

Amount Awarded under California Labor Code Constitutes Loss under EPL Policy

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A federal district court in California has held that an endorsement to a policy was invalid because it was a material change for which the insurer failed to provide sufficient notice to the insured. *Classic Distributing & Beverage Group, Inc. v. Travelers Cas. & Surety Co.*, 2012 WL 3860597 (C.D. Cal. Aug. 29, 2012). The court also determined that amounts awarded under California Labor Code § 2802 constituted "Loss" under an insurance policy but that amounts awarded under California Labor Code § 226 were not covered based on the policy's "Wage-and-Hour Law" exclusion. Finally, the court determined that the insured was entitled to independent counsel because a "significant" and "actual" conflict existed as a result of the fact that the insurer could "steer coverage away from a potentially covered claim."

The insured employer was named as a defendant in a class action suit alleging violations of the California Labor Code. The insured tendered the lawsuit to its employment practices liability insurer, and the insurer provided a defense pursuant to a reservation of rights. Plaintiffs filed an amended complaint, alleging failure to reimburse work-related expenses under California Labor Code § 2802, unlawful failure to pay overtime wages pursuant to California Labor Code §§ 201, 221, 226, 510, 511, 558, 1194 and 1198, unfair competition and seeking statutory penalties under the California Labor Code. The insurer provided a defense under a reservation of rights against the § 2802 claim and disclaimed coverage for the remainder of the lawsuit, as well as for any amounts awarded under § 2802 that did not constitute "Loss" under the policy. The insured sought independent counsel pursuant to California Civil Code § 2860, the state's independent counsel statute. The insurer disagreed, explaining that because coverage for indemnity had been denied as to all of the causes of action, there was no conflict of interest and thus no obligation to appoint independent counsel. The underlying action settled, and the insured brought a coverage action against the insurer. Both parties filed motions for summary judgment, which the court granted in part and denied in part.

The court first addressed the insured's argument that the "Wage-and-Hour Law" exclusion contained in an endorsement to the policy was invalid because it was a material change to the policy form for which adequate notice was not provided. The court found that the endorsement was invalid because the insurer provided no specific notice to the insured separate from the policy materials and did not identify the endorsement as part of the quoted premium for the policy. The court also highlighted that the policy included numerous endorsements "attached to the end of a nearly one-hundred page policy," and that the body of the policy form did not refer to the relevant endorsement at all, "let alone in a clear and conspicuous fashion" as

required for adequate notice.

Next, the court turned to the insurer's argument that amounts awarded under California Labor Code § 2802 constituted restitution and thus were not insurable "Loss" under the policy. The court disagreed with the insurer, ruling that the insurer's characterization of the award as restitution "swe[pt] too broadly and would even apply to standard breach of contract actions," and finding that the recovery available under § 2802 was more akin to damages than restitution. Because an employee is required to prove certain elements before he or she can recover expenses under § 2802, such recovery is "outside any plausible reading of the words 'return' or 'restore,'" which are synonymous with restitution, according to the court.

Although the court found that the "Wage-and-Hour Law" endorsement was invalid, the body of the policy included an exclusion that precluded coverage for any claim "for an alleged violation of responsibilities, duties or obligations imposed on an Insured under any Wage and Hour law." Under this provision, the court determined that the insurer was not liable for "Loss" resulting from claims brought under California Labor Code § 226. The court explained that Section 226 pertained to itemized wage statements and was "part of a comprehensive statutory scheme governing the payment of wages."

Finally, the court also determined that the insurer should have appointed independent counsel because the conflict between the insurer and insured was both "significant" and "actual." In reaching its conclusion, the court noted that the policy provided indemnity coverage, that the insurer had the ability to "steer coverage away from potentially covered claims," and that certain actions taken by the insurer "may be read as an attempt to do just that."