

Tenth Circuit Holds That E&O Coverage Does Not Extend to Intentional Acts

December 1999

Rejecting a policyholder's contention that the word "negligent" in an employee benefits liability endorsement extending coverage to "any negligent act, error or omission" in handling employee benefits should only modify "acts" and not "errors or omissions," the U.S. Court of Appeals for the Tenth Circuit has held that liability coverage was barred for an employer's intentional refusal to remit the value of stock options to a former employee. *New Hampshire Insurance Co. v. Westlake Hardware, Inc.*, No. 98-3203, 1999 WL 1066836 (10th Cir. Nov. 29, 1999) (applying Kansas law).

An employee of the policyholder corporation resigned his position as its chief financial officer. A dispute ensued over the correct amount the corporation owed the employee for shares of common stock he purchased through an unfunded employee benefit plan. The approximate value of the shares was placed in a trust while the corporation investigated alleged acts of malfeasance, breach of fiduciary duty and negligence on the part of the employee. The corporation ultimately refused to distribute the trust funds. The employee sued, alleging that the policyholder breached its fiduciary duties as trustee of the irrevocable trust. The parties settled their dispute for \$423,574.00, and the corporation sought coverage for the underlying suit and settlement from its liability insurer. The liability policy contained an employee benefits liability endorsement, in which the insurer agreed to indemnify the corporation for all damages it became legally obligated to pay based on any claim by a former employee for injury caused by "any negligent act, error or omission" of the corporation in handling employee benefits. The insurer denied defense and indemnity on the grounds that the refusal to distribute the trust funds was an intentional act outside the scope of coverage.

The district court granted summary judgment to the insurer, and the Tenth Circuit affirmed. The Tenth Circuit held that no indemnity obligation existed because the refusal to release the trust funds constituted an intentional act, not covered under the "negligent act, error or omissions" language of the endorsement. The court similarly found that the insurer had no duty to defend because the underlying suit was "wholly outside any coverage obligations assumed in the policy" and the insurer would have no liability if the underlying plaintiff secured a judgment against the policyholder. The court rejected the policyholder's argument that the word "negligent" only modified "act" and not "error or omission," reasoning that, if the insurer intended that meaning, it could easily have crafted language that would make that intention clear. Further, the court determined that it would be "self-defeating" to limit the definition of the phrase to negligent acts, but at the same time cover intentional errors and omissions.