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ALERT

Employees' Claims for Unpaid Medical Benefits Not "Loss" under Company's Fiduciary Liability Policy

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The United States District Court for the Southern District of West Virginia has held that employees' claims for unpaid medical benefits arising from the mismanagement of a company's benefits plan constituted "benefits due" and therefore were carved out from the definition of "loss" in the entity's fiduciary liability policy. *Guyan Int'l, Inc. v. Travelers Cas. & Surety Co.*, 2011 WL 6225398 (S.D. W. Va. Dec. 12, 2011). The court also held that the unpaid medical benefits claims fell within a clear and unambiguous ERISA exclusion in a separate errors and omissions policy issued to the company.

The insured company established an employee benefits plan in 2007 and hired a third party to administer the program. After discovering in 2010 that the administrator had misappropriated funds and failed to pay some employees' claims for medical and prescription benefits, the policyholder sought coverage from two insurers. The first insurer issued a claims-made policy to the company covering the period from March 31, 2010 to March 31, 2011 that provided both fiduciary liability and crime coverage. The second insurer issued an errors and omissions policy to the entity covering the period from July 1, 2009 to July 1, 2010. Both insurers denied coverage.

The court held that the claims for unpaid medical benefits constituted "benefits due" and therefore did not come within the 2010-11 policy's fiduciary liability coverage, which carved out of the definition of "loss" the "payment of medical, pension, severance, Employee Stock Ownership Plan benefits or Employee Benefits which are or may become due." However, with respect to the 2010-11 policy's crime coverage, the court rejected the insurer's argument that coverage

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was barred based on the company's discovery of the claims prior to the policy's inception because there was a factual dispute as to when the policyholder first learned of the potential loss. The court also held that the 2010-11 policy's crime coverage part—which provided coverage only for theft committed by a fiduciary—did not unambiguously exclude the plan's third-party administrator from its definition of "fiduciary" and therefore must be construed in favor of providing coverage.

The court next addressed the coverage defenses raised by the 2009-10 insurer. The court agreed that the errors and omissions policy's ERISA exclusion, which barred coverage for "Loss for which the insured is liable because of liability imposed on a fiduciary by [ERISA]," was clear and unambiguous and operated to bar coverage for the unpaid medical benefits claims because such claims "aris[e] from ERISA-imposed fiduciary liability." The court also agreed with the 2009-10 insurer that the plan administrator's failure to pay medical benefits claims "was anything but negligent" and therefore did not come within the policy's coverage for a "negligent act, error or omission" arising out of the insured company's administration of the benefits plan. The court acknowledged that the company itself may have been negligent in failing to monitor the third-party administrator, but held that the administrator's misconduct, rather than the insured's negligence, was the proximate cause of the policyholder's loss.