seeks relief within the coverage of the policy. . . . Thus, the Court of Appeal fundamentally misconstrued the kind of potential coverage that gives rise to a duty to defend when it concluded that [the insurer] had a duty to defend the civil action merely because [the employee] might, at some indeterminate time in the future, file a workers' compensation claim that did fall within [the insurer's] coverage.[112]

In short, the supreme court rejected the "mandated coverage" application of the reasonable expectations doctrine on the facts of the *La Jolla* case.

Nevertheless, it remains the case that the broad duty to defend under California law is premised on precisely the rationale that the supreme court rejected in *La Jolla*: that the substance of the claims, and not a third party claimant's erroneous pleading, should determine the scope of the duty.[113] The opinion of the court of appeal in *La Jolla*, then, appears to apply the reasonable expectations doctrine more consistently with the precedents, and might be followed in other jurisdictions willing to accept the far-reaching ramifications of the "mandated coverage" application of the reasonable expectations doctrine. The supreme

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112. *Id.* at 1058.

113. The court claimed to follow the analysis set out in the seminal duty to defend case, *Gray v. Zurich Ins. Co.*, 419 P.2d 168 (Cal. 1966), but there is no easy reconciliation of the two cases. In *Gray*, the insured was sued for maliciously and intentionally assaulting the plaintiff, and eventually suffered a plaintiff's jury verdict and an award of damages. Injuries to third persons resulting from the insured's intentional acts were not within the scope of coverage of the liability policy. However, the court held that the insurer breached its duty to defend, since the plaintiff "could have amended his complaint to allege merely negligent conduct," thereby triggering potential coverage under the policy. *Id.* at 177. There seems to be no principled basis for distinguishing between the possibility that a plaintiff might amend a civil claim in light of the insured's anticipated defense, and the possibility that a plaintiff might withdraw a civil claim and refile it as a claim for worker's compensation benefits in light of the employer's defense to the claim. More importantly, if the employer's claim is in fact subject to the exclusive jurisdiction of the worker's compensation system, it appears only reasonable for an employer to expect its insurance carrier to secure a dismissal of the improperly filed civil action (or certain counts in the complaint) and to protect the employer's interests in the worker's compensation forum with respect to such claims. For this reason, *La Jolla* is perhaps best read as a decision by the court that it will not mandate litigation coverage when to do so would place enormous strains on the already overburdened workers' compensation system.

For an approach that rejects the *La Jolla* supreme court decision, albeit in light of a different statutory scheme that appears to require the worker's compensation insurer to defend a claim mistakenly filed in civil court or to bear the full indemnification risk, see HDH Corp. v. Atlantic Charter Ins. Co., 668 N.E.2d 872 (Mass. Ct. App. 1996), *rev. granted*, 672 N.E.2d 539 (Mass. 1996).

court reversal arguably represents the judgment that the harsh reality of the business and insurance environment in California should override the extension of the reasonable expectations doctrine, which is to say that the court declined to mandate litigation coverage in a situation where to do so would cause more harm than good. Despite this apparent resolution, there most certainly will be additional litigation in California regarding an employer's ability to secure a defense from its liability carriers for employment litigation, especially since the *La Jolla* court was careful to limit its analysis to the duty to defend under the worker's compensation portion of the policy, and was also careful not to decide the scope of the duty to defend under the Employer's Liability portion of the policy.[114]

In summary, the doctrine of reasonable expectations is vitally important to employers seeking coverage for discrimination litigation, since a painstaking review of the specific language of many liability policies will reveal that coverage is not afforded for many liabilities arising out of discrimination claims. However, it would be a mistake to conclude that courts will disregard policy terms; therefore, it is important for employment lawyers to determine which application of the reasonable expectations doctrine best fits the facts of the case and serves their clients' needs.

IV. INTERPRETING INSURANCE POLICIES IN LIGHT OF PUBLIC POLICY

It is well established that courts will not enforce contracts that are contrary to public policy, regardless of the parties' clear intent to be bound to the contract terms.[115] Insurance contracts are subject to this general rule no less than other contracts.[116] This limitation on the parties' freedom to contract is premised on the fact that a contract is never entirely a private matter, especially if the contract is a liability insurance policy.[117] By definition, a contract of liability insurance affects the injured third party seeking compensation from the insured by providing a source of funds to satisfy a judgment. Obviously, there is a strong public policy in favor of ensuring that injured parties are compensated to the fullest extent possible. The contract might also affect other persons, however, if the existence of insurance encourages an insured to inten-

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114. *La Jolla*, 884 P.2d at 1051. If *Gray* remains good law, these arguments should prove persuasive, since the result in *La Jolla* is premised on the forum in which the complaint was filed. Liability policies other than the worker's compensation policy, of course, provide coverage for damages awarded in civil suits within the terms of the policy.

115. *See* RESTATEMENT (SECOND) OF CONTRACTS § 178 (1979); E. ALLEN FARNSWORTH, CONTRACTS §§ 5.1-5.9 (2d ed. 1990).

116. *See* COUCH, *supra* note 17, § 39:14.

117. *See* FARNSWORTH, *supra* note 114, § 5.1.

tionally harm others by absolving the insured of financial accountability.[118] It is equally obvious that there is a strong public policy in favor of reducing injurious behavior and requiring that certain wrongdoers bear the full consequences of their actions.

The public policy defense, when used as a limitation on promised coverage in an insurance policy, amounts to a decision on the facts of a particular case that the public policy in favor of compensating injured parties is outweighed by the public policy in favor of preventing future injuries.[119] Thus, courts deem certain claims to be uninsurable, despite the undesirable effect of eliminating a source of funds to satisfy any judgment obtained by an injured third party claimant. The general rule in this regard, known as the principle of "fortuity," is that "a contract of insurance to indemnify a person for damages resulting from his own intentional misconduct is void as against public policy and courts will not enforce such a contract."[120] In this context, it is important to read "intentional" narrowly. Many courts recognize that public policy does not prohibit insurance coverage for all liabilities incurred due to intentional torts, but instead precludes coverage only for liabilities arising out of conduct intended to cause harm. Put differently, public policy is implicated only when an employer seeks indemnification for injuries that it intended to inflict, and not when an employer seeks coverage for intentional actions that have resulted in injuries.[121] If it is accurate to say that courts "make insurance" with the doctrine of reasonable expectations, then it is no less accurate to say that they also "unmake insurance" with the public policy limitation on enforcement of policy terms.

The circumstances under which courts will void coverage on the grounds of public policy have been carefully considered in a number of cases involving discriminatory employment practices. These cases

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118. *See* Ranger Ins. Co. v. Bal Harbour Club Inc., 549 So. 2d 1005, 1007 (Fla. 1989) ("The rationale underlying . . . [the public policy doctrine] is that the availability of insurance will directly stimulate the intentional wrongdoer to violate the law."). Based upon this rationale, for example, courts will not permit a party to insure against liabilities it incurs by engaging in criminal conduct. *See, e.g.*, State Farm Fire & Cas. Co. v. Baer, 745 F. Supp. 595, 597-98 (N.D. Cal. 1990), *aff'd*, 956 F.2d 275 (9th Cir. 1992).

119. *See Ranger*, 549 So. 2d at 1007.

120. *Dixon Distrib. Co.*, 641 N.E.2d at 401. This public policy doctrine may be judicially acknowledged, or in some cases, it is directly stated in legislation. *See* CAL. INS. CODE § 533 (West 1993); MASS. GEN. L. ch. 175, § 47 (1994).

121. This distinction was drawn in *Lumbermens Mut. Cas. Co. v. S-W Indus., Inc.*, 39 F.3d 1324 (6th Cir. 1994), where the court interpreted the policy language defining a covered occurrence as being neither "expected nor intended" as preserving "the element of 'fortuity'" by preventing insureds from using liability coverage as a shield for the consequences of their anticipated intentional conduct. *Id.* at 1331. The court distinguished this narrow limit on coverage from the "broader range of losses" constituting intentional torts and held that the employer's insurer must indemnify the employer for compensatory damages paid to an employee after suffering a jury verdict for an intentional tort. *Id.*

exemplify the fundamental tension between the two important public policies at stake: leaving third party plaintiffs without recourse to funds contractually owed the defendant employer, and permitting an employer to purchase insurance against prospective liability for discriminating against employees and applicants for employment. Title VII of the Civil Rights Act of 1964,[122] which prohibits various forms of employment discrimination, poses subtle issues in light of two salient features of the statute. First, liability may exist even in the absence of a specific intent to cause harm by discrimination.[123] Second, the statute is structured as a public civil rights act rather than a purely compensatory scheme to aid injured parties. Although the courts have had little difficulty in concluding that insurance coverage for unintentional "disparate impact" liability is not precluded by public policy, the insurability of "disparate treatment" discrimination has proved to be more difficult to resolve satisfactorily.

When the underlying complaint against the employer alleges "disparate impact" discrimination, courts generally hold that the existence of liability insurance does not undermine the strong public policy against discrimination embodied in Title VII.[124] Thus, even in the face of a statute precluding insurance coverage of intentional acts that had been interpreted to preclude coverage for sexual harassment and employment discrimination, a California district court held that the statute did not preclude coverage of a suit alleging disparate impact discrimination.[125] Similarly, in 1994 the New York Department of Insurance clarified its longstanding prohibition on insurance coverage for discrimination by making clear that there is no public policy bar to insuring disparate impact discrimination.[126] Courts and regulators have adopted this same

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122. 42 U.S.C. §§ 2000(e)-2000(6) (West Supp. 1993).

123. See *Griggs v. Duke Power Co.*, 401 U.S. 424 (1971), where the United States Supreme Court held that Title VII was directed against discriminatory effects in the workplace, as well as intentionally discriminatory actions by employers. *Id.* at 431. In the lexicon of discrimination law, the former cases involve "disparate impact," whereas "disparate treatment" is involved in the latter cases.

124. *See* Solo Cup Co. v. Federal Ins. Co., 619 F.2d 1178 (7th Cir. 1980). The court stated that:

> We do not think that allowing an employer to insure itself against losses incurred by reason of disparate impact liabilities will tend in any way to injure the public good, which we equate here with that equality of employment opportunity mandated by Title VII. To the contrary, the fact of insurance may be helpful toward achieving the desirable goal of voluntary compliance with the Act.

Id. at 1188; Union Camp Corp. v. Continental Cas. Co., 452 F. Supp. 565, 568 (S.D. Ga. 1978).

125. *See* Save Mart Supermarkets v. Underwriters at Lloyd's London, 843 F. Supp. 597, 606 (N.D. Cal. 1994) (interpreting CAL. INS. CODE § 533) (West 1993).

126. *See* American Management Ass'n v. Atlantic Mut. Ins. Co., 641 N.Y.S.2d 802, 808 (Sup. Ct. 1996) (analyzing the New York Insurance Department letter dated May 31, 1994), *aff'd*, 651 N.Y.S.2d 301 (N.Y. App. Div. 1996).

approach when dealing with other anti-discrimination statutory schemes that assess liability without proof of an intent to discriminate.[127]

In contrast, a claim by an employee under Title VII that he or she has suffered "disparate treatment" on discriminatory grounds necessarily includes an allegation that the employer intended to discriminate.[128] Some courts have concluded that insurance coverage for intentional discrimination would undermine the strong public policy against discrimination. A leading case adopting this view in the context of housing discrimination is *Ranger Insurance Co. v. Bal Harbour Club, Inc.*[129] The Florida Supreme Court held that a complaint alleging that a country club discriminated against Jewish applicants, thereby precluding them from purchasing a home in an area that required club membership, could not trigger the coverage provisions of the club's liability policies for reasons of public policy.[130] The supreme court employed a two-part test for weighing the public policies at stake, first inquiring whether the existence of insurance coverage stimulates discrimination, and second, assessing whether the underlying anti-discrimination statute is intended primarily to compensate the victim or to deter wrongdoing.[131] Because religious discrimination, unlike other intentional wrongdoing such as assault and battery, does not yield substantial deterrents independent of civil liability, the supreme court found that the existence of insurance would insulate those persons wishing to "indulge their own preference for discrimination at little risk to themselves."[132] Moreover, the court found that anti-discrimination statutes primarily are intended to deter discriminatory behavior as a matter of civil rights law, and that aggrieved persons would not be left without adequate remedy in the

127. *See* Andover Newton Theological Sch., Inc. v. Continental Cas., 930 F.2d 89, 93 (1st Cir. 1991). The court found that "intent" under the Age Discrimination in Employment Act ("ADEA") included a reckless disregard of the employee's civil rights, and therefore concluded that "Massachusetts public policy does not bar insurance coverage of an employment action solely because it is found to violate the ADEA in an individual disparate treatment case." *Id.* at 93. As explained by the court, "Massachusetts law only proscribes coverage of acts committed with the specific intent to do something the law forbids." *Id.* at 92 n.3. *See also* BLasT Intermediate Unit 17 v. CNA Ins. Co., 674 A.2d 687, 690-91 (Pa. 1996) (holding that negligent violations of the Equal Pay Act could not be condoned, but that public policy did not preclude insurance coverage of the damage award); Ron Tonkin Chevrolet Co. v. Continental Ins. Co., 870 P.2d 252, 254 (Or. Ct. App. 1994) (holding that liability for failing to make a reasonable religious accommodation does not require a finding of intentional actions, and so insurance coverage was permitted).

128. *See* Texas Dep't of Community Affairs v. Burdine, 450 U.S. 248, 253 (1981) (noting that when claiming "disparate treatment," the employee has an affirmative burden of production and the ultimate burden of proof regarding the employer's discriminatory intent).

129. 549 So. 2d 1005 (Fla. 1989).

130. *See id.* at 1009.

131. *See id.* at 1007.

132. *Id.* at 1008 (quoting Western Cas. & Sur. Co. v. Western World Ins. Co., 769 F.2d 381, 385 (7th Cir. 1985)).

absence of insurance coverage since most suits are brought against commercial enterprises.[133]

Consequently, the supreme court held that permitting insurance coverage of religious discrimination in housing would violate the public policies and underlying purposes of the statutes in question. Although *Ranger* does not directly consider the insurability of liabilities arising under employment discrimination statutes, other courts have adopted the *Ranger* court's analysis when considering whether disparate treatment employment discrimination is insurable.[134] Courts also have interpreted state statutes precluding insurance coverage for intentional wrongdoing as a direct statement of public policy that precludes coverage for disparate treatment discrimination.[135]

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133. *See id.* at 1009.

134. *See* Groshong v. Mutual of Enumclaw Ins. Co., 933 P.2d 1287 n.6 (Or. Ct. App. 1996), *rev. allowed*, 934 P.2d 1125 (Or. 1997). Although not citing *Ranger*, a similar approach was followed in *Foxon Packaging Corp. v. Aetna Casualty & Surety Co.*, 905 F. Supp. 1139 (1995). After holding that the racial discrimination charge was excluded from coverage under the terms of the policy, the court continued by declaring (in dicta) that insurance coverage for intentional discrimination is void as against public policy:

> Aetna argues, and this court agrees, that the public policy of the State of Rhode Island as articulated in the Fair Labor Practices Act, militates against judicial creation of a safe harbor within which Foxon may presumably violate the law at will with impunity. Such a result would do violence to the public policy of the state and eviscerate the statute's intended guarantee of a workplace free of discrimination.
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> . . . .
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> Foxon comes before this court to seek, in essence, insulation from its own wrongdoing . . . It would be a clear violation of public policy if businesses and individuals could insure themselves against liability for committing intentional acts of discrimination. This result would promote, rather than deter discriminatory behavior. . . Foxon's knowing failure to address the blatantly discriminatory acts of its employees should not be condoned by shifting the burden of satisfying Hernandez's damage awards to Aetna.

Id. at 1146.

Some courts summarily hold that public policy precludes insurance coverage of disparate treatment liabilities without providing any detailed justification. *See* Jefferson-Pilot Fire & Cas. Co. v. Sunbelt Beer Distrib., Inc., 839 F. Supp. 376, 381 (D.S.C. 1993) ("The discrimination that Ms. Pressley complains of is not the type of action that an employer should be able to insure against.").

135. *See* Coit Drapery Cleaners, Inc. v. Sequoia Ins. Co., 18 Cal. Rptr. 2d 692, 698 (Cal. Ct. App. 1993) (interpreting CAL. INS. CODE § 533 which forbids insurance for willful acts as precluding insurance coverage in a case involving egregious, predatory, and intentional sexual harassment); B&E Convalescent Ctr. v. State Compensation Ins. Fund, 9 Cal. Rptr. 2d 894, 907-09 (Cal. Ct. App. 1992) (holding that liability for disparate treatment employment discrimination is precluded by the public policy embodied in CAL. INS. CODE § 533, as well as in the anti-discrimination statutes); Boston Hous. Auth. v. Atlanta Int'l Ins. Co., 781 F. Supp. 80, 83 (D. Mass. 1992) (interpreting state statute precluding insurance for deliberate or intentional wrongdoing as precluding coverage in light of allegations that the insured flagrantly and deliberately violated anti-discrimination provisions and government orders).

However, the legislatively enunciated public policy is not implicated when the potential for disparate impact liability is raised in a complaint and the insured seeks a defense. In a recent case,

Despite the *Ranger* line of authority, some courts have enforced insurance coverage even for intentional "disparate treatment" of employees, finding that such coverage is not necessarily contrary to public policy.[136] These cases often involve variations of D&O or E&O policies written for public school districts, which provide insurance for liabilities arising out of "wrongful acts," and generally do not exclude intentional wrongs. Because the very purpose of many of these types of policies is to protect the public school from the substantial losses that it may incur vicariously, and also by defending and indemnifying its employees for their intentional wrongful acts, insurers must rely on public policy arguments in an effort to avoid coverage obligations. A number of courts have held that insurance carriers cannot rely on the public policy defense to coverage in these cases, effectively rejecting the *Ranger* analysis.[137]

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the California Court of Appeal clarified the *Coit* and *B&E* decisions by noting that the policy before the court specifically included coverage for discrimination, and the complaint did not preclude an ultimate finding of liability under a disparate impact theory. *See* Melugin v. Zurich Canada, 57 Cal. Rptr. 2d 781, 784-85 (Cal. Ct. App. 1996).

136. *See* Union Camp Corp. v. Continental Cas. Co., 452 F. Supp. 565 (S.D. Ga. 1978). The court stated that:

> The proposition that insurance taken out by an employer to protect against liability under Title VII will encourage violations of the Act is based on an assumption that is speculative and erroneous. . . . Where a class of employees is entitled to back pay under a court order and the employer is financially unable to comply with the same, insurance would provide the mandated compensation.

Id. at 567-68. The court also noted that the insurer remains free to exclude such liabilities from coverage, and emphasized that intentional discrimination was excluded from coverage by the policy terms in that case). *Id.* at 568. *See also Clark-Peterson*, 492 N.W.2d at 677-78 (utilizing the doctrine of reasonable expectations to extend coverage beyond the precise terms of the policy with respect to intentional discrimination on account of disability).

137. *See, e.g.*, School Dist. for the City of Royal Oak v. Continental Cas. Co., 912 F.2d 844, 847-50 (6th Cir. 1990). In *Royal Oak*, the court expressly rejected the *Ranger* analysis, holding that an insurance carrier is able to protect itself by excluding discriminatory conduct from coverage, and that an empirical inquiry into the actual "stimulative" effect of liability insurance on wrongdoing is too cumbersome to employ as a legal test. *Id.* at 847-50. The court further noted:

> Perhaps the existence of liability insurance might occasionally "stimulate" such a contretemps, but common sense suggests that the prospect of escalating insurance costs and the trauma of litigation, to say nothing of the risk of uninsurable punitive damages, would normally neutralize any stimulative tendency the insurance might have.
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> Pace Professor Willborn, moreover, we do not believe that most courts would wish to encourage litigation over the question whether particular insurance policies did or did not have a stimulative effect in particular cases. The insurability of "intentional" discrimination in a given state is likely to be decided categorically, we think, rather than case-by-case.

Id. at 848.

The *Royal Oak* court cited an article by Professor Willborn with approval, concluding that the presumption that liability insurance might "stimulate" future discriminatory conduct is unfounded. *See* Steven L. Willborn, *Insurance, Public Policy, and Employment Discrimination*, 66 MINN. L. REV. 1003 (1982). Professor Willborn argues that insurance coverage should generally be enforced to effectuate the public policy favoring compensation unless the insured displays

Of course, if the policy limits coverage only to negligent acts, then "disparate treatment" discrimination will fall outside the coverage even if public policy would permit it.[138]

The different result in these cases is not explained by the courts using a different test, but rather by a different application of an agreed balancing test: weighing the benefit to the plaintiff of permitting insurance coverage against the harm to society of encouraging future inten-

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a "calculating intent" to engage in discrimination based on the existence of insurance. *Id.* at 1027-30. Thus, Willborn's proposal would appear to strike a middle ground between the presumption in *Ranger*, that insurance will have a stimulative effect, and the presumption in *Royal*, that it will not, or at least that carriers can avoid adverse selection by excluding intentional discrimination.

Royal was recently affirmed by the Sixth Circuit Court of Appeals in *North Bank v. The Cincinnati Insurance Companies*, 1997 WL 599910 (6th Cir. 1997). The *North Bank* court reasoned that the risks of hefty premiums, bad publicity, and uninsurable punitive damages would deter intentional discrimination, and that the public interest might be better served by making funds available to victims of discrimination. *Id.* at *5.

For cases finding no public policy bar to coverage of intentional discrimination, see New Madrid County Reorg. Sch. Dist. No. 1 v. Continental Cas. Co., 904 F.2d 1236, 1241-43 (8th Cir. 1990); *see also* University of Ill. v. Continental Cas. Co., 599 N.E.2d 1338, 1351 (Ill. App. Ct. 1992). The court stated that:

> [W]e find there is no Illinois public policy prohibiting insuring for damages caused by one's intentional acts except to the extent that the insured wrongdoer may not be the person who recovers the policy proceeds. The fact that many insurance policies contain an exclusion for intentional conduct demonstrates insurers have not relied on any broad public policy. Defendant could have included such an exclusion in its BEL policy, but did not. This court will not rewrite the BEL policy to create an exclusion.

Id. at 1351; Independent Sch. Dist. No. 697, Eveleth v. St. Paul Fire & Marine Ins. Co., 515 N.W.2d 576 (Minn. 1994). The court expressed:

> We do not believe that a school district will discriminate against its employees simply because it carries wrongful act insurance coverage; nor do we believe that school districts carrying this type of insurance coverage have a license to commit intentional wrongs. Accordingly, we enforce the contract as it is written.

Id. at 580; *cf.* Continental Cas. Co. v. Canadian Universal Ins. Co., 924 F.2d 370, 375 (1st Cir. 1991) (finding that coverage for sexual harassment is unambiguous under the "wrongful acts" trigger and offering no discussion of any potential public policy bar to enforcement).

138. *See, e.g.*, Golf Course Superintendents Ass'n of Am. v. Underwriters at Lloyd's, London, 761 F. Supp. 1485, 1491 (D. Kan. 1991) (providing that D&O policy restricting coverage to negligent "wrongful acts" provides no coverage for intentional discrimination, even though the Kansas common law precluding insurance for intentional acts was modified by a statute permitting coverage of punitive damages assessed against and insured vicariously for the intentional acts of its agents); School Dist. No. 1 v. Mission Ins. Co., 650 P.2d 929, 943 (Or. Ct. App. 1982) (holding that there is no need to reach the public policy issue when "wrongful act" is defined in terms of negligence only), *rev. denied*, 662 P.2d 725 (1983).

Similarly, when the plaintiff is suing only for bodily injuries, an educational liability policy (which excludes such injuries from coverage) will not be triggered, although coverage under the insured's CGL policy may well be triggered. *See* Wayne Township Bd. of Sch. Comm'rs v. Indiana Ins. Co., 650 N.E.2d 1205, 1211-12 (Ind. Ct. App. 1995) (holding CGL coverage was triggered, but not coverage under an Educational Errors and Omissions Policy in a suit for injuries caused when a school principal sexually molested a student).

tional wrongdoing.[139] Courts permitting coverage reject the hypothesis that discrimination will be reduced by denying coverage, and they emphasize the desirability of compensating the victims of discrimination.

In short, public policy does not prohibit an employer sued for discrimination from ever obtaining a defense and indemnification under liability insurance. In fact, recent court decisions evidence a willingness to permit insurance coverage even for intentional discrimination by agents of the employer. However, if the wrongful act amounts to a purposeful effort by the employer to cause injury to the employee, courts generally will still refuse to enforce otherwise available insurance for reasons of public policy. In such cases, however, the insurance policy will often preclude coverage in unambiguous terms in either the insuring agreement or the exclusions; thus, the public policy doctrine should only rarely place an additional limitation on the scope of coverage.[140]

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139. For example, the dissent in *Ranger* questioned the courts analysis in the application of the rule rather than in the formulation of the rule itself. Judge Erlich first argued that an important part of anti-discrimination legislation is providing financial redress to injured parties, stating that:

> From the point of view of the insured, protection is the primary function of insurance. From the standpoint of the victim, insurance affords financial responsibility. Both of these are respected, desired consequences of insurance in our society. . . . To say that the primary purpose of the imposition of liability is to deter wrongdoers is unreal in this world of ours.

See Ranger, 549 So. 2d 1005, 1011 (Erlich, J., dissenting). He then argued that discriminatory behavior would not be stimulated by the availability of insurance coverage, especially in light of the possibility of verdicts beyond policy limits and the imposition of uninsurable punitive damages. Judge Erlich stated that:

> Permitting insurance coverage in the factual setting provided in this case can under no stretch of the judicial imagination encourage religious discrimination. . . . In support, I would cite that libel and slander are intentional acts for which insurance coverage can be obtained in the marketplace. The majority's porous analysis would have us believe that this encourages libel and slander. If this were true, there would be empirical data to support their assertion, but the fact is that there is none.

Id. at 1012 & n.3. The *Royal Oak* court cited Judge Erlich's opinion in holding that public policy permitted coverage of intentional discrimination. *See Royal Oak*, 912 F.2d at 848-49.

One student author has suggested that the different applications of the general balancing test might be captured in a secondary general rule that could synthesize the cases and guide future decision making. He argues that employers should be permitted to insure against employment discrimination liabilities premised on its negligent supervision of the offending employee, or that result from imputing liability to the employer for the intentional discrimination of its employees. Sean W. Gallagher, Note, *The Public Policy Exclusion and Insurance for Intentional Employment Discrimination*, 92 MICH. L. REV. 1256, 1262 (1994). This principle might explain the difference between *Ranger* (in which a private club controlled by the discriminating members was denied coverage) and *Royal Oak* (in which a public school sought coverage with respect to liabilities imputed to it for discrimination committed by an employee), by focusing on the fact that the presence of insurance will stimulate wrongful behavior only when the insured entity is implicated directly in that behavior.

140. In most cases, the intentional nature of the conduct will remove the case from coverage under the terms of the policy, and so the public policy issue need not be reached. *See, e.g.*,

Even when a court determines that insurance coverage of intentional employment discrimination is precluded by public policy, the duty to defend the action under the policy is not necessarily unenforceable as well. Courts have found that the duty to defend does not raise the same public policy concerns as the duty to indemnify for damages awarded

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American Guar. and Liab. Ins. Co. v. Vista Med. Supply, 699 F. Supp. 787, 789-90 (N.D. Cal. 1988) (holding that California law permits insurance coverage unless there is a "preconceived design to inflict injury," but that the policy in that case restricted coverage of intentional act to a much greater degree); Intermountain Gas Co. v. Industrial Indem. Co., 868 P.2d 510, 515 (Idaho Ct. App. 1994) (holding that intentional discrimination is excluded under the policy); Daly Ditches Irrigation Dist. v. National Sur. Corp., 764 P.2d 1276, 1278 (Mont. 1988).

A recent Massachusetts case underscores the importance of policy exclusions in this regard. *See* Rideout v. Crum & Forster Commercial Ins., 633 N.E.2d 376 (Mass. 1994). In *Rideout*, shortly after being ordered to pay claimants who alleged "disparate treatment" sex discrimination, an employer ceased operations. The claimants brought a direct action against the employer's CGL carrier to recover their judgment, but summary judgment was entered for the insurer on the ground that the policy excluded coverage for intentional acts. The Massachusetts Supreme Judicial Court affirmed on this ground, not reaching the question whether coverage would be precluded under the statutorily defined public policy against insuring intentional harm. *Id.* at 379. It is conceivable that the public policy balancing under these particular facts, involving injured claimants with no other means to satisfy the judgment and a now defunct employer, might not void coverage had it been available.

A similar issue arises when an insured seeks indemnification for the punitive damages component of an otherwise covered loss. There has been a great deal of litigation regarding the insurability of punitive damages. *See* ROBERT H. JERRY, II, UNDERSTANDING INSURANCE LAW (2d ed. 1996). The author states that:

> The debate is a vigorous one. Not surprisingly, courts are split on the question of whether punitive damages liability for reckless, wanton, or grossly negligent conduct is uninsurable. Roughly two-thirds of the states that have considered the question have held that punitive damages are insurable, and the remaining states have held that punitive damages are not insurable. Where punitive damages are insurable, however, all states that have considered the matter recognize an exception when the insured's conduct is intentional.

Id. at 475; *see also* Alan I. Widiss, *Liability Insurance Coverage for Punitive Damages? Discerning Answers to the Conundrum Created by Disputes Involving Conflicting Public Policies, Pragmatic Considerations and Political Actions*, 39 VILL. L. REV. 455, 493 (1994) (surveying the current state of the law and arguing that punitive damages ought to be insurable in many instances); George L. Priest, *Insurability and Punitive Damages*, 40 ALA. L. REV. 1009, 1009 (1989) ("Our courts conflict sharply: some deny coverage on grounds of public policy; the majority allow coverage."). As Professor Priest notes, the increasing willingness to permit coverage of punitive damages is directly related to the substantial expansion of the availability of the remedy, to the extent that the traditional "requisite level of moral depravity to justify punitive liability" that raises the public policy question in the first place may now be lacking. *Id.* at 1034. Given the availability of punitive damages for some forms of employment discrimination, this question is of significant concern for employers and insurers. *Cf.* Lumbermens Mut. Cas. Co. v. S-W Indus., Inc., 39 F.3d 1324, 1329 (6th Cir. 1994) (holding that an employer is not entitled to indemnification for a $2.5 million punitive damage award, although the employer was entitled to indemnification for compensatory damages awarded for an intentional tort). The *Lumbermens* court reasoned that, because punitive damages are designed to punish and deter, public policy weighs much more heavily against insurability than it does with respect to compensatory damages for intentional actions resulting in harm. *Id.*

pursuant to an anti-discrimination statute.[141] Other courts have held that there is no enforceable duty to defend when coverage is precluded for reasons of public policy, since the insured could have no reasonable expectation of being defended in a suit that raises uninsurable claims.[142] Of course, if the complaint potentially raises claims of unintentional discrimination or other acts that fall within coverage, then the insurance carrier will be obligated to provide a defense of the action, even if the case ultimately ends with a finding of liability premised on intentional discrimination for which coverage is unavailable as a matter of public policy.[143]

V. Insurance Coverage for Discrimination Liabilities—Case Law Organized by Different Policy Coverages

An insured employer facing employment discrimination liabilities will generally have a number of liability policies as part of its "three dimensional" insurance program, several of which may potentially provide coverage. This section of the article discusses the potential for coverage under the most commonly owned liability products.

A. *Worker's Compensation and Employer's Liability*

Part One of the Worker's Compensation and Employer's Liability ("WC/EL") policy provides coverage for liabilities that the employer incurs pursuant to the worker's compensation statutes in its jurisdiction, on account of bodily injury resulting from accident or disease caused by or aggravated by the conditions of employment. If an employee suffers bodily injury in the workplace as a consequence of discriminatory behavior and files a claim for worker's compensation benefits, the duty to defend the worker's compensation action clearly is triggered, and any resulting awards will be paid by the carrier. A much more difficult case is posed when an employee seeks damages for bodily injury caused by discriminatory behavior as part of a civil lawsuit against the employer,

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141. *See* American Management Ass'n v. Atlantic Mut. Ins. Co., 641 N.Y.S.2d 802, 808 (Sup. Ct. 1996); Andover Newton Theological Sch., Inc. v. Continental Cas. Co., 930 F.2d 89, 95 (1st Cir. 1991).

142. *See* B&E Convalescent Ctr. v. State Compensation Ins. Fund, 9 Cal. Rptr. 2d 894, 908-09 (Cal. Ct. App. 1992) (interpreting Cal. Ins. Code § 533); Boston Hous. Auth. v. Atlanta Int'l Ins. Co., 781 F. Supp. 80, 83-84 (D. Mass. 1992).

143. For a discussion of the duty to defend, which is broader than the scope of coverage, see *Republic Indem. Co. v. Superior Court*, 273 Cal. Rptr. 331, 334 (Cal. Ct. App. 1990), (interpreting Cal. Ins. Code § 533 as permitting a carrier to assume the defense of an action that potentially could result in liability for a non-willful failure to make a reasonable accommodation for an employee's medical condition); *see also* Horace Mann Ins. Co. v. Barbara B., 846 P.2d 792 (Cal. 1993) (en banc) (statutory bar applies only to indemnification for the intentional conduct, and not to the duty to defend in a case that may involve some non-intentional acts giving rise to liability).

since the claim may, in substance, be a claim for worker's compensation benefits that is filed improperly as part of a civil action. Under these circumstances, it is unlikely that the worker's compensation policy will be triggered.

First, the worker's compensation policy is designed to pay only worker's compensation benefits, which cannot be ordered as damages in a civil action. For example, when a Hispanic employee sued for employment discrimination, assault, failure to supervise, and failure to provide a safe work site due to the physical intimidation he suffered, the employer's effort to obtain coverage under its worker's compensation policy was rejected.[144] Although the related tort actions alleged bodily injuries caused by the conditions of employment, the court held that these torts are barred by the exclusivity of the worker's compensation laws and the policy was deemed to cover only proper filings for worker's compensation benefits.[145] Similarly, courts have held that discriminatory terminations in retribution for filing a claim for worker's compensation benefits do not trigger coverage under the policy since the suit is not for benefits, but rather for damages arising out of a wrongful discharge from employment.[146] As discussed earlier in this article, California employers were successful for a short period of time in asserting that, a claim raised in the context of a discrimination lawsuit that was potentially subject to the exclusivity of the worker's compensation system of benefits, triggered the duty to defend under the worker's compensation policy until such time as the claims in question were dismissed from the improper civil venue. The California Supreme Court has now definitively rejected this argument, but the same argument has been successful in other jurisdictions with different worker's compensation statutory schemes.[147]

Bodily injuries caused by some forms of discriminatory behavior in the workplace may fall outside the scope of the worker's compensation laws, eliminating any potential argument that the worker's compensation carrier must appear and defend the civil suit until such time as the putative worker's compensation claims are dismissed. In particular, courts have found that bodily injuries caused by sexual harassment fall outside the *quid pro quo* of the worker's compensation system, in which an employee gives up his or her right to sue in exchange for prompt no-fault payments for injuries. This means that the employee is free to pursue recovery in a civil action without reference to the worker's com-

144. *See* Bond Builders, Inc. v. Commercial Union Ins. Co., 670 A.2d 1388, 1390 (Me. 1996).

145. *See id.*

146. *See* Fidelity & Cas. Co. of N.Y. v. Gaedcke Equip. Co., 716 S.W.2d 542, 543 (Tex. Ct. App. 1986); Artco-Bell Corp. v. Liberty-Mut. Ins. Co., 649 S.W.2d 722 (Tex. Ct. App. 1983).

147. *See* HDH Corp. v. Atlantic Charter Ins. Co., 668 N.E.2d 872, 874 (Mass. Ct. App. 1996).

pensation system.[148] If an employee files a claim for worker's compensation benefits on account of bodily injury suffered as a consequence of sexual harassment, the worker's compensation carrier will be within its right to refuse settlement of the claim and to seek dismissal on the ground that the claim must be pursued in a civil action, even though this defense works against the employer's economic interest.[149]

Part Two of the WC/EL policy provides coverage known as "employer's liability" insurance, which extends beyond statutory liabilities for workplace injuries. Because this part of the coverage specifically provides coverage for civil actions seeking damages on account of bodily injuries by accident or disease caused by or aggravated by the conditions of employment, there is far more likelihood that coverage will be triggered in a typical discrimination case.[150] Pleading intentional torts in conjunction with a claim of discrimination will likely avoid the exclusivity of the worker's compensation system and trigger the employer's liability part of the policy.[151]

In response to the growing number of claims under EL policies in connection with discrimination suits, many carriers explicitly exclude any liabilities for personnel policies and practices, including discrimination and harassment.[152] Express exclusions of discrimination liabilities are generally enforced by the courts.[153] In light of this exclusion, some

148. *See, e.g.*, Ottumwa Hous. Auth. v. State Farm Fire and Cas. Co., 495 N.W. 2d 723, 729 (Iowa 1993).

149. *See id.* at 730 (holding that the carrier did not act in bad faith by refusing to settle and securing the withdrawal of the claim for worker's compensation benefits by a harassment plaintiff).

150. *See, e.g.*, EEOC v. Southern Publ'g Co., Inc., 894 F.2d 785, 790-91 (5th Cir. 1990) (ruling that allegation of assault and battery premised on an offensive touching in the workplace that caused physical pain falls within EL coverage); NPS Corp. v. Insurance Co. of N. Am., 517 A.2d 1211, 1213 (N.J. App. 1986).

151. *See, e.g.*, Conrad v. Mike Anderson Seafood, Inc., No. 89-1481, 1991 WL 22925, at *8 (E.D. La. Feb. 15, 1991).

152. The standard exclusion developed by the National Council on Compensation Insurance, Workers Compensation and Employers Liability Insurance Policy (April 1, 1992) provides that there is no coverage for "damages arising out of coercion, criticism, demotion, evaluation, reassignment, discipline, defamation, harassment, humiliation, discrimination against or termination of any employee, or any personnel practices, policies, acts or omissions." This exclusion is likely to pass judicial muster in most cases. *See* General Star Indem. Co. v. Schools Excess Liab. Fund, 888 F. Supp. 1022, 1028 (N.D. Cal. 1995) (no duty to defend suit alleging conduct intended to humiliate, harass and intimidate an employee, given clear exclusionary language).

153. *See* Bond Builders, Inc. v. Commercial Union Ins. Co., 670 A.2d 1388, 1390 (Me. 1996); Transamerica Ins. Co. v. Superior Court, 35 Cal. Rptr. 2d 259 (Cal. Ct. App. 1994); *Ottumwa Hous. Auth.*, 495 N.W.2d at 729. *Cf.* B&E Convalescent Ctr. v. State Compensation Ins. Fund, 9 Cal. Rptr. 2d 894, 910 (Cal. Ct. App. 1992) (noting that the EL policy did not exclude bodily injury caused by discrimination, but precluded otherwise available coverage on the grounds of public policy).

courts hold that separate allegations of bodily injury, in fact, pertain to the *measure* of injury caused by discriminatory behavior, rather than to the *source* of damages, thus, bringing allegations of tortious behavior within any applicable exclusions for damages suffered on account of discrimination.[154]

Nevertheless, even this broadly worded exclusion is subject to judicial interpretation. In one recent case, the court found that the exclusion was designed to exclude coverage only for intentional conduct that causes injury to an employee.[155] Employing the doctrine of reasonable expectations, the court held that the exclusion "does not specifically exclude coverage for vicarious liability resulting from workplace sexual harassment."[156] Consequently, the court found that coverage existed for the corporate employer to the extent that it was vicariously liable for the intentional harassment and assaults committed by the company president. However, the exclusion did work to deny coverage to the president, who was also an insured on the policy.[157]

B. *Commercial General Liability and Excess Liability*

The CGL policy is not an "all risks" policy that insures against any and all claims and losses suffered by the employer. Instead, the CGL policy obligates the insurer to assume only certain specified risks. Consequently, the insuring agreement simultaneously grants coverage, while also limiting it. The CGL policy consists of three separate grants of coverage, the first two of which are pertinent to employment-related claims. As discussed earlier, the insuring agreement of Coverage A obligates the insurer to pay those sums that the insured becomes legally obligated to pay as damages because of bodily injury or property damage caused by an occurrence. Each element of this grant of coverage poses interpretive questions when an employer is seeking insurance coverage for a discrimination claim.

Civil suits seeking redress for discriminatory employment practices might not meet the coverage requirement that the employer must be sued for "damages," since an award of back pay, reinstatement, and an injunction as to future employment practices are equitable in nature.[158]

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154. *See, e.g.*, Atlantic Mut. Ins. Co. v. Roffe, Inc., 872 P.2d 536, 538-39 (Wash. Ct. App. 1994).

155. Schmidt v. Smith, 684 A.2d 66, 72-73 (N.J. Super. Ct. 1996).

156. *Id.* at 73.

157. *Id.* at 75-76.

158. *See, e.g.*, Foxon Packaging Corp. v. Aetna Cas. & Sur. Co., 905 F. Supp. 1139, 1144 (D.R.I. 1995) (no coverage for award of back pay and attorneys fees made by a state commission in response to a charge of racial discrimination); School Dist. of Shorewood v. Wausau Ins. Cos., 488 N.W.2d 82, 88-90 (Wis. 1992) (finding no coverage for suit seeking injunctive relief

As one court concluded, the "costs of compliance with an injunction cannot reasonably be regarded as a sum payable 'as damages.'"[159] On the other hand, courts have read the requirement of damages broadly and concluded that the term damages should be construed "in accord with the plain meaning of the term and the reasonable expectations of the insured" to provide coverage for back pay awards that technically are equitable in nature.[160] This latter approach appears to be the majority rule that is growing in acceptance.[161]

The coverage requirement of "bodily injury," defined as "injury, sickness or disease," is crucial in the discrimination context because an employee may allege only economic, reputational, or psychic injury. The traditional rule is that emotional upset resulting from discriminatory treatment does not constitute a bodily injury unless it is manifested as independent physical impairments, such as migraine headaches, sleeplessness, etc.[162] Some courts find that emotional distress caused by physical abuse is an outgrowth of a "bodily injury," thus providing an argument in favor of coverage in sexual harassment and discrimination cases.[163] A growing number of courts have rejected the limitation to

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requiring reorganization and new hiring practices to remedy past discrimination, and attorney fees); Maryland Cup Corp. v. Employers Mut. Liab. Ins. Co. of Wis., 568 A.2d 1129, 1132 (Md. Ct. Spec. App. 1990) (finding no coverage for suit seeking equitable award of back pay under ADEA and Title VII).

159. *School Dist. of Shorewood*, 488 N.W.2d at 91.

160. Liberty Mut. Ins. Co. v. Those Certain Underwriters at Lloyd's, 650 F. Supp. 1553, 1560 (W.D. Pa. 1987). *Cf.* BLaST Intermediate Unit 17 v. CNA Ins. Co., 674 A.2d 687 (Pa. 1996) (holding that an award of back pay under the Equal Pay Act is within coverage since the insured experiences a real loss, rejecting the argument by the insurer that the employer is unjustly enriched to characterize these payments as damages).

161. *See* James E. Scheuermann & John K. Ballie, *Employer's Liability and Errors and Omissions Insurance Coverage for Employment-Related Claims*, 18 W. NEW ENG. L. REV. 71, 84 (1996) (advocating *Liberty Mutual*'s rejection of the "hyper technical distinction" between legal and equitable forms of relief and noting that the contrary approach is followed in a "distinct minority" of cases).

162. *See, e.g.*, Jefferson-Pilot Fire & Cas. Co. v. Sunbelt Beer Dis., Inc., 839 F. Supp. 376, 379 (D.S.C. 1993); Kline v. The Kemper Group, 826 F. Supp. 123, 129 (M.D. Pa. 1993), *aff'd*, 22 F.3d 301 (3d. Cir. 1994); Lapeka, Inc. v. Security Nat'l Ins. Co., Inc., 814 F. Supp. 1540, 1548 (D. Kan. 1993); Steve Spicer Motors, Inc. v. Federated Mut. Ins. Co., 758 S.W.2d 191 (Mo. Ct. App. 1988); Presidential Hotel v. Canal Insurance Co., 373 S.E.2d 671, 672 (Ga. Ct. App. 1988); Greenman v. Michigan Mut. Ins. Co., 433 N.W.2d 346, 348-49 (Mich. Ct. App. 1988).

However, if the plaintiff specifically alleges that the discrimination caused her to suffer "bodily injury" without further elaboration, then the insurer may not be able to avoid its duty to defend, at least until such time as there is no potential for recovery for "bodily injury" as defined in the policy. *See* Mutual Serv. Cas. Ins. Co. v. Co-op Supply, Inc., 699 F. Supp. 1438, 1440 (D. Mont. 1988).

163. *See, e.g.*, Wayne Township Bd. of Sch. Comm'rs v. Indiana Ins. Co., 650 N.E.2d 1205, 1211 (Ind. Ct. App. 1995) (ruling that allegations under Title IX that a principal sexually molested a student in his office triggers coverage because a claim of emotional trauma caused by physical abuse comes within the policy definition of bodily injury).

physically manifested injuries altogether, reasoning that the policy definition of bodily injury does not require physical manifestation, and concluding that emotional distress is as much an affliction of the body as a physically manifested symptom.[164]

The "property damage" trigger almost certainly is not implicated in a typical discrimination suit, since the discriminatory behavior does not cause injury to the employee's "tangible property." Courts have uniformly rejected the claim that lost earnings due to discriminatory treatment amount to property damage.[165]

The policy definition of "occurrence" as an "accident" presents the employer with a substantial coverage hurdle since discriminatory behavior often involves intentional actions, such as setting wage rates, terminating employment, and adopting corporate policies. The requirement that bodily injury be caused by an accident is mirrored by an exclusion of coverage for any injuries "expected or intended from the standpoint of the insured." Courts often regard sexual harassment and disparate treatment discrimination as intentional acts for purposes of insurance coverage as a matter of law, regardless of whether the wrongdoer had any subjective expectation of injury.[166] In the words of one court: "We

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164. *See, e.g.*, Griffin v. Cameron College, Inc., 1997 WL 567958, at *2 (E.D. La. Sept. 11, 1997) (rejecting a bright-line distinction between physical and mental injuries in medicine or in law, and holding that a discrimination complaint alleging mental pain and anguish and embarrassment falls within the "bodily injury" definition). *See* Scheuermann & Ballie, *supra* note 161, at 76-78.

165. *See Jefferson-Pilot*, 839 F. Supp. 376; *Kline*, 826 F. Supp. 123; *Lapeka*, 814 F. Supp. at 1549; *Mutual Serv. Cas.*, 699 F. Supp. at 1442; *see also* Lamar Truck Plaza, Inc. v. Sentry Ins., 757 P.2d 1143 (Colo. Ct. App. 1988). In *Lamar*, the court reasoned that:

> Here, the employees' claims were purely economic, and the trial court correctly concluded that they did not constitute damage to, or loss of use of, tangible property. Lamar's argument that federal reserve notes are tangible property is inapposite, as there was no claim that the employees were deprived of any particular, identified bills or coins.

Id. at 1144.

166. *See* American Mfrs. Mut. Ins. Co. v. Wodarski, 68 F.3d 483 (10th Cir. 1995) (finding that sexual harassment, assault and battery, and intentional infliction of emotional distress are not occurrences); *Jefferson-Pilot*, 839 F. Supp. at 380 (finding that a firing motivated by racial discrimination is not an occurrence); Old Republic Ins. Co. v. Comprehensive Health Care Assoc., Inc., 786 F. Supp. 629, 632 (N.D. Tex. 1992), *aff'd*, 2 F.3d 105 (5th Cir. 1993); Sena v. Travelers Ins. Co., 801 F. Supp. 471 (D.N.M. 1992); Commercial Union Ins. Cos. v. Sky, Inc., 810 F. Supp. 249, 254 (W.D. Ark. 1992); Moore v. Continental Ins. Co., 51 Cal. Rptr. 2d 176, 181 (Cal. Ct. App. 1996) (finding that sexual harassment is intentional behavior as a matter of law); Elliott v. National Fire Ins. Co., 922 S.W.2d 791, 793 (Mo. Ct. App. 1996) (ruling that alleged "willful, wanton and malicious" sex discrimination is not an occurrence); Northern Ins. Co. v. Morgan, 918 P.2d 1051, 1055 (Ariz. Ct. App. 1995) (ruling that sexual harassment and intentional discrimination are not occurrences as a matter of law); State Farm Fire & Cas. Co. v. Compupay, Inc., 654 So. 2d 944, 947 (Fla. 3d DCA 1995) (finding sexual harassment is not an occurrence as a matter of law, regardless of the state of mind of the perpetrator); Rideout v. Crum & Forster Commercial Ins. Co., 633 N.E.2d 376, 379 (Mass. 1994); Jackson County Hosp. v. Alabama

do not believe that an average person would consider intentional discrimination to be an 'accident' or a 'condition which results in bodily injury neither expected not intended.' Therefore, we hold that there is no coverage."[167] When the insured did not personally harass or discriminate against the plaintiff, but is legally liable for the actions of a non-insured, courts still hold that the alleged injury is not an "accident" and was "expected or intended from the standpoint of the insured" if the insured "knew or should have known that there was a substantial probability that nonconsensual sexual contact was likely to result" from referring clients to work with a third person.[168] However, when the underlying complaint alleges that the employer negligently responded to the discriminatory situation, or when disparate impact discrimination is the source of the claim, most courts have concluded that discrimination can be an occurrence.[169] Nevertheless, some courts have held that the

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Hosp. Ass'n Trust, 619 So. 2d 1369, 1372 (Ala. 1993) (finding disparate treatment discrimination is not an occurrence); Kline v. The Kemper Group, 826 F. Supp. 123, 128-29 (M.D. Pa. 1993), *aff'd*, 22 F.3d 301 (3d Cir. 1994); St. Paul Fire and Marine Ins. Co. v. Skapyak, No. C5-89-524, 1989 WL 84180 (Minn. Ct. App. Aug. 1, 1989) (finding that alleged willful and malicious discrimination resulting in demotion and termination is not an occurrence); Presidential Hotel v. Canal Ins. Co., 373 S.E.2d 671, 673 (Ga. Ct. App. 1988) (finding sexual harassment is not an occurrence); Continental Ins. Co. v. McDaniel, 772 P.2d 6, 8-9 (Ariz. Ct. App. 1988); Daly Ditches Irrigation Dist. v. National Sur. Corp., 764 P.2d 1276, 1278 (Mont. 1988) (finding retaliatory termination is not an occurrence); Greenman v. Michigan Mut. Ins. Co., 433 N.W.2d 346, 349 (Mich. Ct. App. 1988) (finding sexual harassment and intentional infliction of emotional distress are not occurrences); Mary & Alice Ford Nursing Home Co., Inc. v. Fireman's Ins. Co., 446 N.Y.S.2d 599, 601 (N.Y. App. Div. 1982) (finding disability discrimination is not an occurrence), *aff'd*, 57 N.Y.S.2d 656 (1982).

167. Industrial Indem. Co. v. Pacific Maritime Assoc., 777 P.2d 1385, 1388 (Or. Ct. App. 1989). *But see Griffin*, 1997 WL 56958, at *3-4 (denying summary judgment for the insurer as to claims by the plaintiff that she suffered emotional distress as a result of discrimination on account of her disabilities, since the record did not make clear an intent by the defendant to cause those injuries); Maine State Academy of Hair Design, Inc. v. Commercial Union Ins. Co., 699 A.2d 1153, 1157 (Me. 1997) (reversing summary judgment for the insurer because, although there may be an expectation of harm when engaging in sexual harassment, "bodily injury is not necessarily expected or intended by the perpetrator of unwanted sexual advances and wrongful discharge").

168. American Family Mutual Ins. Co. v. M.B., 563 N.W.2d 326, 328 (Minn. Ct. App. 1997) (agent liable for sending models to work with a photographer employed by a separate corporation under the control of the agent, when she had reason to know that the photographer would sexually assault and harass the models).

169. *See* Duff Supply Co. v. Crum & Forster Ins. Co., CIV. A. No. 96-8481, 1997 WL 255483, at *13-14 (E.D. Pa. May 1997) (finding complaint, alleging intentional and reckless behavior potentially, triggered coverage for sexual discrimination claims since "recklessness" is sufficient scienter to impose vicarious liability under Title VII); Wayne Township Bd. of Sch. Comm'rs v. Indiana Ins. Co., 650 N.E.2d 1205, 1208 (Ind. Ct. App. 1995), (finding that an allegation that school acted negligently when the principal sexually molested a student in his office was an occurrence, since Title IX does not require a finding of intent for liability to attach); Ron Tonkin Chevrolet Co., Inc. v. Continental Ins. Co., 870 P.2d 252 (Or. Ct. App. 1994), (ruling that liability for failure to make religious accommodation for employee is an occurrence because it is not predicated on an intentional act); Lapeka, Inc. v. Security Nat'l Ins. Co., 814 F. Supp. 1540, 1548 (D. Kan. 1993) (finding disparate impact liability qualifies as an occurrence); School Dist. of

discriminatory disparate impact of an intentionally adopted and applied employment policy is not caused by an accident.[170]

If an employer can demonstrate that it is subject to a suit seeking damages for bodily injury caused by an occurrence, it has satisfied the requirements of the insuring agreement. However, Coverage A also contains a number of exclusions from coverage that considerably narrow the scope of insurance. The most pertinent clause excludes suits seeking damages for bodily injury to an employee arising out of, and in the course of, employment. Most courts hold that bodily injury caused by discrimination "arises out of and in the course of employment" by definition, and thus, is excluded even if the case falls within the coverage provisions of the insuring agreement.[171] Courts frequently note that the language of the exclusion is broad and unqualified, and does not, by its terms, exclude only those claims subject to the exclusive jurisdiction of the worker's compensation system; thus, it raises the possibility that a discrimination suit will not trigger coverage under the employer's CGL or WC/EL policies.[172] On the other hand, an employer can utilize the *contra proferentem* maxim and the reasonable expectations doctrine to

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Shorewood v. Wausau Ins. Cos., 488 N.W.2d 82, 87 (Wis. 1992) (finding that allegations of indirect discrimination due to the discriminatory practices of other agencies is an occurrence); Seminole Point Hosp. Corp. v. Aetna Cas. & Sur. Co., 675 F. Supp. 44, 47 (D.N.H. 1987) (exclusion of intentional acts and discrimination is ineffective as to an employee's allegations of corporate negligence in hiring and supervising the offending employee); Bensalem Township v. Western World Ins. Co., 609 F. Supp. 1343, 1351 (E.D. Pa. 1985) (ruling willful violation of ADEA can be an occurrence because "willful" does not refer necessarily to intentional behavior in this statutory context).

170. *See* Educational Testing Serv. v. Liberty Mut. Fire Ins. Co., No. 96-2790-VRW, 1997 WL 220315, at *4 (N.D. Cal. 1997); Loyola Marymount Univ. v. Hartford Accident & Indem. Co., 271 Cal. Rptr 2d. 528, 532 (Cal. Ct. App. 1990).

171. *Duff Supply Co.*, 1997 WL 255483, at *13 (applying a "but for" causation test and refusing coverage of an employment discrimination claim). *See Educational Testing Serv.*, 1997 WL 220315, at *6; Schmidt v. Smith, 684 A.2d 66, 72 (N.J. Super. Ct. 1996); Mattox Enterprises, Inc. v. St. Paul Mercury Ins. Co., No. 95-629, 1995 WL 541471, at *2 (Minn. Ct. App. Sept. 12, 1995); Jefferson-Pilot Fire & Cas. Co. v. Sunbelt Beer Distrib., Inc., 839 F. Supp. 376, 379 (D.S.C. 1993); Old Republic Ins. Co. v. Comprehensive Health Care Assocs., Inc., 2 F.3d 105, 109 (5th Cir. 1993); McLeod v. Tecorp Int'l, Ltd., 865 P.2d 1283, 1288 (Or. 1993) (excluding coverage for alleged wrongful discharge and intentional infliction of emotional distress); Conrad v. Mike Anderson Seafood, Inc., No. 89-1481, 1991 WL 22925, at *6 (E.D. La. Feb. 15, 1991); St. Paul Fire & Marine Ins. Co. v. Skapyak, No. 89-524, 1989 WL 84180, at *2 (Minn. App. Aug. 1, 1989); Castle & Cooke, Inc. v. Great Am. Ins. Co., 711 P.2d 1108, 1110 (Wash. Ct. App. 1986).

172. *See* Ottumwa Hous. Auth. v. State Farm Fire & Cas. Co., 495 N.W.2d 723, 728 (Iowa 1993); Omark Indus. v. Safeco Ins. Co., 590 F. Supp. 114, 121,(D. Or. 1984). This reading of the CGL policy makes sense, given that there is often a separate exclusion for liabilities incurred pursuant to the state's Worker's Compensation laws. *See* Meadowbrook, Inc. v. Tower Ins. Co., 559 N.W.2d 411, 420 (Minn. 1997); Fieldcrest Cannon, Inc. v. Fireman's Fund Ins. Co., 477 S.E.2d 59, 71 (N.C. Ct. App. 1996) ("We find persuasive that exclusion (I) specifically references liability for injuries covered under workers' compensation, while exclusion (j) does not.").

limit the scope of the exclusion to the coverage otherwise provided by WC/EL policies if the CGL form was marketed in this manner.[173] In any event, the employer may insist that its insurer provide a defense of an employment related claim until such time as the insurer can demonstrate that all of the alleged wrongdoing falls within the exclusion.[174] With respect to coverage, however, the employer must demonstrate that the suit seeks damages against an insured that is not the employing entity, or that the wrongdoers were acting outside the course of their employment when they caused injury to the plaintiff, in order to avoid this exclusion.[175]

The insuring agreement of Coverage B provides coverage for damages resulting from a "personal injury" or "advertising injury," without limiting coverage to accidental occurrences. The policy definition of "personal injury" makes clear that Coverage B provides coverage for non-bodily injuries arising out of one or more of the listed torts, including invasion of privacy by publication, libel, and slander. Given the many obstacles to asserting coverage under Coverage A, and the increasing frequency of defamation claims being added to employment discrimination claims, many employers rely upon Coverage B to demand a defense of the suit.

The primary advantage of pursuing coverage under Coverage B is that it is triggered by certain intentional "offenses" rather than by "occurrences," eliminating the requirement that the injuries in question be the result of an accident.[176] Many older umbrella policy forms

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173. *See* Save Mart Supermarkets v. Underwriters at Lloyd's London, 843 F. Supp. 597, 604 (N.D. Cal. 1994).

174. Sphere Drake Ins. Co. v. Shoney's, 923 F. Supp. 1481 (M.D. Ala. 1996); Terra Nova Ins. Co. v. Chillum Corp., 526 A.2d 642 (Md. Ct. Spec. App.), *cert. denied*, 532 A.2d 168 (Md. 1987).

175. *See, e.g.*, Maine State Academy of Hair Design, 699 A.2d at 1158 (reversing summary judgment for insurer because the plaintiff did not allege that the acts of discrimination arose out of and occurred within the course of her employment); Bond Builders, Inc. v. Commercial Union Ins. Co., 670 A.2d 1388, 1391 (Me. 1996) (finding that the duty to defend is triggered and not excluded, because there is a possibility that the assault by the plaintiff's fellow workers was not in the course of their employment); *Schmidt*, 684 A.2d at 75-76 (exclusion does not cover post-hiring, pre-employment harassment and assault at the company Christmas party); Western Heritage Ins. Co. v. Magic Years Learning Ctrs. & Child Care, Inc., 45 F.3d 85, 90 (5th Cir. 1995) (ruling that exclusion only applies to corporate employer, but husband and wife "owners" who sued in their individual capacities for harassment are entitled to coverage as named insureds on the policy). In *Western Heritage*, note, however, that the exclusion in the current CGL form provides that the exclusion applies whether "the insured may be liable as an employer or in any other capacity." *Id.* at 90.

176. This distinction between Coverage A and Coverage B sometimes is misunderstood, leading to a great deal of confusion. In *Missouri Property & Casualty Insurance Guaranty Association v. Petrolite Corp.*, 918 S.W.2d 869 (Mo. Ct. App. 1996), the insurance carrier refused to defend or indemnify the employer once a determination was made that the employer's actions constituted a "willful" violation of the ADEA because there could be not occurrence, but the court properly noted that coverage was sought under Coverage B for Personal Injuries caused by

expanded the coverage for personal injuries by specifically adding "discrimination" to the list of covered torts, thereby providing an obvious trigger of coverage.[177] However, newer policies are either unlikely to contain this express coverage of discrimination, or will include the coverage only with explicit limitations.[178] Consequently, the duty to defend is often triggered by allegations of defamation made in connection with the underlying discrimination allegations.[179]

Given the broad duty to defend any action that could potentially

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intentional torts. *Id.* at 873. The court noted the absurdity of the insurer's interpretation: "Reading the 'personal injury' definition and the 'occurrence' definition together, the policy apparently provides coverage for 'unintentional intentional torts' not committed by or at the direction of the insured . . . the result of such language is 'complete nonsense.'" *Id.* The easy answer to this apparent dilemma is that Coverage B does not require an occurrence, but instead provides coverage for personal injuries caused by an "offense." *But see* Edquist v. Insurance Co. of N. Am., No. C6-95-1111, 1995 WL 635179, at *2-3 (Minn. Ct. App. Oct. 31, 1995) (ruling that a business auto portion of the insured's liability package collapsed bodily injury and personal injury into one designation (personal injury) that was covered only if caused by an "occurrence" and arising out of the use of the auto, rendering intentional torts committed by a supervisor against a female employee while in the company car uninsurable).

177. *See* Solo Cup Co. v. Federal Ins. Co., 619 F.2d 1178, 1182 (7th Cir. 1980); Clark-Peterson Co., Inc. v. Independent Ins. Assocs., Ltd., 492 N.W.2d 675, 677 (Iowa 1992) (en banc). In *United States Fire Insurance Co. v. Caulkins Indiantown Citrus Co.*, 931 F.2d 744 (11th Cir. 1991), the court denied an attempt by an umbrella carrier to obtain contributions from the employer's CGL carriers because the CGL carriers had more carefully drafted their policies to exclude discrimination from coverage. *Id.* at 749-50. *Cf.* American Motorists Ins. Co. v. Allied-Sysco Food Servs., Inc., 24 Cal. Rptr. 2d 106, 112 (Cal. Dist. Ct. App. 1993) (personal injury defined to include "racial or religious discrimination" must be read according to its plain meaning as not including all Title VII liabilities).

178. *See Duff Supply Co.*, 1997 WL 255483, at *10-12 (coverage for discrimination later limited by exclusion of personal injury arising on the basis of race, creed, color, sex, age, national origin, or termination of employment held not to encompass allegations of sexual discrimination); Kline v. The Kemper Group, 826 F. Supp. 123 (M.D. Pa. 1993), *aff'd*, 22 F.3d 301 (3d Cir. 1994); Transport Ins. Co. v. Lee Way Motor Freight, Inc., 487 F. Supp. 1325, 1327 (N.D. Tex. 1980) (describing the carrier's change in umbrella policy forms between 1972 and 1973 to stop including discrimination in the definition of personal injury). One limitation is to include coverage only for discrimination not committed by the insured or at its discretion, in an attempt to provide coverage only for liabilities incurred by an employer on account of the acts of its agents. *See* Town of South Whitley v. Cincinnati Ins. Co., 724 F. Supp. 599, 604 (N.D. Ind. 1989) (exclusion of discrimination "committed by you" in an umbrella policy is enforced because the alleged discriminatory refusal to hire was an action by the insured Town Board of Trustees, rather than by an agent of the Town), *aff'd*, 921 F.2d 104 (7th Cir. 1990). Another limitation provides coverage for discrimination liabilities generally, but excludes liabilities for employment discrimination. *See* Teague Motor Co., Inc. v. Federated Serv. Ins. Co., 869 P.2d 1130, 1132-33 (Wash. Ct. App. 1994) (finding that limited coverage for non-employment discrimination in umbrella policy is neither ambiguous nor illusory, even though all sexual harassment claims would necessarily be excluded).

179. *See, e.g.*, EEOC v. Southern Publ'g Co., 894 F.2d 785, 790-91 (5th Cir. 1990) (allegation of defamation against employer president regarding his remarks about the reasons why the plaintiffs were terminated falls within the coverage of slander); *Maine State Academy of Hair Design*, 699 A.2d at 1159 (allegations of damage to professional reputation create at least the potential for coverage under Part B of the policy).

result in a covered verdict, some courts will construe sexual harassment complaints alleging sexist comments about the plaintiffs as triggering this duty, even if no cause of action for defamation has been pleaded formally in the complaint.[180] Coverage in these circumstances is not assured, however, since many courts will not read into the complaint defamation allegations that are not raised explicitly, nor will they construe discriminatory behavior as defamatory in itself.[181] Additionally, plaintiff employees often include allegations of false imprisonment in their sexual harassment complaints, another enumerated intentional tort under the definition of "personal injury" in Coverage B. However, not every unwelcome physical encounter amounts to a false imprisonment, and so the facts, as pleaded in the complaint, will trigger coverage only if they constitute the tort of false imprisonment.[182] The exclusions in Coverage B are less pertinent to employment litigation, generally, but the exclusion of personal injury "arising out of the willful violation of a penal statute or ordinance committed by or with the consent of the insured" designates an uninsurable risk that may be relevant to some

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180. *See, e.g., Duff Supply Co.*, 1997 WL 255483, at *6-8 (finding that allegations that the plaintiffs were generally referred to as "sluts" and "whores" raised the potential for a recovery for defamation, even though not separately pleaded); American Guar. & Liab. Ins. v. Vista Med. Supply, 699 F. Supp. 787, 793 (N.D. Cal. 1988); *United States Fire*, 511 N.E.2d at 751 (finding that allegations of harassment and discrimination by means of false and defamatory (sexist) comments about the plaintiff falls within the coverage of slander).

181. *See* Farr's Stationers, Inc. v. State Farm Fire & Cas. Co., No. 96-55179, 1997 WL 267786 (9th Cir. May 20, 1997). The court stated that:

> Under California law, however, where, as here, the complaint does not expressly contain a cause of action for defamation, a duty to defend can be triggered only where the extrinsic facts clearly put the insurer on notice that there is potential for defamation liability. There is no indication in this case that, by asserting in her supplementary declaration that she had been called a 'bitch' in front of other sales representative, the plaintiff was seeking damages on account of injury to her reputation as a result of a false statement of fact.

Id. at *2; Fieldcrest Cannon, Inc. v. Fireman's Fund Ins. Co., 477 S.E. 2d 59, 68-70 (N.C. App. 1996); Moore v. Continental Ins. Co., 51 Cal. Rptr. 2d 176, 182 (Cal. Ct. App. 1996) (no potential coverage found because the plaintiff did not plead independent allegations of defamation or false imprisonment, and factual descriptions of acts of sexual harassment, such as being backed into a corner and fondled, are insufficient to trigger these coverages since "the allegations in question do no more than reflect the reality that such harassment can take place behind closed doors or in the presence of coworkers"); American Motorists Ins. Co. v. Allied-Sysco Food Servs., Inc., 24 Cal. Rptr. 2d 106, 112 (Cal. Ct. App. 1993) (finding that personal injury, defined to include "humiliation," is not triggered by discrimination complaint, since any humiliation experienced by the employee was a result of sex discrimination, a non-covered risk).

A complaint alleging sexual harassment does not automatically trigger personal injury coverage for libel and slander. *See* Lindsey v. Admiral Ins. Co., 804 F. Supp. 47, 52 (N.D. Cal. 1992); Omark Indus., Inc. v. Safeco Ins. Co., 590 F. Supp. 114, 120 (Or. Ct. App. 1984).

182. *See, e.g.*, Cornhill Ins. PLC v. Valsamis, Inc., 106 F.3d 80, 85 (5th Cir. 1997) (allegation that supervisor attempted to force himself on plaintiff employee in a supply room doesn't trigger coverage because there was no allegation that the door was locked or that the supervisor detained her in the room for any period of time by use of physical force or threats).

discrimination claims.[183]

During the past ten years, a number of employers have been able to trigger the duty to defend when Coverage A has been ambiguously drafted, when Coverage B expressly includes discrimination, or when the underlying complaint raises other torts defined as personal injury. In response to this rapidly expanding source of liability, the ISO prepared an "Employment-Related Practices Exclusion" endorsement designed to amend both Coverage A and Coverage B by removing employment discrimination litigation from the scope of basic coverage provided by the CGL policy.[184] Generally, insurers have been successful in enforcing this type of exclusion, and so it should be expected that liability policies will include such clauses with increasing frequency.[185] However, even the comprehensive employment-related practices exclusion will be subject to judicial interpretation and will not prove to be an absolute bar to

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183. It seems unlikely that this exclusion would apply to any violation of a statutory scheme. *See, e.g.*, Bensalem Township v. Western World Ins. Co., 609 F. Supp. 1343, 1350 (E.D. Pa. 1985) (finding a willful violation of the ADEA does not bring the matter within the exclusion because "willful" is defined differently in the two usages). This exclusion is likely intended to exclude civil liabilities arising out of illegal actions. *See* MGM, Inc. v. Liberty Mut. Ins. Co., 855 P.2d 77, 80 (Kan. 1993) (enforcing exclusion by denying coverage to an employer that subjected its employees to wiretaps that were illegal under the federal criminal code).

184. *See* Joseph P. Monteleone, *Coverage Issues Under Commercial General Liability and Directors' and Officers' Liability Policies*, 18 W. NEW ENG. L. REV. 47, 69-70 (1996). The new provision excludes coverage of bodily injury or personal injury arising out of any refusal to employ that person, termination of that person's employment, or "employment-related practices, acts or omissions, such as coercion, demotion, evaluation, reassignment, discipline, defamation, harassment, humiliation or discrimination directed at that person." *Id.*

185. *See, e.g.*, Board of County Comm'rs v. International Surplus Lines Ins. Co., No. 93-3417, 1994 WL 540663, at *6 n.4 (6th Cir. Oct. 3, 1994) (unpublished disposition); Old Republic Ins. Co. v. Comprehensive Health Care Assoc., Inc., 2 F.3d 105 (5th Cir. 1993) (enforcing a "sexual abuse" exclusion and an "employment-related claim" exclusion in a CGL policy, and enforcing an "employment" exclusion in an umbrella policy); Reliable Springs Co. v. St. Paul Fire & Marine Ins. Co., 869 F.2d 993, 996 (6th Cir. 1989) (enforcing "discrimination and unfair employment practices" exclusion); Potomac Ins. Co. of Ill. v. Peppers, 890 F. Supp. 634, 644-45 (D. Tex. 1995) (enforcing "employment-related practices, policies, acts or omissions" exclusion with regard to defamation claim by one partner against another); P&C Bakeries v. Northbrook Nat'l Ins. Co., No. C-92-2555VRW, 1992 U.S. Dist. LEXIS 19355, at *4-5 (N.D. Cal. Oct. 31, 1992); New England Mut. Life Ins. Co. v. Liberty Mut., 667 N.E.2d 295, 298 (Mass. Ct. App. 1996); Transamerica Ins. Co. v. Superior Court, 35 Cal. Rptr. 2d 259, 265 (1994) (exclusions in Worker's Compensation and Employer's Liability Policy); Teague Motor Co. v. Federated Serv. Ins. Co., 869 P.2d 1130 (Wash. Ct. App. 1994) (exclusion of employment discrimination from umbrella policy); Ottumwa Hous. Auth. v. State Farm, 495 N.W.2d 723, 727 (Iowa 1993) (exclusion barring coverage for claims arising out of conduct at the workplace upheld); Loyola Marymount Univ. v. Hartford Accident & Indem. Co., 271 Cal. Rptr. 528, 531 (Cal. Ct. App. 1990) (enforcing exclusion of personal injuries "as a result of an offense directly or indirectly related to the employment or prospective employment" of the claimant); Alexandra House, Inc. v. St. Paul Fire & Marine Ins. Co., 419 N.W.2d 506, 510 (Minn. Ct. App. 1988) (no duty to defend defamation count because the alleged personal injury was "related to his or her employment").

coverage for all forms of employment discrimination liability.[186]

Lawsen v. Strauss[187] provides a good example of the "holes" that may remain in the exclusion. In *Lawson*, the Louisiana Court of Appeal held that the new ISO exclusion did not defeat coverage when women employees sued several doctors and their Eye Center employer for assault and battery and intentional infliction of emotional distress, since the doctors were not carrying out their employment duties.[188] The court reasoned that the "mere fact that an employee is involved does not mean that a 'personnel practice,' etc. is at issue or the exclusion would have been written to simply state that no claims by employees are covered."[189] However, other courts have challenged this pro-insured reading of the exclusion. In *Frank and Freedus v. Allstate Insurance Co.*,[190] the California Court of Appeal adopted a more traditional "plain meaning" approach to applying the clause.

> Nor is the term "employment-related" ambiguous because it is not specifically defined in the policy. The term is not technical in nature. It is used in its ordinary sense, i.e., related to employment. As a term, it modifies the specified acts (including defamation) as well as the terms "practices, policies, acts or omissions." The clear meaning of subdivision (2) of the exclusion is coverage for practices, policies, acts or omissions which are related to employment, including employment-related defamation.[191]

Definitive interpretations of this exclusion are unlikely in the near future.

If an employment practices exclusion is more narrow than the ISO language, it obviously is more susceptible to interpretations that benefit the insured. For example, in *Connecticut Interlocal Risk Management Agency v. Town of West Hartford*,[192] a trial court held that an exclusion of claims "arising out of your official employment policies or practices

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186. *See* Lawson v. Strauss, 673 So. 2d 223 (La. Ct. App. 1996). *Cf. Schmidt, supra* notes 155-57 (discussing similar exclusion in WC/EL forms).

187. *Id.*

188. *See id.* at 227.

189. *Id. See also* HS Services, Inc. v. Nationwide Mut. Ins. Co., 109 F.3d 642 (9th Cir. 1997). The court held that "for an act or omission to be 'employment-related' the relationship must be direct and proximate." *Id.* at 647. The court further found that an allegation by a terminated employee, now competing with the insured, that the insured defamed him three months after the termination of employment, is potentially within coverage because "the statements were not made in the context of [his] employment." *Id.*

190. 52 Cal. Rptr 2d 678 (Cal. Ct. App. 1996).

191. *Id.* at 684. *See also* International Brotherhood of Elec. Workers, Local 1357 v. American Int'l. Adjustment Co. Inc., 955 F. Supp. 1218, 1222-23 (D. Haw. 1997) (court repeatedly summarized the scope of the exclusion as applicable to any claims arising from the "employment relationship" in the course of entering summary judgment for the carriers).

192. No. 534047, 1996 WL 219595 (Conn. Spec. Ct. Apr. 10, 1996).

(including but not limited to claims due to demotion, selection, dismissal, failure to promote, and similar activity)" did not absolve the insurer of the duty to defend a complaint that alleged defamatory comments about an employee that in part were unconnected with any personnel action.[193] The court noted that the exclusion language "contrasted sharply" with the ISO language.[194] Moreover, the court opined that even defamatory comments in connection with an investigation of the employee's alleged sexual harassment would trigger the duty to defend, because a claim resulting from such an investigation "is not similar to a claim arising from a change in employment status."[195]

Additional problems arise if the insurer simply adds an employment practices exclusion to an existing policy without carefully integrating it to the other provisions. For example, where an insurer specifically provided coverage for "discrimination," but later in the policy excluded liabilities for personal injuries "directly or indirectly related to the dismissal of any employee of the Insured," a California court found that the apparent effort to disclaim all liabilities related to employment practices was unsuccessful:

> The claims of Smith in the underlying action have no relation at all to a dismissal from employment; she alleged, in fact, that she resigned after being harassed. . . . The mere act of unintentionally discriminating against someone in violation of the law cannot be an "offense" negating the very coverage granted to the insured for claims of "discrimination" by the policy itself. This interpretation by Zurich of its policy would result in an entirely fictional grant of coverage . . . . If Zurich desires to market and sell a policy which provides coverage for claims of discrimination, but excludes all claims of discrimination by employees of any insured, it must say so in clear, unambiguous policy language . . . .[196]

This rationale is particularly persuasive with regard to "discrimination" coverage, but may not be adopted by courts assessing whether the duty to defend is triggered by allegations of another enumerated tort in Coverage B.[197]

Because a multi-count complaint that contains even a single claim potentially within coverage will trigger the duty to defend, it is likely that many discrimination cases will pose difficult interpretive problems. For example, after an employee resigns or is terminated, the employer

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193. *Id.* at *3.

194. *Id.* at *4.

195. *Id.*

196. Melugin v. Zurich Canada, 57 Cal. Rptr. 2d 781, 787-88 (Cal. Ct. App. 1997).

197. *See, e.g., Frank & Freedus*, 52 Cal. Rptr. 2d at 684 (there is no ambiguity in providing coverage for defamation and then later excluding coverage for defamation related to employment).

may make allegedly defamatory comments regarding the employee. A post-employment defamation claim appended to a general discrimination complaint might be construed not to be defamation that amounts to an "employment-related practice," thus taking the claim outside the scope of the exclusion.[198]

C. *Directors & Officers*

Discrimination actions rarely give rise to claims against the officers and directors of a large corporation since they often have little day-to-day oversight of employment matters. Recent revelations, however, about the behavior of Texaco executives in connection with the defense of racial discrimination litigation provide a plausible scenario in which lawsuits might be targeted against individual corporate officers.[199] In contrast, directors and officers of smaller corporations may well be sued personally for harm allegedly resulting from their official actions. Directors and Officers ("D&O") policies do not provide coverage to the employer for its liabilities; therefore, a discrimination complaint that names only the employer and lower level employees usually will not trigger coverage under a D&O policy.[200] Additionally, the policies do not cover directors and officers for wrongful acts committed by them outside of their official capacities, although it is important to distinguish between a director or officer acting within her capacity as such and a

198. *See* Machson & Monteleone, *supra* note 10, at 708 ("For example, coverage could depend on whether the employer said 'you're a stupid and incompetent jerk and you're fired' (arguably not covered because the insult occurred during employment), or 'you're fired, you stupid and incompetent jerk' (possibly covered because the insult occurred post-employment)."). Some courts have construed the exclusion so as to include such claims within its scope. *See Frank & Freedus*, 52 Cal. Rptr. at 684. *Cf.* HS Servs., Inc. v. Nationwide Mut. Ins. Co., 109 F.3d 642 (9th Cir. 1997).

Similarly, intentional torts committed after the underlying discriminatory behavior is completed may provide an independent basis for coverage. *See* Great Am. Ins. v. Hartford Ins. Co., 621 N.E.2d 796, 800 (Ohio Ct. App. 1993) (involving coverage for alleged threat to reveal private, embarrassing facts about the plaintiff in order to induce settlement of an on-going age discrimination claim despite a broadly stated exclusion for employment discrimination).

199. *See Firm's Officials Also Talked of Destroying Documents Sought in Suit, Transcripts Show; Tapes Capture Racist Talk By Texaco Execs.*, CHI. TRIB., Nov. 4, 1996, *available in* 1996 WL 2723585.

200. For example, in *Olympic Club v. Those Interested Underwriters at Lloyd's London*, 991 F.2d 497 (9th Cir. 1993), a private club, sued for racial and gender discrimination by the City, sought a defense from its D&O carrier on the theory that any discriminatory practices resulted from actions of the directors. The court rejected this approach, finding that no directors or officers had been named in the lawsuits and that the discriminatory practices could have been carried out by the members of the club. After emphasizing the nature of D&O insurance, the court concluded that coverage would be triggered only if the employer showed "that the City alleges that a director, officer or employee [per a coverage endorsement] specifically authorized, directed or participated in the Club's discriminatory acts and thereby breached a duty owed to the City and the public at large." *Id.* at 502.

director or officer acting with full agency authority.[201] For example, it is implausible that an officer of a corporation is acting within the scope of his delegated powers when he sexually harasses a female employee, but if he commits the harassment when he ostensibly is carrying out his duties as an officer of the corporation, there would be a strong argument for triggering the D&O policy. In contrast, a corporate officer who assaults a female employee off-premises may not be acting in his capacity as an officer.

Even if the litigation is arguably within the insuring agreement of the D&O policy, a number of employment discrimination claims might be excluded from coverage under the so-called "insured v. insured" exclusion clause. Typically, D&O policies do not provide coverage for officers and directors of a corporation when they are sued by a fellow officer or director.[202] This exclusion has a far-reaching scope if the policy is strictly interpreted by the court since many D&O policies will define "directors and officers" as "employees" of the corporation for purposes of at least some of the coverage.[203] However, when the discrimination plaintiff brings suit after being terminated or constructively discharged, courts interpreting a "claims made" policy may find that the exclusion is inapplicable, since the plaintiff is no longer an insured employee at the time of the "claim."[204]

Contrary to the trend in CGL policies to exclude any liability for employment discrimination claims, many carriers that write D&O coverage have added an endorsement to provide "Employment Practices Liability" coverage at no charge to their customers. This marketing gamble may pay off, since D&O policies do not include a duty to defend and the final disposition of virtually all employment discrimination suits will not result in individual liability for corporate officers and directors. Given this express adoption of coverage, however, employment lawyers are well counseled to examine potential coverage under their clients' D&O policies.

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201. *See* Wayne County Neighborhood Legal Servs. v. National Union Fire Ins. Co., 971 F.2d 1, 4 (6th Cir. 1992) (ruling that a director may be acting in the capacity of a director for purposes of a wrongful termination suit, even though the director's actions were beyond the scope of agency authority).

202. *Compare* Foster v. Kentucky Housing Corp., 850 F. Supp. 558, 561 (E.D. Ky. 1994) (coverage excluded) *with* Conklin v. National Union Fire Ins. Co., No. 4-86-860, 1987 WL 108957, at *2 (D. Minn. Jan. 28, 1987) (exclusion inapplicable).

203. *See, e.g.*, *Foster*, 850 F. Supp. at 559.

204. *Cf.* Township of Center, Butler County, Pennsylvania v. First Mercury Syndicate, Inc., 117 F.3d 115, 119 (3d Cir. 1997) (interpreting exclusion in E&O policy, in light of the purpose of preventing collusive litigation, as not applying to a wrongful discharge suit brought by a former employee).

D. *Errors & Omissions*

The insurance industry has developed a form of Errors & Omissions ("E&O") policy, often known as a "Board of Education Liability Policy," to provide insurance to schools. Educational institutions face a wide variety of potential claims of discrimination, including suits by students under Title IX and by employees under Title VII. Because these policies are designed to protect the school from the wrongful and sometimes intentional acts of its agents, there is often a strong argument that employment discrimination claims are within coverage.[205] If the policy restricts the definition of "wrongful acts" to negligence, however, then only disparate impact discrimination will be within coverage.[206] Similarly, if the policy offsets a broad grant of coverage with plainly worded exclusions of intentional discriminatory acts, no coverage will exist for allegations of sexual discrimination that amount to claims of an intentional sexual assault.[207]

Because these policies often appear to provide coverage even for intentional discrimination, insurers have sought to have such coverage declared void as against public policy.[208] This argument increasingly meets with skepticism, however, since the insurer appears to be seeking a back door out of promised coverage for which premiums have been paid. An Illinois appellate court noted that:

> The fact that many insurance policies contain an exclusion for intentional conduct demonstrates insurers have not relied on any broad public policy. Defendant could have included such an exclusion in its [Board of Education Liability] policy, but did not. This court will not rewrite the BEL policy to create an exclusion.[209]

E&O policies explicitly exclude coverage for bodily injuries, which are covered by the CGL or WC/EL products, and therefore, cases of sexual harassment that include physical abuse might be deemed to fall outside

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205. *See* Canutillo Ind. Sch. Dist. v. National Union Fire Ins. Co., 900 F. Supp. 844 (W.D. Tex. 1995) (holding Title IX liability for sexual discrimination against student is within policy coverage), *rev'd on other grounds*, 99 F.3d 695, 708-09 (5th Cir. 1996) (holding that the Title IX claims were within coverage, even though alleging intentional acts, but that an exclusion of liability arising from criminal acts applied to the alleged sexual assault); Andover Newton Theological Sch., Inc. v. Continental Cas., 930 F.2d 89, 92 n.3, 93 (1st Cir. 1991) (ruling that ADEA intentional discrimination is within "wrongful acts" coverage); Continental Cas. Co. v. Canadian Universal Ins. Co., 924 F.2d 370, 378 (1st Cir. 1991) (allowing coverage for Title IX and Title VII claims); Community Unit Sch. Dist. No. 5 v. Country Mut. Ins. Co., 419 N.E.2d 1257, 1260 (Ill. Ct. App. 1981) (allowing coverage to include race and sex discrimination claims).

206. *See* School Dist. No. 1, Multnomah County v. Mission Ins. Co., 650 P.2d 929, 935-36 (Or. Ct. App. 1982).

207. Horace Mann Ins. Co. v. Peters, 21 Colo. 661 (Colo. Ct. App. 1997).

208. *See supra* Part III.

209. University of Illinois v. Continental Cas. Co., 599 N.E.2d 1338, 1351 (Ill. Ct. App. 1992).

the scope of the typical E&O policy.[210]

E. *Employment-Related Practices Liability Insurance*

As general liability insurers and worker's compensation insurers moved aggressively to exclude discrimination and other employment liabilities from coverage, surplus lines insurers began developing forms to provide coverage to employers for employment-related practices liabilities. More recently, even larger standard market insurers have entered this market. Some of these emerging products are narrowly tailored, providing only reimbursement of legal expenses incurred in defending employment-related litigation, or providing coverage only for certain liabilities, such as discrimination or wrongful termination. However, insurers have created a large market in the past few years for policies that provide broad coverage for employment-related liabilities. This market includes both primary policies and endorsements to umbrella policies.

Awareness of EPLI products has grown tremendously in the past several years as the number of insurers offering this product has multiplied. This awareness was evidenced in dramatic fashion in a recent case involving a discrimination suit brought by a fired chief financial officer. The court recounts that the plaintiff was disturbed by the employer's inattention to her complaints: "concerned by their cavalier attitude, she advised them to 'sober up,' call counsel to determine a corporate response, and find out whether they had employment practices liability insurance."[211] Aggressive marketing by insurers promises to make EPLI a familiar insurance product that might even become part of the standard business liability insurance program if current trends continue.[212]

Although a variety of manuscripted forms exist, common features of these policies reflect the experience of general liability insurers faced with claims for coverage of employment liabilities during the past twenty years. First, most policies continue to include a right and duty to defend, but contain these expenditures within the policy limits. This not only acknowledges that litigation expenses may be of greatest concern to the employers and that the ability to control the defense and settlement

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210. *See* Wayne Township Bd. of Sch. Comm'rs v. Indiana Ins. Co., 650 N.E.2d 1205, 1212 (Ind. Ct. App. 1995).

211. Lynch v. New Deal Delivery Serv., Inc. 1997 WL 528310, at *3 (D.N.J. Aug. 12, 1997).

212. *See* Sally Roberts, *Spotlight Report: A Closer Look at Specialty Risks: Environmental & Professional Liability: Maturing EPL Market Offering Enhanced Cover*, BUS. INS. (June 9, 1997), *reprinted in* 1997 WL 8294830 (describing the increase in the number of carriers offering EPLI, the expansion of coverage, the reduction of premiums, and the continued aggressive marketing during 1997).

of claims may be particularly important to insurers in this area, but also that the expected payouts under the policies must be rendered more certain and stable for the insurer to accept the risk. It is equally important that the policies are underwritten on a claims-made basis, rather than on an occurrence basis. This provides two important benefits to the carrier: it minimizes the insurer's responsibility for risks that existed prior to the underwriting and implementation of its loss prevention programs, and it allows the insurer to quickly adjust in the face of an unexpected negative loss history by eliminating the long tail of coverage that exists under occurrence-based policies. Moreover, many policies require the insurer not only to pay a deductible, but also to participate in the risk by bearing a percentage of the loss. This reflects the belief that an aggressively proactive employer can be motivated by financial considerations to minimize the expected loss.

Because EPLI coverage is so new to the market, no reported cases exist which signal the likely coverage disputes. However, it is possible to anticipate some areas of potential conflict in light of the history of disputes under other primary coverages. At this time, it appears that EPLI policies will be written exclusively on a claims-made basis, as insurers attempt to reduce the uncertainties that the long "tail" of liabilities under occurrence-based policies pose. To preclude adverse selection—the problem that only employers who know of occurrences that might ripen into claims in the near future will seek to purchase EPLI insurance—insurers are utilizing lengthy and detailed applications to elicit information about the employer's personnel practices and knowledge of any potential claims. With the filing of a claim, insurers will scrutinize these applications for evidence of misrepresentations, presumably leading to coverage litigation in some cases.[213]

Since EPLI policies, generally, are written broadly enough to encompass such risks if permitted by law, another major issue will be coverage for disparate treatment discrimination in light of the public policy of the state in which the question of coverage arises. Additionally, because the policies often grant coverage in a manner keyed to terms of art in discrimination law, such as "sexual harassment" and "retaliatory termination," employers may argue that these terms are ambiguous, and therefore, to be broadly construed for insurance purposes in light of the continuing evolution of employment discrimination law.

213. For example, in a dispute involving a claims-made D&O policy, one court found that the insured had made material, albeit honest, misrepresentations on the application regarding knowledge of any facts or circumstances that indicated a probability of a claim within the policy coverage being filed. *See* Board of County Comm'rs v. Int'l Surplus Lines Ins. Co., No. 93-3417, 1994 WL 540663, at *6 (6th Cir. Oct. 3, 1994).

Finally, EPLI policies contain a number of exclusions that will raise coverage questions, such as the exclusion for "willful failure to comply with the law." In the absence of precise definitions, there may be litigation concerning the scope of the exclusions when a plaintiff alleges a "willful" violation of the ADEA, because "willful" and "intentional" may have different meanings for employment discrimination purposes as opposed to insurance coverage purposes. Finally, there may be significant disputes between insurers writing EPLI policies and those writing CGL policies in light of the EPLI exclusion of bodily injuries. It may often be unclear on the basis of a typical vague complaint whether alleged physical injuries flowing from discriminatory treatment trigger CGL coverage or remain within the EPLI scope of coverage.

F. *Timing Issues: "Occurrence-" and "Claims-Made"*

Under occurrence-based insurance, the policy coverage is triggered when the bodily injury or personal injury caused by the occurrence takes place, regardless of when the occurrence itself happens. Consequently, if corporate officials began to follow a promotion policy in 1990 that has the effect of unfairly limiting the opportunities for women and minorities to advance in the business, coverage under an insurance policy for this "occurrence" will be triggered each time an employee suffers injury as a result of this single occurrence.[214] Regardless of the number and timing of the covered injuries caused by the adoption of the discriminatory policy, and therefore the number of policies that might be triggered, there is only one occurrence that is the cause of the losses. Because the deductible is owed per occurrence, rather than per injury, when a number of discrimination claims emanate from "continuous or repeated exposure to substantially the same general harmful conditions," the employer will only be required to pay one deductible.[215] However, the insured will not be indemnified beyond the limit of coverage, which also is specified "per occurrence" for the policy year.[216] These features of occurrence coverage generally works to the advantage of the employer, since a number of relatively small claims arising from the same cause may not exceed the policy limit even when combined, but each claim

214. *See* Appalachian Ins. Co. v. Liberty Mut. Ins. Co., 676 F.2d 56, 62-63, *aff'd*, 676 F.2d 56 (3d Cir. 1982); Transport Ins. Co. v. Lee Way Motor Freight, Inc., 487 F. Supp. 1325, 1331 (N.D. Tex. 1980); Castle & Cooke, Inc. v. Great Am. Ins. Co., 711 P.2d 1108, 1112-13 (Wash. Ct. App. 1986).

215. *See* Transport Ins. Co. v. Lee Way Motor Freight, Inc., 487 F. Supp. 1325 (N.D. Tex. 1980).

216. *See id.*

may be less than the applicable deductible.[217]

In contrast, a "claims-made" policy triggers coverage when a claim is made, rather than when the occurrence takes place or the resulting injuries are suffered. In the context of employment discrimination, there is a great deal of uncertainty about when a "claim" is made for purposes of insurance coverage. Many policies do not define the term, and the requirement that plaintiffs pursue administrative remedies before the EEOC or various state agencies before filing suit renders the notion of a "claim" of employment discrimination ambiguous at best. Given this uncertainty, some courts expressly hold that the requirement of a "claim" must be interpreted in accordance with the reasonable expectations of the employer.[218] The division in the cases is somewhat deceptive, since the insured employer may argue in favor of an EEOC charge being considered a claim in some circumstances, but in different circumstances another employer may wish to argue that the claim is made only when the lawsuit is filed.[219] What seems clear is that many courts will interpret the ambiguous terms against the insurer if it is reasonable to do so. The doctrinal split revolves around the notion that a "claim" is a demand for relief; therefore, a claim is not made until the employee seeks damages. Because the EEOC is empowered to conciliate employment disputes rather than to award damages, many courts do not regard an EEOC charge as a claim.[220] However, proceedings before a state

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217. *See Appalachian Ins. Co.*, 676 F.2d at 61 (finding that single occurrences work in favor of the insured since all individual claims were less than $25,000 deductible).

218. *See* Pinckney Community Sch. v. Continental Cas. Co., 540 N.W.2d 748, 751 (Mich. Ct. App. 1995).

219. For example, in *Pinckney*, when the policy required that the claim be made within two years of policy termination to come within coverage, and the federal lawsuit was not filed until seven years later, the employer argued that the EEOC charge constituted a claim. *Pinckney*, 540 N.W.2d at 750. The court held in the insured's favor, noting that the employer and insurer both reacted to the EEOC filing as if it were a claim that triggered coverage, and also the practical reality that an EEOC charge is the first step in making a claim for relief. *Id.* at 753-54. On the other hand, in *National Union*, when an insured sought coverage under a claims-made E&O policy with an inception date two days after the EEOC charge had been filed, the court reasoned that a "claim" connoted a demand for money damages which cannot be made until the filing of a federal lawsuit. National Union Fire Ins. v. Cary Community Consol. Sch. Dist. No. 26, No. 93C6526, 1995 WL 66303, at *3-4 (N.D. Ill. Feb. 15, 1995).

Nevertheless, in a recent decision, the Minnesota Court of Appeal interpreted the term "claim" broadly in a manner that defeated the insured's basis for seeking coverage, over a strong dissent. *See* City of Mankato v. League of Minnesota Cities Ins. Trust, No. C8-93-1090, 1993 WL 527886, at *2 (Minn. Ct. App. Dec. 21, 1993) (holding that the claim occurred at the latest when the matter was referred to the attorney general, although the federal lawsuit was not filed until a year later when the policy was in force).

220. *See* Campbell Soup Co. v. Liberty Mut. Ins. Co., 571 A.2d 969, 971 (N.J. Super. Ct. App. Div. 1990); *Bensalem Township*, 609 F. Supp. at 1348; *cf. Maine State Academy of Hair Design*, 699 A.2d at 1160 (state administrative agency not empowered to award damages, and so administrative filing is not a "claim" under the policy).

agency with coercive power to award damages and adjudicate the plaintiff's allegations will generally be regarded as a claim.[221]

VI. Claim Processing and Loss Adjustment

Successfully arguing that a liability policy is triggered by a claim of employment discrimination does not end the analysis for the employer. Liability policies impose duties on both parties that are vitally important to the risk management function served by the policies. This section analyzes the obligations assumed by the employer and insurer, and the significance of these duties for the employer's efforts to enforce coverage of the underlying discrimination claim.

A. *Insured's Duties: Notice, Cooperation and the Misrepresentation Defense*

Liability policies generally place conditions on the insurer's obligations to indemnify the insured and to provide a defense. The purpose of these conditions is to establish a claim settlement process which will ensure effective protection under the policy for the employer, while also affording the insurer the information it needs to settle the employer's claim properly. The employer's principal duties under the policy are to provide timely notice of the potentially covered occurrence and to cooperate with the insurer's investigation and defense of the action. The notification requirement in the ISO CGL form is typical. It requires the employer to notify the insurer "as soon as practicable of an occurrence or an offense which may result in a claim" by providing the known details of the occurrence. Additionally, the employer must notify the insurer as soon as practicable of any claim or suit to which the policy applies by immediately sending "copies of any demands, notices, summonses or legal papers." This latter duty is particularly important since the insurer is not only under the obligation to defend the insured in the suit, but also has the right to "investigate any occurrence and settle any claim or suit that may result" in its discretion.

The employer's failure to comply with its obligations under the policy will certainly impair the claim settlement process and may establish a defense to enforcement of the policy in favor of the insurer. Generally, courts are hesitant to deprive the third party claimant of a source of funds to satisfy a judgment solely on the basis of the insured's failure to comply with the notice provisions of the policy. In many jurisdictions, therefore, the insurer is excused from its indemnity obligations

221. *See* Wayne E. Borgeest, et al., *Employment Law Claims: Triggering Coverage Under "Claims Made" Policies*, 18 W. New Eng. L. Rev. 179, 184-86 (1996).

under the policy only if the delay in notice has prejudiced its efforts to investigate and defend the claim.[222] In one case, a court held that the insurer was bound to its policy obligations despite the employer's failure to notify it of the occurrence until two years after a discrimination class action had been filed, due to the insurer's failure to prove actual prejudice resulting from the delay.[223] However, the judicial tendency to enforce coverage despite less than responsible behavior by the insured does have limits. When the employer's delay in providing notice obviously has prejudiced the insurer's rights because the litigation has substantially progressed, the courts have not hesitated to relieve the insurer of its duty to pay judgments or settlements on behalf of the employer.[224] This requirement of prejudice is not applied to the notice requirements under claims-made policies, where the "reporting" requirement is treated as a condition precedent to coverage.[225]

Prejudice occurs not only when the insurer's ability to conduct the litigation has been thwarted, but also when its right to investigate the occurrence has been hampered. Consequently, even when the carrier owes no duty to defend, it can successfully argue that it is absolved of its

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222. *See* KEETON & WIDISS, *supra* note 10, § 7.2(e) (describing the balancing test employed by many courts to determine whether a failure to provide notice prejudices the insured sufficiently to warrant denying a source of funds to the third party claimant by excusing the insurer of its duty to pay damages on behalf of the insured); JERRY, *supra* note 140, at 530 ("The majority view, which places the burden on the insurer to show that it was prejudiced by the lack of timely notice, rejects the presumption of prejudice and refuses to cause a forfeiture of coverage unless the insurer can demonstrate why this is fair.").

223. *See* Castle & Cooke, Inc. v. Great Am. Ins. Co., 711 P.2d 1108, 1111 (Wash. Ct. App. 1986).

224. *See, e.g.*, Twin City Fire Ins. Co. v. King County, 749 F. Supp. 230, 234 (W.D. Wash. 1990) (insurer was prejudiced when the employer failed to notify the insurer of the suit until three years after it was filed, four months after the plaintiff's verdict at trial, and only one day prior to a court-arranged conference to settle the appeal; the employer's claim that it honestly believed that the self-insured retention of $300,000 would not be exceeded in the case was unreasonable), *aff'd*, 942 F.2d 794 (1991); Allstate Ins. Co. v. Occidental Int'l, 967 F. Supp. 642, 647 (D.P.R. 1997) (failure to notify carrier of harassment and discrimination claim until nearly two months after the jury verdict constitutes prejudice as a matter of law); Kerr v. Illinois Central R.R., 670 N.E.2d 759, 766-67 (Ill. Ct. App. 1996) (finding that insurer was prejudiced when the employer failed to notify the insurer of the suit until six years after it was filed, after liability had been upheld on appeal, and settlement negotiations regarding damages to be paid were underway; the employer's claim that it honestly believed that the $1.5 million self-insured retention would not be exceeded in the case was held unreasonable); Dan River, Inc. v. Commercial Union Ins. Co., 317 S.E.2d 485, 487 (Va. 1984) (finding insurer was prejudiced when the employer failed to notify the insurer of the suit until eight years after EEOC filings and a federal lawsuit, three years after a trial before a Special Master, one and one half years after the Special Master reported that the plaintiffs had substantially prevailed, and four months after the Special Master's report unfavorable to the employer was filed; the employer's claim that it honestly believed it would avoid covered liability until the Special Master's report was filed did not meet the requirement of "objectively reasonable" notice).

225. *See* Borgeest, *supra* note 221, at 186-89.

coverage obligations under the policy when the employer has failed to give appropriate notice.[226] Finally, several courts have acknowledged that late notice might preclude reimbursement of defense costs even if it is not sufficiently prejudicial to void the coverage, on the theory that the insurer should not have to pay for a defense that it had the right to conduct.[227] In light of all these considerations, it is vital that the employment lawyer assist the employer in identifying any and all liability policies that potentially provide coverage for an occurrence or claim as soon as possible. This will enable the employer to provide prompt notice to the pertinent carriers in order to facilitate claim processing, and to preserve its right to secure full reimbursement for any defense costs incurred until such time as the insurer assumes the defense.

Insurers seek timely notice of occurrences and suits not only to enable them to settle or defend the matter, but also to make a prompt coverage determination (if the dispute appears to fall outside the scope of the insuring agreement or within the scope of an exclusion), and to advise its insured as quickly as possible if there is no coverage. Although an investigation of coverage primarily will assess the nature of the claims asserted by the injured party in light of the policy language, an important part of the investigation involves determining whether the insurer has any available defenses to coverage on the basis of misrepresentations by the insured during the application or renewal process. Due to the enormous costs of carefully investigating the accuracy of every

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226. *See Kerr*, 670 N.E.2d at 765 (finding that Lloyd's of London excess policies contained no duty to defend). As the *Kerr* court explained:

> Notice provisions in insurance policies serve the important function of allowing the insurer the opportunity to make timely and thorough investigation of the insured's claim . . . . Although generally an excess insurer does not reserve the right to participate in the defense of the claim, this is not tantamount to a surrender by the insurer of its right to protect its own interests . . . . Thus, notice provisions are valid prerequisites to coverage and not mere technical requirements which the insured is free to overlook or ignore with impunity.

Id. See also University of Illinois v. Continental Cas. Co., 599 N.E.2d 1338, 1355 (Ill. Ct. App. 1992) (acknowledging that an insurer may wish to monitor the claim and participate in settlement discussions early in order to limit its exposure, or may wish to institute a loss prevention program with the employer at the earliest opportunity to prevent future claims of a similar nature).

227. *See, e.g.*, SL Indus., Inc. v. American Motorists Ins. Co., 607 A.2d 1266, 1272-73 (N.J. 1992). In *SL Industries*, the employee had sued for age discrimination, and the carrier had denied coverage on the ground that no "bodily injury" or "personal injury," as those terms were defined in the policy, had occurred. Discovery revealed that the employee was seeking recovery for emotional pain and suffering, for which he had received treatment. The insured did not disclose this information to the insurer for another two years. The court stated that the duty to defend is inextricably linked with the insurer's right to control the litigation, a right which could no longer be enforced with respect to the prior two years of litigation. *Id.* Consequently, the court held that "when the insured's delay in providing relevant information prevents the insurer from assuming control of the defense, the insurance company is liable only for that portion of the defense costs arising after it was informed of the facts triggering the duty to defend." *Id.* at 1273.

representation made by an applicant for insurance at the time of the application, insurance companies customarily conduct this inquiry after receiving notice of a potential claim on the policy.

The law of misrepresentation varies from state to state and is often dictated by statute.[228] As a general rule, an insurer will be absolved of its duties under the policy if an applicant or insured makes a false statement of fact during the application or renewal process that is material to a risk assumed under the policy, and the insurer relies on this statement in its setting of premiums or selection of the policy terms.[229] For example, when a claims-made policy is sold, there will be a number of questions on the application relating to any incidents that may develop into claims during the policy period, since the insurer does not want to assume the risk of a claim that is almost certain to occur. If the applicant fails to disclose material facts relating to incidents that the application seeks information about, the insurer will have a strong argument that it has no coverage obligations upon proving the misrepresentation.[230]

Not surprisingly, courts are reluctant to void coverage on account of misrepresentations. In one recent case, an insured, applying for a policy with a new carrier that would cover age discrimination liability, received an EEOC charge three days before the new policy was to take effect, but still answered "no" in response to a question regarding knowledge of facts which may reasonably give rise to a claim.[231] Although these facts, alone, would appear to meet the general requirements of a misrepresentation defense, the court did not void coverage because the insured had answered "yes" to a different question about whether any claims had been made because of unfair or improper treatment.[232] The court concluded that this affirmative response placed the carrier on fair notice given the preliminary status of the EEOC charge, whether or not the insured had this incident in mind when it answered

228. *See* JERRY, *supra* note 140, at 680-94.

229. *See id.* at 680.

230. Insurers may also argue that the applicant concealed material information with the intent to deceive the insurer about the nature of the risk, but this defense is difficult to establish. In addition to having to prove the scienter requirement, in many jurisdictions the insurer will have to demonstrate that it was not feasible to elicit the relevant information during the application process. The standard reasoning is that the insurer is a sophisticated entity that ought to make appropriate inquiries, and that the circumstances in which the affirmative burden of providing information falls on the insured will be relatively rare. *See* JERRY, *supra* note 139, at 697 (noting that "the concealment doctrine developed during a time when underwriting procedures were less sophisticated than they are today . . . More recently, numerous courts have held that unless the insurer specifically requests information, a prospective insured is under no duty to volunteer it").

231. *See* National Union Fire Ins. Co. of Pittsburgh v. Cary Community Consol. Sch. Dist. No. 26, No. 93C6526, 1995 WL 66303 (N.D. Ill. Feb. 15, 1995).

232. *See id.* at *6.

the question.[233] The insured's responses on the application, taken together as a whole, were deemed sufficient to trigger a duty on the part of the carrier to follow up with further inquiry seeking specifics of any potential or incipient claims.

Despite the hesitancy of many courts to void coverage, another recent decision underscores the significance of the misrepresentation defense for insurers.[234] When applying for a variation on a D&O policy that would provide coverage for the actions of public officials carrying out their duties, a member of a Board of County Commissioners answered "no" when asked whether any public official knew of any fact, circumstance, or situation indicating the probability of a claim within the coverage of the policy. Unbeknownst to the official completing the application, the county sheriff had quietly entered into a confidential conciliation agreement with an employee who had filed an EEOC charge alleging sexual harassment and retaliatory discrimination. The employee filed a new charge and a federal lawsuit after the local paper reported the matter, and the county then sought insurance coverage for the matter. The Sixth Circuit held that the insurer was not obligated under the policy due to the material misrepresentations about the prior EEOC charge.

> There is no suggestion that the Board consciously withheld information from [the insurer]. Rather, it is mutually agreed that the failure to disclose resulted from Commissioner Bell's innocent ignorance of the emerging problem. Nevertheless, the sheriff is a "public official" in Holmes County, and that public official knew very well, at the time that the Board applied for renewal of the . . . policy, that a claim or action was probable. Consequently, the district court correctly found that . . . the policy excluded from coverage all claims for indemnification.[235]

The insured's duty to be truthful in the application process is not just a duty to avoid fraudulent misrepresentations, but also a duty to avoid even innocent misrepresentations of facts material to the risk.

B. *Insurer's Duties: Indemnification and Defending Claims*

The principal obligation of the insurer is to pay covered losses. For example, the CGL policy provides that the insurer will pay those sums that the insured becomes legally obligated to pay as damages for covered losses. This obligation is straightforward. Although complex dis-

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233. *See id.*

234. *See* Board of County Comm'rs v. International Surplus Lines Ins. Co., No. 93-3417, 1994 WL 540663 (6th Cir. Oct. 3, 1994).

235. *Id.* at *6.

putes may arise over whether the losses are covered under the policy, the insurer's duty to pay damages on behalf of the insured is usually not controversial once these matters have been adjudicated. An important exception is the line of "bad faith" cases that involve an insurer refusing to settle a pending claim within the policy limits, thereby exposing the insured to excess liability.[236]

In contrast to the duty to pay damages, the insurer's "right and duty" to defend the employer in suits seeking such damages raises more complex issues. As a general rule, primary liability coverages provide that the insurer "will have the right and duty to defend any suit seeking"

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236. *See* Comunale v. Traders & Gen. Ins. Co., 328 P.2d 198 (Cal. 1958). This landmark case established the modern cause of action for "bad faith" in insurance claims settlement, involving an insurer that failed to take account of its insured's interests when it declined to settle the case within the policy limits, thereby subjecting the insured to liability in the amount that the judgment exceeded the policy limits. Although premised on the general duty of good faith and fair dealing implied in every contract, *id.* at 201, insurance carriers are subjected to tort damages when they breach this contractual duty. *Cf.* Foley v. Interactive Data Corp., 765 P.2d 373, 396 (Cal. 1988) (refusing to extend tort damages beyond the insurance context, holding that only contract damages are available to an employee suing his employer for a breach of the implied covenant of good faith and fair dealing).

The unique "bad faith" cause of action in the insurance context "evolved as a means of imposing sanctions on insurers whose negligence or intentional misconduct frustrate the smooth functioning of the insurance mechanism." STEPHEN S. ASHLEY, BAD FAITH ACTIONS: LIABILITY AND DAMAGES § 1.11 (1994). If not subjected to tort damages, insurers would be free to withhold a reasonable settlement offer in an effort to obtain a defendant's verdict at trial, knowing that their exposure for this calculated risk is "capped" by the policy limits. *Id.* § 2.03.

Refusing to indemnify the employer after the litigation has ended with a verdict that falls within the coverage of the policy will likely render the insurer subject to a tort action for bad faith. *See, e.g.*, Bugni v. Employers Ins. of Wausau, No. 86-1005, 1987 WL 267484 (Wis. Ct. App. Feb. 17 1987). In *Bugni*, the insured employer sued for bad faith breach when the primary and excess carriers refused to indemnify him for his defense expenditures, and the jury verdict entered in favor of the employee. The court held that the jury verdict (finding a wrongful discharge but no bad faith on the part of the employer) eliminated the insurer's arguments that the allegations concerned intentional actions excluded by the policy. *Id.* at *5. "[W]e conclude that, once the federal verdict was rendered, none of the defenses the [insurer] asserted had a reasonable basis in the law. None of the propositions upon which [the insurer] founded its refusal to pay was fairly debatable." *Id.* The case was remanded for further fact-finding regarding the bad faith claim.

The "bad faith" doctrine was raised in an interesting manner by an employer in *Ottumwa Housing Authority v. State Farm Fire & Casualty Co.*, 495 N.W.2d 723 (Iowa 1993). In *Ottumwa*, the employee had sued for sex discrimination and filed a claim for worker's compensation benefits. The insurer defended the worker's compensation claim but refused to defend the discrimination suit under either the Workers' Compensation policy or the CGL policy. The employee eventually withdrew her claim for worker's compensation benefits in the face of a vigorous defense and pursued only her civil claims. The employer claimed in later litigation against the insurer

that the insurer had acted in bad faith by refusing to settle the worker's compensation claim, on the theory that settlement of the worker's compensation claim would have assisted with the disposition of the civil claim. The court made short work of responding to this assertion: "Because there was no basis for [the employee's] workers' compensation claim, State Farm—under the duty to defend provision—had every right to defend the claim in the way it did." *Id.* at 730.

damages that fall within the coverage provisions.[237] Because discrimination claims can often involve fact-specific claims arising in an unsettled or contested area of law, the resulting extensive discovery and motion practice means that defense costs are often as substantial as the ultimate recovery or settlement obtained by the employee. Thus, the insurer's obligation to provide a defense is an extremely important part of the policy. Because the duty to defend is independent of the insurer's duty to indemnify, it is possible that an employer can secure a defense of an action that ultimately results in liabilities that are not covered by the policy.

Many states continue to define the insurer's duty to defend by employing the traditional rule—that the court need only compare the allegations in the underlying complaint with the coverage provisions of the policy.[238] In some cases, courts have held that there is no duty to defend, even if some of the causes of action pleaded in the complaint appear to be within coverage, if the factual allegations of the complaint taken as a whole, if proven, would not trigger coverage.[239] Other states have articulated a modern rule that more broadly interprets the duty to defend, holding that the duty is triggered not just by the facts alleged in the underlying complaint, but also in light of all relevant extrinsic facts.[240] As one court recently explained, the liberal rule is warranted

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237. Of course, not all liability policies provide for a defense of suits seeking covered damages, and so the policy language must be examined to determine the employer's rights. *See* Society Nat'l Bank v. Nat'l Union Fire Ins. Co. of Pittsburgh, No. 68624, 1995 WL 753943, at *3-4 (Ohio Ct. App. Dec. 20, 1995) (involving a policy that afforded the insurer the "right" but not the "duty" to defend); Save Mart Supermarkets v. Underwriters at Lloyd's London, 843 F. Supp. 597, 603-04 (N.D. Cal. 1994) (policy provided only for indemnification, no duty to defend). On the other hand, the employer should not look just to its primary liability carriers for a defense, as an excess policy may contain a "drop down" duty to defend in the absence of a duty to defend under a primary policy. *See, e.g.*, Omark Industries, Inc. v. Safeco Ins. Co. of Am., 590 F. Supp. 114, 116 (D. Or. 1984).

238. *See generally* APPLEMAN, *supra* note 16, § 4683 (1979). For example, Texas and Indiana have held to the "four corners" rule in the face of change, limiting the duty of defense to cases in which the complaint pleads a covered injury. *See* Old Republic Ins. Co. v. Comprehensive Health Care Ass'n, Inc., 2 F.3d 105, 107 (5th Cir. 1993); Transamerica Ins. Servs. v. Kopko, 570 N.E.2d 1283, 1285 (Ind. 1991) (rejecting the liberal test adopted by the court of appeals).

239. *See, e.g.*, State Farm Fire & Cas. Co. v. Compupay, Inc., 654 So. 2d 944, 947 (Fla. 3d DCA 1995) (holding that the duty to defend is not triggered despite the plaintiffs allegations of negligent retention of an employee engaging in sexual harassment, since the facts pleaded alleged a continuing pattern of discrimination and harassment that was known to the employer).

240. In contrast, California has adopted the more liberal test, construing the duty to defend to be implicated when either the facts alleged in the complaint or extrinsic facts raise the possibility that the complaint might later be amended to seek recovery for a covered injury. *See* Gray v. Zurich Ins. Co., 419 P.2d 168, 177 (Cal. 1966) (ruling that the duty to defend is based on the "facts which the insurer learns from the complaint, the insured, or other sources. An insurer, therefore bears a duty to defend its insured whenever it ascertains facts which give rise to the potential of liability under the policy").

because employers "expect their coverage and defense benefits to be determined by the nature of the claim against them, not by the fortuity of how the plaintiff, a third party, chooses to phrase the complaint."[241] This rationale seems especially apt in the discrimination context, where generally pleaded complaints might be tried on a disparate treatment, disparate impact, or combined theory, once discovery is complete and the case is framed by the plaintiff's lawyer.[242] However, even under the liberal "extrinsic facts" test, the duty to defend is not without limits. The insured cannot trigger the duty to defend simply by denying the uncovered allegations of the complaint and then contend that any potential liabilities will fall within coverage.[243]

Even when judged solely against the allegations in the complaint, the general rule is that the duty to defend is triggered when the *potential* exists for the third party plaintiff-employee to prevail against the insured on the basis of a covered occurrence or claim.[244] This standard provides

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241. SL Indus., Inc. v. American Motorists Ins. Co., 607 A.2d 1266, 1272 (N.J. 1992). One commentator notes that this rule "is sensible: an insurer should not be allowed to escape its obligations by ignoring true facts, simply because the plaintiff failed to allege them." JERRY, *supra* note 140, at 733. *See, e.g.*, American Guar. and Liab. Ins. Co. v. Vista Med. Supply, 699 F. Supp. 787, 794 (N.D. Cal. 1988) (providing that a duty to defend is triggered when an employee alleges in her declaration in support of the complaint that the employer made false statements to humiliate her, although the complaint does not allege facts giving rise to potential liability for defamation).

The "liberal" rule is required in states that have adopted notice pleading, since the complaint in these jurisdictions is an unreliable gauge of the facts forming the basis of the plaintiff's claims. *See* Great Am. Ins. Co. v. Hartford Ins. Co., 621 N.E.2d 796, 798 (Ohio Ct. App. 1993). Of course, the "liberal" rule might work in the insurer's favor if the complaint potentially triggers coverage, but the facts surrounding the matter establish that no coverage under the policy in fact is triggered. *See, e.g.*, Northern Ins. Co. of N.Y. v. Morgan, 418 P.2d 1051, 1053-54 (Ariz. Ct. App. 1995) (holding that the insurer had no duty to defend because the sexual conduct in question either was intentional and excluded from coverage, or was consensual and therefore nonactionable, regardless of the phrasing of the allegations in the complaint).

242. *See* Castle & Cooke, Inc. v. Great Am. Ins. Co., 711 P.2d 1108, 1111-12 (Wash. Ct. App. 1986) (providing that the duty to defend is triggered by a complaint pleading only disparate treatment discrimination, given that the case ultimately was tried on both theories and extrinsic evidence suggested the potential of disparate impact liability, and in light of the complexity of discrimination law and the liberal notice pleading rules of modern civil procedure).

243. *See* Moore v. Continental Ins. Co., 51 Cal. Rptr. 2d 176 (Cal. Ct. App. 1996). The court stated that:

> [A] mere denial of liability does not create the potential for coverage. If that were the case, an insurer would have the duty to defend every tendered claim without regard to the limitations of its policy. . . . Thus, the issue under the policy is not whether the appellants have admitted liability, but rather whether [the underlying plaintiff's] allegations would be covered if they were true.

Id. at 183.

244. *Compare* Ellis v. Transcontinental Insurance Co., 619 So. 2d 1130 (La. Ct. App. 1993) (holding that a wrongful discharge claim premised on retaliation for assertion of FLSA rights triggered the duty to defend because the retaliatory actions pleaded in the complaint might ultimately result in an award of damages for personal injuries on account of covered torts, such as

employers facing discrimination suits with the argument that, even though the underlying complaint is framed in terms of disparate treatment, there is a real potential for liability being assessed under a disparate impact theory of recovery.[245] In a recent New York decision, the supreme court pushed this rationale even further by finding that there was a duty to defend a complaint alleging intentional age discrimination, even though disparate impact is not recognized as a cause of action under the Age Discrimination in Employment Act. Instead, the court argued that the "reasonable possibility" that a disparate impact theory might ultimately be "recognized as valid" raised the potential that the complaint would result in covered damages.[246] Nevertheless, if the facts alleged in the complaint, even when considered in the context of all available extrinsic evidence, do not raise the potential for covered liabilities, the insurer will have no duty to defend.[247]

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invasions of privacy, humiliation and discrimination, even though these torts were not expressly pleaded) *with* French Cleaners, Inc. v. Aetna Casualty & Surety Co., No. CV 92-0518285, 1995 WL 91423, at *4 (Conn. Super. Ct. Feb. 17, 1995) (finding no coverage for an age discrimination claim that alleged no defamatory statements by the employer that caused injury: "A different question might have been presented if [the employee] had sought damages for injury to her professional reputation as a result of [the employer's] allegedly discriminatory treatment of her on account of her age."). In California, which has adopted the "extrinsic facts" test of the duty to defend, the rule regarding the broad scope of the duty to defend is summarized as follows:

> The duty to defend arises as long as the facts (either expressed or implied in the third party's complaint, or as learned from other sources) give rise to a potentially covered claim, even though the insurer's investigation produces facts showing the claim is baseless. It is the insurer's duty to prove the allegations false.

Devin v. United Serv. Auto. Ass'n, 8 Cal. Rptr. 2d 263, 268 (Cal. Ct. App. 1992) (citations omitted). *See also* City of Old Town v. American Employers Ins. Co., 858 F. Supp. 264, 269 (D. Me. 1994); Intermountain Gas Co. v. Industrial Indem. Co., 868 P.2d 510, 513 (Idaho Ct. App. 1994).

245. *See* Solo Cup Co. v. Federal Ins. Co., 619 F.2d 1178 (7th Cir. 1980) (finding that, despite an EEOC complaint alleging intentional discrimination, a duty to defend existed because the complaint was broadly alleged so as to permit recovery under either theory of discrimination). The court reasoned:

> Especially since the advent of notice pleading, in a case where there is doubt as to whether a theory of recovery within the policy coverage has been pleaded in the underlying complaint, the insurer must defend, and its defense obligations will continue until such time as the claim against the insured is confined to a recovery that the policy does not cover.

Id. at 1185 (citations omitted).

246. American Management Ass'n v. Atlantic Mut. Ins. Co., 641 N.Y.S.2d 802, 807 (Sup. Ct. 1996).

247. *See, e.g.*, Zack Company v. Liberty Mut., No. 93-7015, 1995 WL 33135 (N.D. Ill. June 2, 1995) (finding that the insurer's duty to defend ended when the defamation allegations that triggered the duty to defend were dropped in the amended complaint); Kline v. The Kemper Group, 826 F. Supp. 123 (M.D. Pa. 1993) (excess carrier's duty to defend is not triggered where the underlying suit seeking back pay had no potential to result in damages exceeding the $1 million primary layer of insurance), *aff'd*, 22 F.3d 301 (3d Cir. 1994); Reliable Springs Co. v. St. Paul Fire & Marine Ins. Co., 869 F.2d 993, 994 (6th Cir. 1988) ("[W]hile the mere possibility of coverage may trigger an obligation to defend, such obligation is not without limitation. Where a

It is universally acknowledged that the duty to defend is broader than the duty to pay losses under the policy.[248] This is true in a very obvious sense, given that the insurer promises to defend any suit alleging damages covered by the policy, whereas the insurer will not have to pay any sums if the employer prevails in the litigation.[249] The breadth of the duty to defend is more expansive than the duty to pay in other far-reaching respects as well, due to the expansive reading of the duty by most courts. First, the general rule is that a complaint that raises one claim within the policy coverage generally triggers a duty to defend the insured against all claims asserted in the complaint, due to the difficulty of bifurcating control over the litigation or of later apportioning the costs when the case involves a number of interlocking and overlapping claims.[250] Moreover, even where the policy provides that the duty to defend terminates when the policy limit has been exhausted "in the pay-

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claim is the subject of a clear exclusion, there is no duty to defend."). *But see* Independent Sch. Dist. No. 697, Eveleth v. St. Paul Fire & Marine Ins. Co., 495 N.W.2d 863, 869 (Minn. Ct. App. 1993) (dissenting judge argued that the duty to defend should not be triggered when the plaintiff was seeking only reinstatement rather than damages, since there was no potential that the employer would incur covered liabilities), *aff'd*, 515 N.W.2d 576 (Minn. 1994).

248. A frequently litigated question is whether the insurer must defend the employer in proceedings before an administrative agency, with the issue framed in terms of whether the administrative proceeding has the potential to result in covered liabilities. *See* Campbell Soup Co. v. Liberty Mut. Ins. Co., 571 A.2d 969 (N.J. Super. Ct. App. Div. 1990) (holding that an EEOC probable cause determination in itself does not institute a "suit" that is coercive in nature with the potential of an award of covered damages); *Solo Cup Co.*, 619 F.2d at 1188 (finding a General Services Administration review of the employer's alleged discriminatory practices, resulting in a "proposal" to pay back wages as part of a conciliation process in order to maintain federal government contracting status, did not raise the potential of an award of covered damages).

249. *See Reliable Springs Co.*, 869 F.2d at 994 ("The obligation to defend is broader than the duty to indemnify. The insured must be defended where there is any possibility of coverage. The duty to indemnify only arises when there is, in fact, coverage."). For example, in *American Family Mutual Ins. Co. v. M.B.*, 563 N.W.2d 326 (Minn. Ct. App. 1997), the insurer provided a defense through trial, but then successfully argued that the jury verdict established that the insured's actions were not an occurrence.

250. *See, e.g.*, *Schmidt*, 684 A.2d at 76 (duty to defend exists until the allegation of negligent infliction of emotional distress is resolved in the insured's favor; no apportionment of defense costs is appropriate when the negligent count remains in the case until the verdict is rendered); Wong v. State Compensation Ins. Fund, 16 Cal. Rptr. 2d 1 (Cal. Ct. App. 1993) ("If a complaint states several possible theories of recovery, the insurer must defend the entire claim unless and until the insurer is able to limit the complaint to theories for which it has provided no insurance."), *overruled on other grounds by* LaJolla Beach & Tennis Club, Inc. v. Industrial Indem., 884 P.2d 1048 (Cal. 1995) (en banc); Great Am. Ins. Co. v. Hartford Ins. Co., 621 N.E.2d 796, 800 (Ohio Ct. App. 1993). *But see Great American*, 621 N.E.2d at 801-02 (Ford, J., dissenting) (arguing that the court should more strictly assess whether covered and non-covered claims arise from the same occurrence); *SL Industries*, 607 A.2d at 1280 (holding that the duty to defend arises only with respect to covered claims and rejecting the majority rule presuming that these costs cannot be apportioned between insurer and insured). Courts have shown a willingness to bifurcate defense costs between covered and non-covered claims when the circumstances of the case make it relatively easy to do so. *See* EEOC v. Southern Publ'g Co., Inc., 894 F.2d 785, 791-92 (5th Cir. 1990) (holding that defense costs incurred by the insured could be prorated reasonably and fairly

ment of judgments or settlements," many courts hold that the insurer cannot refuse to provide a defense in on-going litigation, even if it agrees to tender the policy limits into the court registry to be applied against the eventual judgment or settlement.[251] Finally, courts have also employed the doctrine of reasonable expectations to expand the duty to defend by finding that reasonable insureds expect to be defended in civil actions even when the potential for an award of covered losses is slim.[252]

Wrongfully refusing to provide a defense is a breach of contract by the insurer, but the consequences of breaching this provision go beyond the standard remedies for breach of contract. Obviously, if the insured wins a later lawsuit alleging that the insured failed to provide a defense, the employer will be able to recover the defense expenditures it incurred in addition to indemnification for covered judgments or settlements, and may even be able to recover the attorneys' fees and costs incurred in securing this reimbursement.[253] The measure of damages is much broader, however, in light of the rule that an insurer that wrongfully refuses to provide a defense will be "estopped from raising noncoverage as a defense under the indemnity provisions of the policy."[254] This rem-

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where the duty to defend was triggered by allegations of assault and battery, but these counts were dismissed because the statute of limitations had run).

A collateral effect of broadly construing the duty to defend in this way is to raise a significant conflict of interest between the insurer conducting the litigation and the employer/defendant. Because the insurer will only be obliged to pay covered damages awarded in the suit, it has a financial interest in ensuring that a verdict will be more heavily weighted toward non-covered claims. Given this conflict, states adopt a variety of responses, including: allowing the insured to select the defense counsel, requiring the insurer to reimburse the employer's counsel to monitor the litigation, or simply ignoring the potential for conflict altogether. *See* Eric M. Holm[illegible], *Conflicts-of-Interest Roadmap for Insurance Defense Counsel: Walking an Ethical Tightr[illegible], Without a Net*, 26 WILLAMETTE L. REV. 1 (1989); Todd R. Smyth, Annotation, *Duty of Insured to Pay for Independent Counsel When Conflict of Interest Exists Between Insured and Insurer*, 56 A.L.R. 4th 932 (1986 & Supp. 1996).

251. JERRY, *supra* note 140, at 744-48. *Cf.* Ellis v. Transcontinental Ins. Co., 619 So. 2d 1130, 1130 (La. Ct. App. 1993) (holding that CGL and umbrella carriers who refused to defend an action where some of the allegations potentially came within the policy coverage were liable for the attorney fees expended by the insured and the settlement paid to the employee, subject to the trial court's assessment of the reasonableness of those sums).

252. *See generally supra* Part II.B.

253. *See, e.g.*, Jostens, Inc. v. Mission Ins. Co., 387 N.W.2d 161, 168 (Minn. 1986); *Schmidt*, 684 A.2d at 76 (insured employer whose harassment was outside coverage but nevertheless was entitled to a defense under the policy is entitled to attorneys' fees in subsequent coverage litigation).

254. Society of Mount Carmel v. National Ben Franklin Ins. Co., 643 N.E.2d 1280, 1292 (Ill. App. Ct. 1994) (noting the congruity of Illinois and California law on this point); *Solo Cup Co.*, 619 F.2d at 1184:

> If . . . we determine that the duty to defend was violated, the applicable Illinois law holds that the insurer is estopped to deny coverage . . . and provides for the following broad measure of damages to the insured: (1) the costs of defending the

edy is potentially significant, since the duty to defend is broader than the duty to indemnify. If the verdict is unclear with regard to the grounds for the award, the insurer that failed to defend the action is bound to provide coverage as if the jury had specified that covered events resulted in the damage award.[255] Moreover, even if the verdict establishes that there was no covered occurrence, an insurer with a duty to defend an employer must reimburse the employer for damages attributable to non-covered events. Additionally, if the employer resolves the matter by settlement, this same logic leads some courts to preclude the insurer from challenging the amount of the settlement or attempting to allocate it among covered and non-covered claims.[256] Finally, some courts have extended the "bad faith" analysis to apply to the insurer's refusal to provide a defense, presumably on the ground that even the foregoing remedies may be insufficient to prevent the insurance company from strategically refusing to expend large amounts in defense costs until forced to do so by an employer who brings suit.[257]

Given the substantial damages facing an insurer if it wrongly refuses to defend a tendered claim, one might expect insurers to provide

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suit; (2) the amount recovered from the insured, either by way of judgment or settlement; and, (3) any additional damages caused by the insurer's breach of contract.

255. *See Schmidt*, 684 A.2d at 69.

256. *See* JERRY, *supra* note 140, at 754-55. The insurer is estopped from challenging the settlement or attempting to allocate it between covered and non-covered claims, but the insurer is protected by the rule that the insured must demonstrate that the settlement was reasonable. School Dist. for City of Royal Oak v. Continental Cas. Co., 912 F.2d 844 (6th Cir. 1990) (remanding the case for a factual determination of whether the employer reasonably paid $250,000 to a discrimination plaintiff when the record indicated that the case could have settled for $60,000 if the plaintiff had been reinstated with tenure).

257. *See generally* Tibbs v. Great Am. Ins. Co., 755 F.2d 1370 (9th Cir. 1985) (affirming an award of $600,000 punitive damages for breach of the duty to defend); State Farm Fire & Cas. Co. v. Price, 684 P.2d 524, 532 (N.M. Ct. App. 1984) (remanding the case to determine whether the insurer's breach of the duty to defend amounted to closing its eyes to the facts and acting in bad faith).

With respect to employment discrimination liabilities, it often is the case that an insurer's denial of coverage is premised on a good faith and reasonable objection to the insured's reading of the policy in the context of a complex and dynamic legal environment; thus, recovery by an insured for bad faith denial of coverage is likely to be rare. *See, e.g.*, New Madrid County Reorganized Sch. Dist. No. 1 v. Continental Cas. Co., 904 F.2d 1236, 1243 (8th Cir. 1990) (holding that the insurer was not subject to damages for vexatious refusal to pay policy proceeds and emphasizing that it "is clear that Continental Casualty entertained an honest difference of opinion as to the policy's coverage. Although its position ultimately was rejected, that position was by no means frivolous or unreasonable"); Clark-Peterson Co. Inc. v. Indep. Ins. Assoc., Ltd., 514 N.W.2d 912, 916 (Iowa 1994) ("Defendants were not overly litigious, they merely believed no coverage existed under the policy, a contention with which we initially agreed. Once a final determination was made, the defendants promptly paid the entire claim. . . . The coverage was reasonably debatable in view of our final determination."); Castle & Cooke, Inc. v. Great Am. Ins. Co., 711 P.2d 1108, 1114 (Wash. Ct. App. 1986) ("A denial of coverage based on a reasonable interpretation of the policy is not bad faith.").

a defense until such time as the coverage matters are clarified. However, the general rule is that an insurer that assumes the defense of an action is precluded from later raising coverage defenses, given the obvious prejudice that the insured could suffer if the insurer is permitted to control, and thereby, reshape the litigation in a manner that defeats coverage.[258] "[T]he rule prevents an insurance company from taking over the defense of a matter but avoiding coverage of the end result, without an adequate reservation and warning to the insured [which would permit] the insured [to] make its own decision regarding the need [to hire] independent defense counsel" in order to protect the insured's rights.[259] However, this rule is inapplicable if the insurer can demonstrate that it undertook the defense in a manner that did not prejudice the insured's interests, as when an insurer simply reimburses the insured for defense expenditures for counsel selected by and controlled by the insured.[260]

Consequently, an insurer appears to be faced with a difficult choice: refuse to defend and be estopped from asserting coverage defenses if there was a duty to defend, or undertake the defense and be estopped from asserting coverage defenses due to its prejudicial control of the litigation. However, the courts have fashioned a middle ground approach that permits the insurer to preserve its rights, while still protecting the insured's interest in receiving a defense promptly after the litigation is commenced. When facing a claim that, arguably, is outside coverage, the prudent insurer will either assume the defense with a written reservation of right to later deny coverage and seek reimbursement if the suit is found to be outside coverage, or it will assume the defense and immediately file a declaratory judgment action to absolve it of further defense obligations.[261] In order to preserve its right to seek later

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258. *See* JERRY, *supra* note 140, at 757 (noting that "it is well settled that if the insurer undertakes to defend the action, it will be estopped to deny coverage by virtue of performing its defense duty").

259. Golf Course Superintendents Assoc. of Am. v. Underwriters at Lloyd's, London, 761 F. Supp. 1485, 1492 (D. Kan. 1991).

260. *See id.* at 1493; *see also* KEETON AND WIDISS, *supra* note 10. The authors state:

> When an insurer has selected the defense attorney and provided direction for the defense, the case for issue preclusion [regarding coverage] is very persuasive. However, if the insurer was not involved either as a party in the tort litigation or in the capacity of providing a defense to the insured (typically as a consequence of selecting, instructing, and compensating the defense counsel), the justification for concluding that the resolution of the tort suit precludes an insurer from an opportunity for adjudication is not equally evident.

Id. at 861.

261. *See* JERRY, *supra* note 140, at 757; *see also* Zach Co. v. Liberty Mut. Ins. Co., No. 93-7015, 1995 WL 33135 (N.D. Ill. Jan. 25, 1995). In *Zach*, an insured employer was sued for retaliatory discharge, intentional infliction of emotional distress and defamation, but the defamation count was not included in a later complaint after the first complaint was dismissed voluntarily. The district court first awarded summary judgment to the insurer. *Id.* at *2. The

reimbursement of the defense costs that it incurs, the insurer is under an obligation to put the insured on fair notice that it is reserving this right and cannot rely upon a generally worded reservation of rights later.[262]

The burden of the duty to defend is accepted by insurers in order to obtain the extremely valuable right to control the litigation and disposition of the underlying claim. This control is crucial in the employment litigation setting, since emotions often run high. Recently, the United States Court of Appeals for the Third Circuit held that a law firm could not prevent its liability insurer from settling a hostile environment and sexual harassment suit.[263] Although the firm argued that the litigation was groundless and that settling the suit would injure its reputation, and also that the settlement would preclude it from pursuing a later suit for malicious prosecution against the plaintiff, the court permitted the insurer to settle with the plaintiff based on the clear provisions in the policy.[264] The court noted that an employer wishing to retain control over settlement of cases (as many professionals choose to do in their malpractice policies) must purchase a policy that affords this right.[265]

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insured argued that the insurer's failure to seek declaratory judgment or to provide a defense under a reservation of rights estopped the insurer from denying coverage. However, the court found that the second complaint filed by the insured's employee did not trigger the duty to defend, thereby relieving insurer of any obligations. *Id.* Nevertheless, this judgment was subsequently vacated to the extent that the insured sought recovery of attorneys fees for defending the first complaint until it was dismissed. Zack Co. v. Liberty Mut. Ins. Co., No. 93-C-7015 1995 WL 340955, at *6 (N.D. Ill. June 2, 1995).

262. *See* United States Fire Ins. Co. v. Caulkins Indiantown Citrus Co., 931 F.2d 744, 749 (11th Cir. 1991) (finding that an umbrella carrier that entered into a "Compromise Settlement Agreement" with an employer to defend a pending racial discrimination suit is precluded from recouping its defense costs, despite the absence of coverage, because it undertook the defense without adequately reserving its rights); *see also* American Motorists Ins. Co. v. Allied-Sysco Food Servs., Inc., 24 Cal. Rptr. 2d 106, 114-15 (Cal. Ct. App. 1993) (finding that an insurer that undertook defense after sending a reservation of rights letter to the employer was precluded from seeking reimbursement, despite a final determination of no duty to defend or indemnify, since the insured employer did not expressly or impliedly agree to the reservation). In *Buss v. Superior Court*, 47 Cal. App. 4th 679 (Cal. Ct. App. 1996), a coverage case involving commercial liabilities, the court recently offered a sensible rule: an insurer that provides a defense under a proper reservation of rights is not entitled to reimbursement of defense expenditures in connection with claims for which potential coverage existed but were ultimately determined not to be covered (since the duty to defend covers such situations), but is entitled to recover reimbursement for defending claims as to which there was no potential for coverage but nonetheless were defended because they were joined with other claims for which a potential for coverage did exist.

263. *See* Caplan v. Fellheimer Eichen Braverman & Kaskey, 68 F.3d 828 (3d Cir. 1995).

264. *See id.* at 839.

265. *See id.* at 839-40 ("It is not appropriate for us to amend the policy here in order to give [the insured] a type of coverage for which it didn't contract.").

VII. CONSIDERATIONS FOR THE THIRD PARTY PLAINTIFF ALLEGING DISCRIMINATION

As the potential availability of insurance coverage for employers facing discrimination claims has become more widely appreciated, lawyers for discrimination plaintiffs are in a position to frame their factual allegations in order to maximize the likelihood that insurance coverage will either be triggered or precluded. The presence of insurance coverage in the case will undoubtedly change the nature of the litigation. Assuming that the typical plaintiff is interested in achieving a speedy settlement that delivers substantially what they are seeking in the litigation, it is not clear as a categorical matter whether the insurance coverage will be a help or hindrance to achieving this goal.[266]

Discrimination plaintiffs might view insurance coverage as beneficial to their interests for a variety of reasons, including: bringing a third party with control of settlement into the litigation that is focused on a cost-effective resolution of the dispute, and is less tied up with the personalities and emotions involved; ensuring a source of proceeds from which to pay a settlement or judgment; and securing representation of the employer by counsel selected by the insurer that may have broader discrimination law experience and might provide a more balanced assessment of the potential exposure than would be provided by the employer's regular litigation counsel. Conversely, discrimination plaintiffs might view insurance coverage as detrimental to their interests for a variety of reasons, including: having to deal with a third party that is oriented toward economic resolutions of the dispute, rather than pursuing reinstatement or other non-economic solutions; bringing insurance defense counsel into the matter who may be less likely to effectuate a quick settlement by aggressively investigating and assessing the case at the outset; providing the employer with a "free" defense of the action, and therefore, removing some of the economic incentive to reach an early settlement; and running the risk of facing an insurance company that takes a very aggressive stance in litigation in order to develop a reputation among the plaintiffs' bar for refusing to settle matters easily.

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266. *Cf.* Olympic Club v. Those Interested Underwriters at Lloyd's London, 991 F.2d 497, 505 (9th Cir. 1993) (Reinhardt, J., dissenting) (arguing against the majority's narrow reading of the duty to defend in light of the specific allegations of the complaint, because it would permit a discrimination plaintiff "by artful construction of its pleadings, [to] preclude its opponent's insurance coverage and thereby obtain a tremendous litigation advantage"). However, as discussed below, it will not necessarily be the case that a plaintiff will seek to preclude coverage; moreover, a plaintiff can still artfully construct its pleadings to affect potential insurance coverage even in those jurisdictions that give the broadest possible reading of the duty to defend. A plaintiff's lawyer is likely to view insurance coverage in a favorable light. *See* Wayne v. Outten, *What a Plaintiff's Lawyer Looks for When Evaluating a Potential Lawsuit*, *in* AVOIDING WORKPLACE LITIGATION (PLI, No. H4-5261, Apr. 1997).

These conflicting considerations about the effects of insurance are likely to be weighed only in light of the specific context of a particular lawsuit.

A discrimination plaintiff seeking to trigger coverage should pursue several general strategies.[267] First, allegations of negligent, as well as intentional, behavior should be expressly pleaded.[268] In particular, the plaintiff should plead both disparate impact and disparate treatment theories of discrimination to the extent warranted by the facts. Additionally, the plaintiff should plead all related torts stemming from the discriminatory incidents, since one or more torts such as defamation, humiliation, false imprisonment, invasion of privacy, harassment, or assault and battery, may be included within the grant of coverage in a general liability policy or excess policy. In many cases where the court denies coverage to the employer, there is a suggestion that a differently pleaded complaint might well have triggered coverage in the case.[269]

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267. To state the obvious, a plaintiff seeking to avoid insurance coverage should proceed in exactly the opposite manner. Needless to say, the discussion that follows assumes that the plaintiff will abide by all rules of professional conduct and will not plead her complaint in a frivolous or vexatious manner solely to trigger or preclude insurance coverage. The considerations discussed in this section pertain to decisions about how to frame the complaint given a core set of factual allegations, as opposed to "creating" causes of action out of thin air for strategic purposes.

268. This can be particularly important when the plaintiff is suing for intentional harassment and assault, but also can seek to recover in negligence against the employing business entity. *See, e.g., Schmidt*, 684 A.2d at 68-69 (coverage exists when plaintiff pleaded negligence counts against corporate defendant and the insurer refused to defend). However, one commentator, a senior vice president at an insurer, has suggested that several recent decisions "evidence a willingness of the courts to look beyond the allegations framed within the four corners of a complaint and not allow a 'negligent tail' to wag the 'intentional dog.'" Monteleone, *supra* note 184, at 53. A recent example of such a result is Vienna Family Med. Assocs., Inc. v. Allstate Ins. Co., 78 F.3d 580 (9th Cir. 1996) (finding that the negligence allegations made by the plaintiff employee were a transparent attempt to trigger coverage for claims clearly premised on intentional acts).

269. *See, e.g.*, Jefferson-Pilot Fire & Cas. Co. v. Sunbelt Beer Distrib., Inc., 839 F. Supp. 376, 381 (D.S.C. 1993) ("Although Ms. Pressley alleges loss of reputation as part of her damages, her complaint contains no cause of action for invasion of privacy or defamation."); Omark Indus., Inc. v. Safeco Ins. Co. of Am., 590 F. Supp. 114, 120-21 (D. Or. 1984) ("The gravamen of the . . . plaintiffs' complaint was for employment discrimination because of sex. They did not allege damage to their own reputation or other damage to them flowing from the publication or utterance of any libelous, disparaging statement. Therefore, coverage . . . is inapplicable."); Moore v. Continental Ins. Co., 51 Cal. Rptr. 2d 176, 181 (Cal. Ct. App. 1996) (finding no coverage when the plaintiff failed to plead defamation and false imprisonment separately, since the allegations of a pattern of sexual harassment "do no more than reflect the reality that such harassment can take place behind closed doors or in the presence of coworkers"), *reh'g granted, opinion not citeable* (Apr. 26, 1996), *opinion on reh'g not for publication* (June 14, 1996); State Farm Fire & Cas. Co. v. Compupay, Inc., 654 So. 2d 944, 948 (Fla. 3d DCA 1995) (finding no coverage was available since the plaintiff failed to allege defamation or invasion of privacy by publication), *rev. denied*, 662 So. 2d 341 (Fla. 1995); French Cleaners, Inc. v. Aetna Cas. and Sur. Co., 1995 No. CV92-051-8285, WL 91423, at *4 (Conn. Super. Ct. Feb. 17, 1995) (finding that personal injury coverage is not triggered, but that a "different question might have been presented if Ms. Javier had sought damages for injury to her professional reputation" as a result of the discriminatory discharge); Ottumwa Hous. Auth. v. State Farm Fire & Cas. Co., 495 N.W.2d 723, 727-28 (Iowa

Finally, as facts develop during discovery, the plaintiff should be attentive to the possibility of amending the complaint to include allegations more likely to trigger insurance coverage.[270] In the event that the employer has purchased an EPLI policy, there will likely be little dispute as to whether the claim triggers insurance coverage; thus, strategic pleading is less of a concern.

VIII. Conclusion: The Future of Insurance Coverage of Employment Discrimination Claims

For the employer seeking insurance coverage of a discrimination claim, the *contra proferentem* maxim and the reasonable expectations doctrine are tools for transforming various forms of liability policies into valuable economic resources for managing the employer's exposure and losses. The flexibility evidenced in the court decisions is not wholly unprincipled, however, since most courts at some point will respect the ability of insurers to define the scope of the risks they are assuming by careful policy drafting. Insurers are most likely to be able to enforce limitations on coverage for employment litigation if: (1) they limit their risks plainly and clearly and in accordance with the policy premiums being charged (2) the limitations are either consistent with the employer's reasonable expectations or are marketed in a manner designed to eliminate such expectations.[271] The recent efforts by insurers to amend their policies to exclude clearly and precisely any coverage for liability related to employment practices are likely to continue to pass judicial muster. If so, in many cases employers may be precluded from asserting potential coverage under the policy, and thereby, triggering the insurer's duty to defend. Nevertheless, the dynamic character of the law governing employment relations and the insurance industry's responses to these changes will continue, and so will the battles between employers and their insurers. The relatively new market for EPLI insur-

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1993) (holding that no coverage existed since the plaintiffs did not seek damages for injury to their reputations despite interpreting coverage of "publication of . . . disparaging material" to be broader than the tort of defamation).

270. *Cf.* EEOC v. Southern Publ'g Co., Inc., 894 F.2d 785 (5th Cir. 1990) (finding that coverage was triggered when plaintiffs intervened in a Title VII complaint brought by the EEOC and alleged additional counts of assault and battery against their harasser and defamation against the company president for statements made about their termination). A recent case demonstrates the limit of such strategic behavior. In *Cornhill Insurance PLC v. Valsamis, Inc.*, 106 F.3d 80 (5th Cir. 1997), the plaintiff-employee reached a settlement with the insured-employer, pursuant to which she agreed not to execute on the judgment in return for an assignment of the employer's claims against its various insurers. The employee then sued the employer's various insurers after amending her complaint to delete all allegations of intentional wrongdoing. The court denied coverage under all policies. *Id.* at 88-89.

271. *Cf.* Keeton & Widiss, *supra* note 10.

ance might be expected to grow quickly to fill the gap created by the increasing use of carefully drafted exclusions, but this development will likely lead to new questions and problems as courts begin to interpret these new policies.

Perhaps the most important development will not be the shifts in the unending coverage disputes between employers and their liability carriers, but rather the effect on employer behavior if liability coverage becomes generally available for employment discrimination claims. It may well be, as noted by several courts and commentators, that the existence of insurance coverage will foster increased compliance with anti-discrimination statutes by instituting a secondary system of incentives and penalties that attach to employer behavior. Rather than the dubious motivations engendered by suffering a large verdict in an emotional jury trial or paying a large settlement at the urgings of defense counsel, the regular and rational adjustment of premiums in response to proactive measures designed jointly by the insurer and the employer has the potential to have a profound impact in the workplace.[272] If this impact materializes, the provision of insurance coverage for employment discrimination claims will prove to be one of the most important developments in the law of employment relations in the last several decades.

272. For example, the availability and cost of EPLI policies for law firms is directly linked to the proactive practices adopted by firms. *See Carriers Stepping Up to Plate With Lawyer's EPLI Coverage*, 3 LAW FIRM PARTNERSHIP & BEN. REP. 1 (Feb. 1997); *Practices Impacting Premiums*, *Id.* at 3; *Why Chubb Chooses Not to Cover Counselors*, *Id.* at 6.