

Coverage Triggered by Claim for Failure to Pay Wages Under Fair Labor Standards Act

April 2012

Applying Virginia law, the United States Court of Appeals for the Fourth Circuit has held that a school board's alleged failure to pay wages as required by the Fair Labor Standards Act (FLSA) constitutes a "wrongful act" and that the liquidated damages and attorneys' fees recoverable under the FLSA constitute loss within the meaning of the school board's liability policy. *Republic Franklin Ins. Co. v. Albemarle County School Bd.*, 670 F.3d 563 (4th Cir. Feb. 24, 2012).

Employees of the school board brought suit alleging that they were not paid for all of the time that they worked and that they were not paid at the premium overtime rate when they worked more than 40 hours in a week. The employees demanded from the school board, among other things, unpaid wages and overtime pay, liquidated damages as authorized by the FLSA and attorneys' fees. The school board tendered the suit to its liability insurer, which took the position that it had no obligation to defend the school board or to provide indemnification on the grounds that the failure to pay wages in accordance with the FLSA was not a "wrongful act" covered by the policy because the board had a preexisting duty to pay its employees in compliance with the law.

In the coverage litigation that followed, the court rejected the notion that the failure to abide by a pre-existing obligation or duty cannot be a wrongful act. According to the court, "[e]very duty breached or violated is necessarily a preexisting duty, and it is the breach or violation of that duty which constitutes a wrongful act." In this regard, the court noted that the policy defined the term to include "any breach of duty" and held therefore that the school board's purported breach of the duty imposed by the FLSA to pay certain wages constituted a "wrongful act" within the meaning of the policy.

Turning to the issue of "loss," the court recognized that coverage was limited to loss resulting from a wrongful act. In this regard, while the breach of a preexisting duty to pay is a wrongful act, the obligation to pay back wages is not necessarily a loss resulting from that wrongful act. Such loss, according to the court, could only arise if the failure to fulfill the preexisting duty to pay wages caused damages apart from the back wages not paid. The court found that liquidated damages and attorneys' fees recoverable under the act were not payable because of any preexisting duty, and thus met the policy's requirement that they result from a wrongful act. The court also found that liquidated damages and attorneys' fees were not fines or penalties, but rather represented compensatory damages within the scope of covered loss under the policy.