

California Court Concludes Settlement Payments for Unpaid Wages May Constitute Loss Under D&O Policy

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A California appellate court, in an unpublished opinion, has held that a settlement payment in connection with resolution of a class action alleging violations of state wage and hour laws was a covered loss under a D&O policy, provided that it was not an uninsurable form of restitution. *SWH Corp. v. Select Ins. Corp.*, 2006 WL 2786930 (Cal. Ct. App. Sept. 28, 2006).

The insured company, which owned and operated a chain of restaurants in California, obtained a D&O and private company indemnification policy. The policy afforded coverage for "Loss... incurred by the Insured Company as the result of any... Employment Claim." The policy defined "loss" to include "the total amount... which the Insured Company becomes legally obligated to pay as the result of all Claims first made during the Policy Period against the Insured Company, for covered Wrongful Acts, including but not limited to damages, judgments, settlements, front pay awards, back pay awards...." The policy stated that "Loss does not include: (1) Benefits of the Insured Persons; [or]... (6) matters uninsurable under the law pursuant to which this Policy is construed." The policy defined "Benefits of the Insured Persons" to include "perquisites, fringe benefits... and any other payment to or for the benefits of an employee arising out of the employment relationship."

During the policy period, a group of current and former employees filed a putative class action lawsuit against the company. The class alleged that the company unlawfully designated class members as exempt employees to avoid paying them overtime wages. In November 2003, the company settled with the class through a joint stipulation that contained a complete settlement and release of "any and all wage claims." Subsequently, the company filed a declaratory action against the insurer seeking coverage for the settlement proceeds.

The appellate court found that the settlement was a covered loss rather than an excluded "Benefit of the Insured Persons." First, the court reasoned that, since the policy insured against "Loss caused by an Employment Claim," loss should cover a settlement for wages. The court explained the definition of "loss" was ambiguous since, on one hand, it included "settlements" of employment claims, but, on the other hand, did not include "Benefits of the Insured Persons." The court reconciled the ambiguity in favor of the company by interpreting "Benefits of the Insured Persons" to mean that the policy did not insure the company's payroll and

employee benefits.

The court also ruled that the settlement was a covered loss under the term "back pay awards." Although the insurer contended that some cases and statutes use "back pay" in a technical sense to describe "the remedy for wrongful discrimination or termination," the court held that the policy failed to demonstrate an intent to use this technical meaning. Therefore, the court interpreted the term in its ordinary sense as "payment for work done in the past," which included the settlement.

The court then concluded that questions of fact regarding whether the company's settlement constituted uninsurable restitution precluded summary judgment. After surveying California decisions, the court concluded that, under a narrow public policy exception, only "restitution of property or money obtained by criminal, willful, or fraudulent conduct, and/or restitution that is punitive in nature" was uninsurable. Because there was a question of fact regarding whether the settlement proceeds were uninsurable restitution, the court remanded the case.