



KD Alert: California Federal Court Holds Insurer Required to Cover Employee Reimbursement and Wage Hour Claims and More Under EPLI Policy

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When Travelers Cas. and Surety Co. of America sought to deny an insured coverage on wage and hour claims brought against it, adhering to the EPLI policy's exclusion of such claims, its denial was rebuffed by a federal court sitting in the Central District of California, citing bad faith [Classic Distributing and Beverage Group, Inc. v. Travelers Cas. and Surety Co. of America, Central District Court of California, Case No: 2:11-cv-07075 (August 29, 2012)]. In ruling on cross motions for summary judgment, a California federal court judge in the Central District held (a) the insurer was required to cover employee reimbursement claims made against its insured, Classic Distributing and Beverage Group, Inc. ("Classic"), as covered "Loss," (b) that the Wage and Hour Claim Exclusion endorsement included in the policy renewal was invalid and unenforceable, (c) Classic was entitled to appointment of independent counsel, and (d) Classic was entitled to recover attorney's fees and costs associated with covered claims.

The District Court also determined that Classic was entitled to a defense against all claims in the underlying class action suit, and to indemnity for some of those claims. Further, the District Court denied Travelers' motion for summary judgment as to Classic's bad faith claim, because there were triable issues of material fact as to whether Travelers' coverage decision was "reasonable" as a matter of law.

The case arose in 2009, when a former Classic employee filed a class action lawsuit against Classic based, in part, on its alleged failure to reimburse work-related expenses in violation of California Labor Code section 2802. Classic settled the underlying lawsuit in 2011 for \$225,000, and memorialized the resolution in a formal settlement agreement in 2012.

In its initial coverage position, Travelers advised Classic that a duty to defend arose only for the Labor Code section 2802 claim, and it was reserving rights to disclaim liability for any damages awarded that did not qualify as "Loss" under the policy. Travelers further claimed there was no coverage for Wage and Hour Law claims, because they were excluded by endorsement, and that plaintiffs in the underlying suit sought restitution, not damages, under Labor Code section 2802. After the underlying lawsuit was amended and re-tendered, Travelers opined there was no duty to indemnify Classic for any of the claims, based on the Wage and Hour Claim Exclusion endorsement. Travelers also took the position that because there was no coverage for indemnity as to any cause of action, there could be no conflict of interest requiring appointment of independent counsel.

Travelers' Wage and Hour Claim Exclusion endorsement that was part of Classic's policy renewal was found unenforceable and invalid. Although the endorsement was labeled "WAGE AND HOUR CLAIM EXCLUSION" and prefaced with "THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY," the District Court held Travelers did not provide sufficient notice to Classic that there was a reduction in coverage. The District Court found the body of the policy did not contain the exclusion and it was included as one of several amendments, attached to the end of the nearly one hundred-page policy. The District Court pointed to the Ninth Circuit's "renewal rule," whereby "unless the notice of the reduction in coverage is 'conspicuous, plain and clear,' the 'insurance company is bound by a greater coverage in an earlier policy when a renewal policy is issued.'"

As to the parties' characterization of the claims made under Labor Code section 2802, the District Court held "Travelers' characterization of awards under that section as 'restitution' sw[er]ed too broadly, and would apply even to standard breach of contract actions." The District Court held awards under Labor Code section 2802 were properly characterized as "damages" and Classic was entitled to indemnification.

The Court rejected Travelers' contention that Classic did not need independent counsel because there was no indemnity coverage for any of the underlying claims, and as such, no opportunity for assigned defense counsel to steer the defense towards a non-covered claim. The District Court agreed with Classic, stating, "Travelers had the ability not only to steer coverage away from potentially covered claims, namely those arising under Cal. Labor Code [Section] 2802, but also to steer any settlement toward awards that would be excluded under the Policy's definition of "Loss." The District Court noted that in light of Travelers' attempts to characterize recovered "wages" as "restitution," the language in the settlement agreement concerning the underlying claims stating that the individual settlement

payments would be treated as “wages” and “penalties” could be read as an attempt to steer the settlement toward awards that would not be covered under the policy.

This decision should prompt insurers to re-evaluate their EPLI policies concerning Labor Code section 2802 employee reimbursement claims. To this end, it is suggested that extra caution be taken in the manner and method in which insureds are notified of policy endorsements seeking to limit or exclude coverage during policy renewal. It would also be advisable to use a separate written notice to the insured with an acknowledgement of receipt to do so.

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