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NEWSLETTER

Sexual Harassment and Discrimination Claims Barred by Employment-Related and I v. I Exclusions

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A federal district court, applying Minnesota law, has held that a D&O insurer has no duty to defend an officer of a company who was sued for sexual harassment and discrimination because the claim was barred under both the employment-related and I v. I exclusions of the policy. *Miller v. ACE USA*, 261 F. Supp. 2d 1130 (D. Minn. 2003). The court also held that, because the insurer had no duty to defend, the policyholder could not bring an action against the insurer for breach of good faith and fair dealing or breach of fiduciary duty.

The insurer issued a D&O policy to a company. The policy contained an employment-related exclusion that barred coverage in connection with any claim "based upon, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving any employment-related matters brought by or on behalf of a director, officer, or employee." The policy also excluded coverage for any claim "for actual or alleged libel, slander, defamation, bodily injury, sickness, disease, death, false imprisonment, assault, battery, mental anguish, emotional distress, [or] invasion of privacy." Finally, the policy contained an I v. I exclusion, barring coverage for any claims "by, on behalf [of], or at the direction of any of the Insureds." "Insureds" was defined to include employees.

A former employee of the policyholder company sued the company and its CFO, alleging a pattern of sexual advances and harassment, followed by discriminatory and retaliatory treatment. After the insurer denied coverage, the CFO initiated coverage litigation.

The court initially rejected the CFO's argument that coverage was available, irrespective of the employment-related exclusion, because a single factual allegation in the complaint alleged that certain assets of the company had been transferred to another entity in an effort to devalue the worth of the company, which arguably implicated a shareholder cause of action. The court explained that the single allegation, which was not tied to any cause of action, could not create coverage "[w]ith no relation to those counts actually enumerated, assuming some type of securities action based on this sole reference to stock devaluation would create a claim [the underlying plaintiff] has not expressly alleged and for which she has provided no basis or explanation, and would unreasonably construe and enlarge what is on its face an employment discrimination and sexual harassment lawsuit."

The district court held that the employment-related exclusion barred coverage for most of the counts in the complaint and that the exclusion barring coverage for assault, battery, and emotional distress barred coverage for the remaining counts. In so ruling, the court rejected the argument that the exclusion should not apply to claims by former employees. The court reasoned that the language of the exclusion was "expansive" and not limited to current employees. It also noted that the company could have, but did not, purchase Employment Practices Liability coverage, which generally covers claims by former employees. Finally, the court reasoned that "[d]enying coverage for claims by employees who sue while still employed with the company, while providing it for those brought by employees who have resigned or been fired, would draw an artificial and impractical distinction that would greatly hinder the purpose of exempting employment-related suits from D&O coverage."

The court also held that the I v. I exclusion applied since the policy language was "explicit and unambiguous." The court rejected the CFO's argument that the I v. I exclusion should apply only to those employees acting as "the functional equivalent" of directors and officers, reasoning that such a distinction did not exist in the policy.

Finally, the court rejected the CFO's argument that the insurer could be liable for breach of the duty of good faith and fair dealing or breach of fiduciary duty. The court explained that since the insurer had no duty to defend, it could not be liable for a breach of good faith and fair dealing. Similarly, because a breach of fiduciary duty requires a fiduciary obligation, which can only exist after the insurer assumes defense of the insured, that allegation against the insurer had no merit.

For more information, please contact us at 202.719.7130.