

Ninth Circuit: Insured v. Insured Exclusion Bars Coverage for Statutory Wage and Hour Claims

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The United States Court of Appeals for the Ninth Circuit, applying California law, has affirmed a district court's holding that an insured v. insured exclusion bars coverage for a claim brought against the insured by its current and former employees alleging statutory wage and hour violations and that such claims do not constitute Employment Practices Wrongful Acts, which are excepted from the exclusion. *Cal. Dairies, Inc. v. RSUI Indem. Co.*, 2011 WL 6392200 (9th Cir. Dec. 21, 2011). In so holding, the court also affirmed the district court's ruling that the insurer did not waive its right to assert the insured v. insured exclusion as a coverage defense by failing to cite that exclusion in its initial coverage letters acknowledging the claim and denying coverage.

The current and former employees of the insured company filed a class action lawsuit alleging that the insured violated various provisions of California's wage and hours laws. The insurer denied coverage based on an exclusion that barred coverage for violations of the Fair Labor Standards Act or any similar provision of state or local statutory law (the FLSA Exclusion). The denial letter did not mention the policy's insured v. insured exclusion, which excluded coverage for any claim brought by or on behalf of any Insured, except an Employment Practices Wrongful Act brought by an Insured Person. The policy defined "Insured Person" to include current and former employees.

The insured filed a declaratory judgment action, and the insurer moved to dismiss on the grounds that coverage was precluded by the FLSA Exclusion and the insured v. insured exclusion. The district court found that the FLSA Exclusion barred coverage in part, that the insurer did not waive its right to rely on the insured v. insured exclusion, and that the insured v. insured exclusion barred coverage in its entirety.

The Ninth Circuit affirmed the district court's holding based upon the insured v. insured exclusion, rejecting the insured's contention that the underlying wage and hour claims fell within the exception to the insured v. insured exclusion for Employment Practices Wrongful Acts. The insured maintained that the underlying claims were Employment Practices Wrongful Acts because they allegedly arose out of an employment-related misrepresentation to employees that the insured implicitly or explicitly represented that it would comply with California laws, or, in the alternative, because the insured's purported failure to follow California law

demonstrated a failure to provide adequate organization policies or procedures. In rejecting these arguments, the Ninth Circuit stated that such an “interpretation would strain the policy language by rendering superfluous the [Employment Practices Wrongful Acts] provisions that give coverage for actions arising out of claims such as ‘[w]rongful dismissal,’ ‘discrimination,’ ‘harassment,’ and ‘[f]ailure to grant tenure or practice privileges.’” The court further noted that the Employment Practices Wrongful Acts coverage “is not illusory, but it is limited to specific claims not asserted here.”

The Ninth Circuit also affirmed the district court's holding that the insurer did not waive its right to rely upon the insured v. insured exclusion by failing to cite that exclusion in its pre-litigation coverage correspondence. Relying on *Waller v. Truck Insurance Exchange, Inc.*, 11 Cal. 4th 1 (Cal. 1995), the court stated that “California rejects an automatic waiver rule” and that an “insurer does not waive policy provisions merely by failing to rely on them in denial of coverage letters.” The court rejected the insured's argument that the insurer violated California's Fair Claim Practice Regulations by not originally relying upon the insured v. insured exclusion, and thus, waived the right to rely on that exclusion, noting that to accept such reasoning “would reinstate the automatic waiver rule rejected by *Waller*.”

Because the Ninth Circuit held that coverage was barred in its entirety by the insured v. insured exclusion, the court did not address the applicability of the FLSA Exclusion to the wage and hour claims.