INSURING EMPLOYER LIABILITY FOR HOSTILE WORK ENVIRONMENT CLAIMS: HOW CHANGES IN DISCRIMINATION LAW MAY AFFECT THE GROWING MARKET FOR EMPLOYMENT-RELATED PRACTICES LIABILITY INSURANCE

FRANCIS J. MOOTZ III*

INTRODUCTION

The market for Employment Practices Liability Insurance ("EPL") continues to grow at a phenomenal rate.¹ The number of insurers offering EPL protection has increased from a handful only eight years ago to more than seventy today. Moreover, the coverages being offered have dramatically expanded even as premiums have been cut substantially.² The rapid expansion of EPL poses no great mystery. In the past thirty years there has been a tremendous increase in employment-related litigation and liabilities, as well as a corresponding unwillingness by insurance carriers to assume this risk in General Liability policies. As with all insurance products,

* Professor of Law, Western New England College School of Law. I would like to thank my colleague, Sam Stonefield, for his many helpful conversations about the uncertain state of sexual harassment law and for his extensive assistance with Part I of this Article in the form of suggesting examples and language for the text. I would like to thank my partner, Caren Senter, for equally illuminating conversations and editorial assistance based on her years of practice experience in the area of sexual harassment law.


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EPL has developed in response to consumer demand to fill a vacuum in the established insurance market.

There is every reason to believe that this growth will continue into the foreseeable future as the EPL market becomes more established. EPL marketers must have been pleased to read in a recent district court opinion that the chief financial officer who was sued for sexual harassment had warned her employer that it better sober up and check to make sure that it had sufficient EPL coverage.\textsuperscript{3} EPL is likely to become a standard part of most business insurance programs as risk managers begin to demand this coverage as part of a comprehensive loss avoidance and insurance program.\textsuperscript{4}

Despite the phenomenal growth and current profitability of EPL, long-term success for this product is by no means guaranteed. EPL faces substantial challenges because employment law is a relatively new field that is still unstable and lacks coherent guiding principles. As employment law matures, EPL carriers might find that they have unwittingly signed onto risks that they can only vaguely imagine today. In the interest of focus and detail, I will assess the challenges facing EPL carriers by discussing only one kind of employment-related liability under federal law that confronts employers. As a form of sexual harassment, "hostile work environment" liability provides just one example of a risk that remains uncertain, not just because the cost of the exposure facing employers is difficult to calculate, but because the very nature of the cause of action remains unsettled. Insurance carriers traditionally respond to uncertain risks by attempting to gather more and better loss data and underwrite more carefully. But when the very nature of the liability is not yet settled, this approach proves problematic.

This Article is relatively complex despite having a narrow focus, but this complexity is part of the theme of the Article. Assessing the role that EPL might play in the future requires an understanding of two murky areas of law: employment law and insurance coverage law. In Part I of the Article I discuss the evolution of employer liability for hostile work environment sexual harassment. Because cases reaching the Supreme Court have in-


\textsuperscript{4} See Michael Bradford, \textit{Lower Liability Outlay Cut Cost of Risk}: \textit{Study}, Bus. Ins., Feb. 8, 1999, \textit{available in} 1999 WL 8767961 (reporting that the 1998 RIMS Benchmark Survey indicated that EPL is becoming a common part of a risk manager's portfolio); see also \textit{Keeping a Lid on Workplace Lawsuits}, 46 Risk Mgmt. No. 2, Feb. 1, 1999 (reporting that a recent survey of human resource professionals revealed that 48% had purchased EPL coverage).
olved wrongdoers who are supervisors, the Court has used agency principles to impose liability on the employer for the actions of its employees. Under this approach, the employer is considered to have acted through its agent to discriminate against one or more employees. However, I argue that the nature of the claim for hostile work environment sexual harassment is such that negligence principles in fact guide the determination of employer liability, and that the uniform practice in the lower courts of using negligence principles to impose liability on employers for hostile work environment harassment committed by co-employees or third persons has effectively been adopted by the Supreme Court in the supervisory context as well. This reconceptualization is significant for insurance coverage purposes because the employer’s liability is no longer premised on the claim that the employer has engaged in the intentional wrongdoing, but only that it negligently permitted the wrongdoing to occur.

In Part II of the Article I analyze the consequences for insurance coverage that follow from recognizing that liability for hostile work environment sexual harassment is grounded on negligence principles. First, I demonstrate that employers will have stronger arguments that coverage for this liability is available under their General Liability policy and under their Workers’ Compensation/Employers’ Liability policy if hostile work environment sexual harassment is founded on the employer’s negligence. Although these policy forms now contain express exclusions for “employment-related practices” liabilities, coverage might be available to the extent that the facts in a given case fall outside the scope of the exclusion. Next, I argue that insurance carriers (including EPL carriers who may attempt to avoid coverage obligations in the event that the risk of liability for hostile work environment sex discrimination dramatically increases) will have no legitimate basis to avoid coverage for hostile work environment sexual harassment under the public policy defense, since liability is not imposed on account of intentional or malicious behavior by the employer.

In conclusion, I emphasize that the changing nature of hostile work environment sexual harassment law is just one example of the doctrinal uncertainty that confronts EPL carriers, and that this one example reveals the complexity of the situation that these carriers face. This is not to suggest that employment-related liabilities are too uncertain to insure. However, it is clear that the companies now racing to participate in this growing market must exercise a great deal of caution and remain attentive to the ever-changing nu-
ances of employment law if they are to succeed in this line of business.

I. NEGLIGENCE PRINCIPLES PROVIDE THE BEST RATIONALE FOR IMPOSING LIABILITY ON EMPLOYERS FOR HOSTILE WORK ENVIRONMENT SEXUAL HARASSMENT.

An employer may be liable under Title VII if its employees are sexually harassed in the workplace. The first harassment cases under Title VII involved racial harassment of employees, but at least by 1977 courts were acknowledging that sexual harassment also provided a basis for employer liability under Title VII. In twenty years sexual harassment has grown from a fledgling interpretation of Title VII to a substantial liability risk that is well known by every employer. Beginning with the Senate hearings on Anita Hill's stunning allegations that, while Chairman of the Equal Employment Opportunity Commission ("EEOC"), Clarence Thomas created a hostile and abusive work environment with his sexual propositions and banter, sexual harassment has received extensive media attention during this decade. Not surprisingly, the number of claims of sexual harassment has increased tremendously in response to this publicity. Between 1990, following the Thomas-Hill hearings, and 1995, the number of sexual harassment claims filed with the EEOC more than doubled. The number of filings has remained at this level in subsequent years.

Most discussions about sexual harassment concern the legal boundaries of actionable behavior. The lay public appears fascinated by judicial determinations of when a crude joke, a clumsy

6. See Rogers v. EEOC, 454 F.2d 234, 238 (5th Cir. 1971) (finding, for the first time, that racial harassment was a violation of Title VII); see also Meritor Sav. Bank, FSB v. Vinson, 477 U.S. 57, 65-67 (1986) (discussing the impact of the Rogers decision).
7. See Barnes v. Costle, 561 F.2d 983, 994 (D.C. Cir. 1977) (holding that there is no support for "the notion that employment conditions summoning sexual relations between employees and superiors are somehow exempted from the coverage of Title VII"). Barnes is generally regarded as the first case to expressly treat sexual harassment as a violation of Title VII.
proposition, or excessive physical contact might constitute a civil rights violation. However, defining conduct that constitutes sexual harassment is only one part of the legal analysis. Because employers are not strictly liable for all forms of sexual harassment in the workplace, courts must separately rule on the employer's culpability after determining that an employee has been sexually harassed. In this part of the Article I argue that an employer's liability under Title VII for hostile work environment sexual harassment should be determined according to negligence principles, and that for all practical purposes, the courts have adopted this approach.

A. Defining Hostile Work Environment Sexual Harassment

Following Catherine MacKinnon's path-breaking book, *Sexual Harassment of Working Women*,\(^\text{10}\) courts and commentators have traditionally recognized two theories of liability for sexual harassment—quid pro quo and hostile work environment. A quid pro quo case exists when the employer's agent demands sexual conduct as a term or condition of the employee receiving the full benefits of continued employment.\(^\text{11}\) If a supervisor demands that a female employee perform sexual acts in exchange for favorable treatment (such as a favorable performance review, a pay raise, or a promotion), that sexual demand becomes part of the exchange (quid pro quo) between the employer and the employee.\(^\text{12}\) In quid pro quo cases, courts have concluded that the employer is automatically liable for the intentional wrongdoing of its authorized agents.\(^\text{13}\) In the second type of sexual harassment case, courts will hold an employer liable under certain circumstances when an employee is subjected to a "hostile work environment." First, the court must find that the


\(^{11}\) The Guidelines on Sexual Harassment promulgated by the EEOC describe quid pro quo harassment in the following terms:

Unwelcome sexual advances, requests for sexual favors, and other verbal or physical conduct of a sexual nature constitute sexual harassment when (1) submission to such conduct is made either explicitly or implicitly a term or condition of an individual's employment, [or] (2) submission to or rejection of such conduct by an individual is used as the basis for employment decisions affecting such individual . . . .

\(^{12}\) 29 C.F.R. § 1604.11(a) (1999).

\(^{13}\) See, e.g., Nichols v. Frank, 42 F.3d 503, 510-13 (9th Cir. 1994).

\(^{13}\) See Merrick T. Rossein, *Employment Discrimination: Law and Litigation* § 6.6 (1997) ("Every court of appeals to address the issue in the quid pro quo context has held the employer absolutely liable for the sexual harassment by a supervisor resulting in tangible detriment to the subordinate employee.").
work environment is so severely or pervasively hostile that it constitutes a discriminatory workplace. As discussed in the next section, the court must also determine whether (and under what circumstances) the hostile work environment should be attributed to the employer as a matter of law.

The Supreme Court first recognized the hostile work environment interpretation of Title VII in *Meritor Savings Bank, FSB v. Vinson.* In what amounted to an easy test case, the Court held that actionable sexual harassment existed when a bank president made repeated demands for sex, raped the employee on several occasions, and repeatedly abused her in front of other employees, even though the employee was not threatened with negative job consequences if she rebuffed this behavior nor did she receive any tangible job benefits for submitting to this behavior. Finding that the harassment was so severe or pervasive as to alter the conditions of the plaintiff's employment by creating an abusive or hostile work environment, the Court held that the employee had suffered discrimination due to her gender despite the absence of a quid pro quo. The *Meritor* test was subsequently refined in *Harris v. Forklift Systems, Inc.,* when the Court ruled that an employer is liable for a hostile work environment even if the employee does not suffer severe psychological harm. The *Harris* opinion established a two-pronged test for determining whether a workplace is hostile: abusive conduct in the workplace must be severe or pervasive enough to create an objectively hostile environment as measured by a reasonable person standard, and the conduct must also be subjectively perceived as abusive by the complaining employee.

The *Harris* test has been applied to widely divergent fact scenarios by numerous courts, leading to a kind of "common law" development of the definition of hostile work environment. These cases make clear that the simple model of quid pro quo, typically sexual activity exchanged for tangible job benefits, has not just been expanded. Instead, a hostile work environment claim represents an entirely distinct type of claim. Although demanding or engaging in unwelcome sexual activity is often an important element in creating

15. See id. at 59-61.
16. See id. at 72-73.
18. See id. at 22-23.
19. See id. at 21.
20. See Rossein, supra note 13, § 6.7.
a hostile work environment, the concept of gender discrimination is not limited to cases in which the wrongdoer is attempting to gratify his sexual desire. In *Oncale v. Sundowner Offshore Services, Inc.*, the Supreme Court recently held that a male employee experienced a hostile work environment when he was subjected to physical assaults of a sexual nature by heterosexual male workers. As Justice Scalia explained, “harassing conduct need not be motivated by sexual desire to support an inference of discrimination on the basis of sex,” because, the “critical issue, Title VII’s text indicates, is whether members of one sex are exposed to disadvantageous terms or conditions of employment to which members of the other sex are not exposed.”

Such a broad interpretation of hostile work environment sexual harassment exposes employers to liability in a wide variety of circumstances. In a tightly reasoned and persuasive article, Professor Vicki Schultz argued that hostile work environment liability ultimately should be reconceptualized to encompass abusive behavior (not necessarily sexual in nature at all) that undermines the full participation of women in the workforce by maintaining workplaces “as bastions of masculine competence and authority.” This approach gained support in *Oncale*’s emphasis that gender discrimination, rather than sexual activity, is the target of Title VII. The purpose of Title VII is not to create a code of sexual morality in the workplace, but instead to eradicate discrimination throughout the economy. Consequently, when a co-worker engages in a pattern

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22. Id. at 1002.
23. Id. (quoting Harris, 510 U.S. at 25 (Ginsburg, J., concurring)).
24. Vicki Schultz, *Reconceptualizing Sexual Harassment*, 107 Yale L.J. 1683, 1687 (1998). Professor Schultz argued that: Singing out sexual advances as the essence of workplace harassment has allowed courts to feel enlightened about protecting women from sexual violation, while at the same time relieving judges of the responsibility to redress other, broader gender-based problems in the workplace. . . . We need an account of hostile work environment harassment that highlights its dynamic relationship to larger forms of gender hierarchy at work.

*Id.* at 1690.

25. See *Oncale*, 118 S. Ct. at 1002 (explaining that gender discrimination exists “if a female victim is harassed in such sex-specific and derogatory terms by another woman as to make it clear that the harasser is motivated by general hostility to the presence of women in the workplace”). Professor Schultz briefly noted that her thesis was supported to some degree by *Oncale*, which was decided just as her article went to press. *See* Schultz, supra note 24, at 1692 n.18.

of physically abusive and derogatory behavior directed at women employees, a cause of action for hostile work environment will lie, despite the lack of any sexual overtones. 27 The developing law of hostile work environment sex discrimination therefore represents a substantial exposure to liability for employers that is not covered by the “sexual favors” model of quid pro quo liability.

B. Employer Liability for Hostile Work Environment Sexual Harassment: The Move Toward a Negligence Standard

The fact-driven standard developed in Meritor and Harris addresses only whether a hostile work environment exists, and not whether the employer should be held liable for the hostile work environment. Because only company officers and supervisors have the authority to grant or withhold tangible job benefits, in quid pro quo cases courts hold the employer automatically and vicariously liable for the actions of these agents when they engage in conduct that constitutes quid pro quo sexual harassment. On the other hand, in hostile work environment cases the wrongdoer need not have any authority in order to create the hostile environment, since co-workers and even third persons such as vendors or customers might act in a manner that renders the workplace hostile. Consequently, the theoretical basis for holding the employer liable for the existence of a hostile work environment is not as clear. In Meritor, the Court refused to adopt a definitive rule of employer liability in light of the undeveloped character of the record in that case, but the Court did embrace the EEOC practice of looking to agency


27. See Smith v. Sheahan, No. 98-2445, 1999 WL 667262, at *4-5 (7th Cir. Aug. 27, 1999). According to the court:

It makes no difference that the assaults and the epithets sounded more like expressions of sex-based animus rather than misdirected sexual desire (although power plays may lie just below the surface of much of the latter behavior as well). Either is actionable under Title VII as long as there is evidence suggesting that the objectionable workplace behavior is based on the sex of the target.

.... In a sex discrimination case, the action need not be inspired by sexual desire, assuming for the sake of argument that rape or sexual assault is anything but an act of violence. Breaking the arm of a fellow employee because she is a woman, or, as here, damaging her wrist to the point that surgery was required, because she was a woman, easily qualifies as a severe enough isolated occurrence to alter the conditions of her employment.

Id. at *5 (citation omitted).
principles for guidance even while noting that "such common-law principles may not be transferable in all their particulars to Title VII." The Supreme Court then waited until 1998 to discuss further the basis for employer liability, and in the intervening twelve years the lower courts struggled to formulate a proper standard of liability.

In *Meritor*, the Supreme Court deferred to the EEOC's interpretation of Title VII by adopting the principles of agency law as the standard for assessing employer liability. This approach is sensible in quid pro quo cases. Because acts directly related to tangible job benefits are "official" actions, they uniformly are regarded as the acts of the employer for legal purposes. However, in the context of hostile work environment sexual harassment, agency principles can be both too strong and too weak to effectively fulfill the purposes of Title VII. Consider the difficulty of using agency principles to determine an employer's liability for continual sexual banter directed at women in the company cafeteria during the lunch hour. If a supervisor is responsible for discriminatory behavior and agency principles are strictly applied, the employer would be automatically and strictly liable for this behavior even if it was personally motivated, harmful to the company, and in direct contravention of express company policy. On the other hand, if a non-supervisory co-worker creates the hostile environment, then under agency principles it would be difficult to hold the employer responsible for this behavior even though the effect on the employee being harassed may be to preclude her from working effectively. The same analysis would apply with even greater force in the case of a customer or vendor who regularly uses the employer's cafeteria and behaves in a manner that creates a hostile work environment. If agency law provided the sole standard for employer liability, the result would be to reduce Title VII from a statutory mandate that employers must keep their workplace free from discrimination to permit the full participation of women in the workforce into a more modest statutory ban on discrimination carried out by the employer through its agents.

Given these complexities, the lower courts struggled after *Meritor* to develop a coherent theory of employer liability that fulfilled the statutory mandate of Title VII. An obvious answer was adopted in numerous cases: negligence principles, rather than the principles of agency law, provide the standard of the employer's lia-

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bility for hostile work environment sex harassment. In cases where the abusive environment was created by co-workers or non-employees, negligence quickly was adopted as the only plausible basis for imposing liability on employers. For example, in a case involving a waitress who was fondled and harassed by customers before fleeing the restaurant in tears, the Tenth Circuit Court of Appeals found that the employer could be liable for hostile work environment sexual harassment only if it had negligently permitted the harassment to occur. Notwithstanding Meritor's adoption of agency principles, some courts adopted a negligence analysis even when supervisors or managers were responsible for the abusive work environment.

The multiple opinions in the en banc decision by the Court of Appeals for the Seventh Circuit in Jansen v. Packaging Corp. of America exemplify the post-Meritor confusion in the lower courts. The per curiam opinion emphasized that a majority of the judges, notwithstanding the tangled array of opinions, held that "negligence is the only proper standard of employer liability in cases of hostile-environment sexual harassment even if as here the harasser was a supervisor rather than a co-worker of the plaintiff." Writing for six of the twelve judges, Judge Flaum persuasively argued that negligence is the only proper ground for finding employer liability because the purpose of Title VII is to deter discriminatory behavior.

The imposition of liability beyond that which is likely to deter sexual harassment serves no constructive purpose and unnecessa-

29. In a comprehensive article on the law of discrimination, David Oppenheimer argued that most discrimination is the result of unconscious forces rather than intentional malevolence, and that "the existing law of employment discrimination, while eschewing the term negligence, frequently incorporates the doctrine." David Benjamin Oppenheimer, Negligent Discrimination, 141 U. PA. L. REV. 899, 899 (1993). Oppenheimer discussed the then still-emerging law of sexual harassment as an example of an area of discrimination law that "provides substantial support for the recognition of negligent employment discrimination." Id. at 945. In subsequent years this has become even more apparent in the law of sexual harassment.

30. The recent Supreme Court decisions appear to endorse this approach in the lower courts, although the Court has not yet considered a case involving peer harassment. See Marley S. Weiss, The Supreme Court 1997-1998 Labor and Employment Law Term (Part I): The Sexual Harassment Decisions, 14 LAB. L. AW. 261, 307-08 (1998).


32. 123 F.3d 490 (7th Cir. 1997).

33. Id. at 494.

34. See id. at 495 (Flaum, J., concurring).
rily imposes costs on employers, costs that are ultimately passed on.

... A negligence standard, which asks whether an employer knew or should have known about an employee's acts of harassment and failed to take appropriate remedial action necessarily focuses on the steps that employers should take in detecting and subsequently correcting harassment.

... Companies' efforts to deal with sexual harassment should be systematic and proactive, rather than discrete and reactive.35

Judge Flaum concluded that the employer is under a heightened duty of care with regard to taking preventive and responsive actions when the harasser is a supervisor, because harassment by a supervisor is more likely to affect the terms or conditions of employment.36

Judge Posner agreed that negligence was the proper standard of liability for behavior by supervisors and co-employees alike, and he emphasized that courts employing a fact-driven negligence analysis would certainly take into account the wrongdoer's status when deciding whether to assess liability on the employer.37 In his characteristically incisive and pedagogical manner, Posner ridiculed the notion that Title VII incorporates the Restatement of Agency even if general agency principles might be relevant to a number of issues under Title VII.38 Posner's characterization of the situation in support of adopting a negligence approach is straightforward and persuasive.

Sexual harassment is an intentional injury by the harasser, but an unintentional injury (in the usual case, and in the two cases before us) by the harasser's superiors, or in other words by the employer itself. The employer is innocent; the victim is innocent;

35. Id. at 498 (Flaum, J., concurring) (citations omitted).
36. See id. at 502 (Flaum, J., concurring). Judge Cudahy wrote separately that the "heightened duty of care" described by Judge Flaum should be implemented by means of a presumption that abusive behavior by supervisors that is severe or pervasive enough to trigger liability is sufficient to place the employer on notice of the wrongdoing and to trigger the employer's duty to respond to the discriminatory behavior. See id. at 504 (Cudahy, J., concurring). Judge Cudahy explained: "The negligence standard used to govern hostile or abusive environment claims involving a supervisor must be negligence as related to a special and demanding duty of care. The standard of care should be somewhat like that imposed on packers of parachutes or open heart surgeons." Id. (Cudahy, J., concurring). In contrast, Judge Kanne argued that there should be no presumption of liability when the harasser is a supervisor, although that fact would be relevant in making a determination of liability under negligence principles. See id. at 505 (Kanne, J., concurring).
37. See id. at 512 (Posner, J., concurring and dissenting).
38. See id. at 506-11 (Posner, J., concurring and dissenting).
the optimal system of liability for minimizing sexual harassment requires cooperation by both.39

Posner concluded that an employer cannot be held liable under negligence principles when an employee unreasonably fails to take advantage of a known company policy for reporting and remediating sexual harassment.40

A recent well-publicized case provides a good working example of the negligence standard in action. The EEOC brought an action against Mitsubishi alleging that it engaged in a "pattern or practice" of discrimination because it "created and maintained a sexually hostile and abusive work environment at [a plant] because it tolerated, from the facility's inception, individual acts of sexual harassment by its employees by refusing to take notice of, investigate, and/or discipline the workers who sexually harassed other employees."41 The complaint was premised on the conduct of numerous supervisors and co-employees over a period of years. The court plainly adopted a straight negligence approach to determining liability: "An employer can be said to be negligent for company-wide sexual harassment when it has a policy or practice of tolerating a work environment that it knows or should have known is permeated with sexual harassment, but does not take steps to address the problem on a company-wide basis."42 In short, the court openly embraced negligence principles by imposing liability for the employer's failure to maintain a workplace free of harassment by supervisors and co-workers, rather than stretching agency principles to hold the employer liable for the acts of its employees.

C. Clinging to an Agency Analysis (For Now): The Ellerth and Faragher Decisions

Despite the increasing use of negligence principles to impose liability on employers for hostile work environment sex discrimination, in two recent cases the Supreme Court reaffirmed the Meritor rule that employer liability is premised on agency principles.43 Despite the express rule in these cases, two important factors suggest that these decisions do not undercut the justification for using negli-

39. Id. at 516 (Posner, J., concurring and dissenting).
40. See id. (Posner, J., concurring and dissenting).
42. Id. at 1075.
gence principles. First, both cases involved harassment by supervisors within the direct line of authority over the victim, and so an agency analysis provided a plausible rationale for liability. Because the wrongdoers were not co-employees or third parties, the Court did not have to consider the uniform practice in the lower courts of using negligence principles to assess employer liability in such cases.\textsuperscript{44} Second, the rule announced by the Court to determine whether the harassment is the act of the employer according to agency principles is for all intents and purposes a statement of negligence principles. Adhering to \textit{Meritor}'s line of analysis in name only, the Court embraced a test of employer liability that is easily reconciled with the negligence principles utilized in cases involving non-supervisory harassment.

In \textit{Burlington Industries, Inc. v. Ellerth},\textsuperscript{45} the Supreme Court took up the confusing array of opinions generated by the Seventh Circuit’s en banc ruling on employer liability in \textit{Jansen}. In \textit{Ellerth}, the plaintiff alleged that she suffered unwelcome and threatening sexual advances by her supervisor’s supervisor, but admitted that she had suffered no adverse tangible job consequences, nor had she complained internally, despite knowing of the employer’s policy against sexual harassment.\textsuperscript{46} Holding the employer liable for the admitted sexual harassment on these facts posed an obvious problem since no official action, such as termination or withholding job benefits, was taken in connection with the harassment, and the employer had established an anti-harassment policy in the workplace.

The Court began by reaffirming the \textit{Meritor} commitment to agency principles for determining the employer’s vicarious liability,\textsuperscript{47} and reaffirmed that “tangible employment action” by the supervisor-harasser (formerly designated as quid pro quo harassment) constitutes the act of the employer for Title VII purposes.\textsuperscript{48} On the facts of \textit{Ellerth}, the Court determined that the case must be remanded and tried to determine if the employer could be held vicariously liable under a newly formulated burden-shifting rule of liability. The Court announced the following rule:

\begin{quote}
An employer is subject to vicarious liability to a victimized employee for an actionable hostile environment created by a super-
\end{quote}

\textsuperscript{44} See \textit{Faragher}, 118 S. Ct. at 2289 (accepting, implicitly, the use of negligence principles in this line of cases).
\textsuperscript{45} 118 S. Ct. 2257 (1998).
\textsuperscript{46} See \textit{id.} at 2262.
\textsuperscript{47} See \textit{id.} at 2265, 2270.
\textsuperscript{48} See \textit{id.} at 2269.
visor with immediate (or successively higher) authority over the employee. When no tangible employment action is taken, a defending employer may raise an affirmative defense to liability or damages, subject to proof by a preponderance of the evidence, see Fed. Rule Civ. Proc. 8(c). The defense comprises two necessary elements: (a) that the employer exercised reasonable care to prevent and correct promptly any sexually harassing behavior, and (b) that the plaintiff employee unreasonably failed to take advantage of any preventive or corrective opportunities provided by the employer or to avoid harm otherwise.\footnote{49}

The Court held that negligence principles set only the minimal standard for employer liability, and that the employer's vicarious liability for the acts of a supervisor exist above this baseline of direct liability in negligence.\footnote{50} This distinction appears analytically proper, but in fact is illusory. By adopting a policy in which the employer will be considered liable for hostile work environment sexual harassment by one of its supervisors unless it can meet the burden of proving, as an affirmative defense, that it acted reasonably to prevent the harm, the Court has embraced the traditional negligence language of duty. Consequently, there appears to be no substantial real world effect in demarcating an area of vicarious employer liability based on agency principles. In dissent, Justices Thomas and Scalia argued that negligence is the only plausible standard of employer liability in such cases, although they embraced a conservative definition of the employer's duty by concluding that the employer in \textit{Jansen} acted reasonably and could not be found liable for violating Title VII as a matter of law.\footnote{51}

The holding in \textit{Ellerth} was adopted verbatim in a companion case decided on the same day, \textit{Faragher v. City of Boca Raton}.\footnote{52} Although the holdings are identical, Justice Souter's opinion in \textit{Faragher} provides a more detailed justification than Justice Kennedy's opinion in \textit{Ellerth}. The facts in \textit{Faragher} provided a stronger case for imposing employer liability since the lifeguard employee was harassed by two of her three direct supervisors, she complained to the third direct supervisor, and the employer did not disseminate its policy against sexual harassment to the work unit in question.\footnote{53} As in \textit{Ellerth}, there was no tangible employment action taken by

\begin{itemize}
\item[49.] \textit{Id.} at 2270.
\item[50.] \textit{See id.} at 2267.
\item[51.] \textit{See id.} at 2273 (Thomas, J., dissenting).
\item[52.] 118 S. Ct. 2275 (1998).
\item[53.] \textit{See id.} at 2280-81.
\end{itemize}
the supervisors, and so the case tested the limits of employer liability for hostile work environment sexual harassment. Although the facts suggested that the question of employer liability should not be difficult to resolve, Justice Souter patiently unraveled the basis for imposing liability on employers.

Justice Souter began his analysis by endorsing Meritor's adoption of agency principles as the "foundation on which we build today." Consequently, he rejected a rule holding employers strictly liable when direct supervisors are guilty of harassment. However, Justice Souter emphasized that the Court will not mechanically apply doctrinal principles and thereby lose sight of the legislative purposes for imposing liability on employers under Title VII. He concluded that it would be inappropriate to hold that supervisors are acting within the scope of their employment when they harass subordinates solely for the purpose of invoking agency principles of vicarious liability, especially since it would be difficult to reconcile this approach with the uniform practice of lower courts that impose liability on employers for harassment committed by co-workers and third persons only if the employer is negligent. Souter concluded that employers are vicariously liable for supervisory harassment, that is, even without a showing of negligence, if the agency relationship aided the supervisor in harassing the victim.

Having established the conceptual rationale for employer liability, Justice Souter then addressed the difficult problem of drawing a line between the rejected rule of automatic vicarious liability for supervisory harassment and imposing liability only when the supervisor is aided by the existence of the agency relationship in harassing his subordinate. Souter rejected a fact-intensive inquiry into whether the supervisor actively utilized his authority to carry out the harassment due to the fact that "the results would often seem disparate even if not demonstrably contradictory, and the

54. Id. at 2286.
55. See id. at 2288, 2291 n.4. The EEOC Guidelines provide that employers are automatically liable for sexual harassment committed by supervisors under an agency analysis, but the Guidelines do not make a distinction between quid pro quo and hostile work environment sexual harassment in this provision. See 29 C.F.R. § 1604.11(e) (1999). In Meritor the Supreme Court endorsed the use of agency principles but rejected a rule of automatic liability for hostile work environment sexual harassment.
56. See Faragher, 118 S. Ct. at 2288.
57. See id. at 2289.
58. See id. at 2290-91.
59. See id. at 2291-92.
temptation to litigate would be hard to resist. 60 Instead, Souter repeated the burden-shifting holding of Ellerth as the best means of determining when a supervisor has been aided by his agency relationship. 61 Souter's reasoning underscores that the burden-shifting affirmative defense essentially establishes a negligence test for liability. Noting that the purpose of Title VII is to prevent discrimination in the workplace rather than to compensate victims of discrimination, Souter concluded:

It would therefore implement clear statutory policy and complement the Government's Title VII enforcement efforts to recognize the employer's affirmative obligation to prevent violations and give credit here to employers who make reasonable efforts to discharge their duty.

... The District Court found that the City had entirely failed to disseminate its policy against sexual harassment among the beach employees and that its officials made no attempt to keep track of the conduct of supervisors like [the wrongdoers]. The record also makes clear that the City's policy did not include any assurance that the harassing supervisors could be bypassed in registering complaints. Under such circumstances, we hold as a matter of law that the City could not be found to have exercised reasonable care to prevent the supervisors' harassing conduct. 62

This passage clearly demonstrates that the vicarious liability of the employer is conditioned on the employer's breach of an affirmative duty to act reasonably to prevent harassment in the workplace. The burden-shifting affirmative defense created by the Court clearly imposes a heightened duty on the employer with regard to the actions of its supervisory staff, but it nevertheless is a negligence-type duty. This heightened duty is justified by the greater potential for harm caused by supervisors and the greater degree of control over supervisory behavior wielded by the employer; thus, the imposition of liability is governed by principles traditionally employed in a negligence analysis. 63

60. Id. at 2292.
61. See id. at 2292-93.
62. Id. (emphasis added) (citations omitted).
63. Justice Thomas, joined by Justice Scalia, dissented from the decision because he believed that the record was inadequate to support a finding of liability as a matter of law, but also to insist that simple negligence principles should control. Under this more conservative approach, an employee would bear the burden of proving that the City failed to provide a reasonable procedure for making complaints. See id. at 2294 (Thomas, J., dissenting).
D. **Employer Negligence as the Basis for Liability for Hostile Work Environment Sexual Harassment**

In *Ellerth* and *Faragher* the Supreme Court upheld the *Meritor* rule that agency principles govern employer liability for hostile work environment sexual harassment, even while implicitly accepting the universal rule that employer liability for hostile work environments created by co-workers and third persons is imposed only on a showing of negligence. Nevertheless, the holdings of these recent cases actually employ negligence principles, although the affirmative duty imposed on an employer by Title VII places a greater burden on the employer in the case of supervisory harassment. Plainly stated, liability attaches for supervisory harassment unless the employer can meet its burden of proving that it acted reasonably to maintain a workplace free of discrimination. In effect, the Supreme Court has adopted the position of several judges of the Seventh Circuit in the *Jansen* case who argued for negligence principles that imposed a heightened duty with regard to supervisors. In short, although the Supreme Court did not explicitly condition liability on a finding of negligence, for all practical purposes employer liability for hostile work environment sexual harassment will be determined under negligence principles.

Agency principles might be an appropriate basis for holding employers liable for hostile work environment sexual harassment in certain circumstances. For example, if the owner and president of a closely-held corporation rapes, sexually assaults, and generally abuses female employees, many commentators would readily agree that the employer should be automatically liable under Title VII in light of the fact that the wrongdoer and the employer can hardly be distinguished on these facts.64 In these relatively rare situations there would be strong grounds for imposing liability automatically because the harassing conduct is the act of the employer. In *Meritor*, *Ellerth*, and *Faragher* the Supreme Court analyzed supervisory

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harassment as being analogous to this “alter ego” scenario by using agency principles of liability, even though the Court has always made clear that liability is never automatic for simple supervisory harassment. However, as large numbers of cases involving co-employees and third party harassers are decided under negligence principles, the Supreme Court may come to see that many cases involving supervisory harassment are more analogous to these third party cases than to the much rarer alter ego cases, even if the employer is held to a higher standard of care in preventing harassment by its supervisors.

The Supreme Court may continue its practice of analyzing supervisory harassment under agency principles for a variety of reasons that have little to do with the theoretical basis for imposing liability on employers. First, the inertial effects of stare decisis often lead courts to continue a line of analysis despite its apparent deficiencies. Additionally, independent doctrinal issues may lead the Supreme Court to adhere to its agency analysis. For example, the Civil Rights Act of 1991 expanded the remedies available to plaintiffs suing for intentional discrimination by authorizing an award of punitive damages if the employer acts with malice or reckless indifference to the employee’s federally protected rights under Title VII.65 It is clear that Congress considered sexual harassment to be intentional discrimination for these purposes, even though the intentional actions by individual wrongdoers can only rarely be regarded as the intentional actions of the employer. Consequently, it is possible that hostile work environment sexual harassment by supervisory personnel will continue to be analyzed as an instance of “intentional” discrimination in order to provide plaintiffs with the full range of remedies intended by Congress.

However, even with respect to available damages, the Supreme Court may regard the nature of these claims as negligence-based. In a case decided this summer, the Supreme Court held that punitive damages can be assessed against an employer under the Civil Rights Act of 1991 when a manager denies a promotion to an employee on account of her gender, but only if the manager’s discrimination was intentional.66 The Court defined the requirement of intentional behavior as requiring at least that the employer discriminated “in the face of a perceived risk that its actions will violate

federal law. A bare majority of the Court extended the analysis by also requiring the plaintiff to demonstrate separately that liability for punitive damages should be imputed to the employer, even though allegations were made against high ranking company officials who withheld tangible job benefits. Writing for the majority, Justice O'Connor began by discussing agency principles, in accordance with the recent decisions in Ellerth and Faragher, but she quickly concluded that punitive damages could not be imposed under strict agency principles that include a "scope of employment" analysis.

In light of the perverse incentives that the Restatement's [of Agency's] "scope of employment" rules create, we are compelled to modify these principles to avoid undermining the objectives underlying Title VII [to prevent discrimination by encouraging antidiscrimination programs]. Recognizing Title VII as an effort to promote prevention as well as remediation, and observing the very principles underlying the Restatement's strict limits on vicarious liability for punitive damages, we agree that, in the punitive damages context, an employer may not be vicariously liable for the discriminatory employment decisions of managerial agents where these decisions are contrary to the employer's "good-faith efforts to comply with Title VII."

In short, even though the case involved facts easily characterized in terms of agency principles, the Court felt compelled to modify the rule of employer liability by adopting guiding principles that are characteristic of negligence law. In the more difficult context of employer liability for punitive damages on account of hostile work environment sex discrimination not involving any tangible job benefits, it is reasonable to assume that the Court's adoption of negligence principles would be more broadly embraced in line with the joint holding in Ellerth and Faragher.

Nevertheless, for insurance coverage purposes it is clear that in the great majority of cases employers are not being subjected to suit for intentional behavior, but rather, for negligently failing to meet their statutory duty of providing a workplace that is free of discrim-

67. Id. at 2125.
68. See id. at 2126-27. Justice Stevens, joined by three other Justices, dissented from this part of the opinion on the ground that the question of the employer's vicarious liability for punitive damages had not been argued or briefed below. Id. at 2132-33 (Stevens, J., concurring in part and dissenting in part).
69. See id. at 2127-29.
70. Id. at 2129 (quoting Kolstad v. American Dental Ass'n, 139 F.3d 958, 974 (D.C. Cir. 1998) (Tatel, J., dissenting) (citations omitted)).
ination. Even if courts continue to describe employer liability in terms of intentional behavior attributed to them under (modified) agency principles, in separate proceedings regarding the availability of insurance for the employer’s liability, a court should regard the employer’s culpable behavior as being negligent in nature.

II. RETHINKING INSURANCE COVERAGE FOR HOSTILE WORK ENVIRONMENT SEXUAL HARASSMENT: IMPLICATIONS OF THE NEGLIGENCE PARADIGM

If courts revise the basis of employer liability for hostile work environment by expressly adopting negligence principles as the governing standard rather than agency principles, the coverage provided by EPL insurers and their reinsurers will automatically track this development in the law. EPL policies extend coverage for “discrimination” and “sexual harassment” generally, and policies define these terms by adopting the legal definition. For example, policies typically define sexual harassment as creating or maintaining an intimidating, abusive, or hostile work environment. To the extent that there are significant developments in the legal standards for assessing whether a particular set of facts meet this general definition, the policy language will incorporate those developments. EPL carriers therefore are at risk of having the scope of coverage under their policies suddenly change, but they have no choice but to assume this increased risk. The marketing of EPL products is premised on persuading employers that they face great uncertainty in light of the rapidly changing landscape of employment law. An EPL policy is of considerably less value if it does not expressly undertake to protect the employer from precisely this uncertainty in the employer’s exposure to liability. EPL carriers are well aware that by assuming the risk of substantial developments within existing causes of action they are sailing into uncharted waters.

There is an important caveat to any discussion about potential effects of changes in employment law. Every EPL policy is written on a claims-made basis, usually with a policy term of one year. Consequently, any substantial increase in risk theoretically has an impact only for one year. However, this theoretical consideration is premised on the assumption that EPL carriers will accurately assess such changes and react promptly. In light of the soft market occasioned by intense competition (reflected in both expanding coverages and shrinking premiums), carriers may react too slowly for fear of losing market placement. Additionally, the soft market is
leading some employers to seek multi-year policies with set premiums, clauses to prevent cancellation of coverage except for nonpayment of premium, and other restrictions on the carrier’s ability to react quickly to a changing legal environment that directly affects the risks assumed under the policy. Finally, there is a tremendous marketing cost if the carrier reacts quickly and decisively to a substantial development in the law, since employers will regard the coverage being provided as somewhat fickle and perhaps even illusory.

If courts recharacterize hostile work environment sexual harassment by imposing liability on employers for negligently carrying out duties imposed on them by a civil rights statute, EPL carriers are likely to face three significant changes in their product market. First, this recharacterization of the basis of liability might result in increased employer liability and therefore affect both the frequency and severity of claims under EPL policies. However, it is unclear how courts would define and apply negligence principles in the sexual harassment context. It is possible that a negligence analysis could be used by conservative judges to cut back on the scope of liability currently created under agency principles. On the other hand, negligence principles could be used to place affirmative duties on employers to eliminate harassment in the workplace by being proactive. Because the effect on employer exposure is purely hypothetical until the negligence analysis is defined, this potential effect on the EPL market will not be discussed in this Article.

Second, this reconceptualization of sexual harassment law could open the potential for coverage under other primary insurance products such as Commercial General Liability ("CGL") policies and Employers’ Liability ("EL") coverages in Workers’ Compensation ("WC") policies, thereby complicating the position of EPL carriers. The potential availability of other insurance in a particular hostile work environment case will lead to coordination of coverage problems and interfere with the universal goal of EPL carriers to maintain unilateral control over employment-related claims and litigation. This effect will be discussed in Part A

71. Generally, conservative judges have advanced the claim that employer liability is grounded in negligence principles. See Burlington Indus., Inc. v. Ellerth, 118 S. Ct. 2257, 2271-75 (1998) (Thomas, J., dissenting) (joined by Justice Scalia); Faragher v. City of Boca Raton, 118 S. Ct. 2275, 2294 (1998) (Thomas, J., dissenting) (joined by Justice Scalia); Jansen v. Packaging Corp. of Am., 123 F.3d 490, 506-17 (7th Cir. 1997) (Posner, J., dissenting) (joined by Judge Manion).

72. On the other hand, if employer liability for sexual harassment is construed as...
Finally, a reconceptualization of hostile work environment liability in terms of negligence principles should lead to a definitive recognition by courts and state insurance departments that there is no per se public policy bar to insurance coverage for this liability, even though the wrongdoer's actions are intentional in nature. This recognition will not only remove doubts about the enforceability of EPL coverage for hostile work environment cases, it will also render coverage for certain hostile work environment cases more likely under CGL and EL policies. This effect on the EPL market will be discussed below in Part B.

A. Insurance Coverage of Hostile Work Environment Sexual Harassment Cases Under CGL and EL Policies

Most first generation EPL policies contained "other insurance" clauses providing that any other applicable insurance would be considered primary and that the EPL policy would apply only as excess insurance. To the extent that changes in the law make it more likely that employers can obtain coverage under other policies, or at least trigger the duty to defend, the vexing problem of "other insurance" clauses will raise its ugly head. More recently, in response to the competitive pressures of the market, many EPL carriers have begun replacing "other insurance" clauses with express commitments to respond first to any claim within coverage. Despite this express commitment to respond first, the availability of other insurance may still prove to be problematic because the employer will often have strong motivation to have another primary insurer answer first. Lower deductibles, the provision of the defense outside of limits, and the ability to fold this exposure into the full range of exposures facing the employer at that time all work in favor of the employer seeking coverage first under non-EPL products. As EPL carriers seek to eliminate nuisance cases from the claims process by raising deductibles and self-insured retentions, vicarious liability for the conduct of employees acting within the course and scope of their employment, then the offending employee might successfully argue that he is entitled to indemnification by the employer, with the employer seeking recovery from its directors' and officers' liability insurance carrier. Cf. State v. Shallock, 941 P.2d 1275 (Ariz. 1997) (en banc) (remanding case for trial to determine if harassment was within the course and scope of director's employment so as to trigger indemnification under a state program).

and by dispensing with the need to provide notice of a claim within the deductible, employers will be even more likely to pursue other available primary coverages.

The availability of two primary insurance coverages for sexual harassment claims presents a problem for EPL carriers. EPL insurers undoubtedly have assumed "first to respond" responsibility in order to "own" these claims. Claims management is an important element of any insurance product, but EPL carriers recognize that loss control strategies and claim management techniques will be crucial to ensuring the growth and profitability of this product. The introduction of other available coverage will frustrate this interest in control and claims management.

It bears emphasis that it is not only employers who have every incentive to be aggressive in pursuing all available insurance coverage. Their employment lawyers have equally strong incentives. An employment lawyer who fails to investigate the availability of insurance coverage for an employment dispute she is retained to handle may face a malpractice action. The potential availability of other insurance coverage raises particularly interesting professional responsibility and liability issues for employment lawyers selected from an EPL panel to assume the defense of an action that has been reported only to the client’s EPL carrier.

Given these considerations, the availability of other primary insurance coverage may result in complexity, if not create problems, for EPL insurers. The following two subsections analyze how the reconceptualization of sexual harassment law is likely to expand the arguments for employers seeking coverage under the EL part of their WC policy and under the terms of their CGL policy.

1. Coverage for Sexual Harassment under the Employers’ Liability Part of the Workers’ Compensation Policy

Employees subjected to sexual harassment in the workplace often suffer some form of bodily injury. Nevertheless, there is little possibility of triggering coverage under Part One of a WC policy even if sexual harassment law is reconceived in terms of negligence. Employers seeking insurance coverage for sexual harassment claims have demanded that their WC carriers defend them in civil actions in which an employee alleges bodily injury as a result of

workplace harassment. Employers have argued that such injuries fall within the exclusivity of the workers' compensation system and therefore their WC carriers have the obligation to secure dismissal of any such improperly filed claims. However, courts uniformly hold that claims for bodily injury arising out of sexual harassment are outside the quid pro quo of the workers' compensation system, in which an employee gives up his or her right to sue in exchange for (hypothetically) prompt no-fault payments for injuries. Consequently, the employee is free to pursue recovery in a civil action and is not limited to the workers' compensation system. Even if an employee's civil claim could potentially result in a finding of a bodily injury not caused by discrimination, and therefore be compensable exclusively under the workers' compensation system, the WC carrier has an obligation to defend only when an administrative claim for benefits under the workers' compensation laws is filed. If an employee incorrectly files a claim for workers' compensation benefits on account of bodily injury caused by sexual harassment, the WC carrier would have the burden of defending the employer. However, the carrier would be within its right to refuse settlement of the claim and to seek dismissal on the ground that the claim must be pursued in a civil action, even though this defense obviously works against the employer's economic interest.

In contrast, insurance coverage for bodily injury resulting from sexual harassment may well be available under Part Two of the standard WC policy, which provides coverage known as Employers' Liability ("EL") insurance. EL policies typically provide coverage for bodily injuries caused by accident or disease that arise out of and in the course of the claimant's employment with the insured but which are not within the scope of the workers' compensation laws. Consequently, it is far more likely that coverage will be triggered under Part Two for the typical civil action alleging sexual harassment.

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76. See La Jolla Beach & Tennis Club, Inc. v. Industrial Indem. Co., 884 P.2d 1048, 1056-57 (Cal. 1995).
77. See Ottumwa Hous. Auth., 495 N.W.2d at 730 (holding that the carrier did not act in bad faith by refusing to settle and securing the withdrawal of the claim for workers' compensation benefits by a harassment plaintiff).
79. See, e.g., EEOC v. Southern Publ'g Co., 894 F.2d 785, 889-90 (5th Cir. 1990) (ruling that an allegation of assault and battery premised on an offensive touching in
In response to the growing number of claims under EL coverage in connection with discrimination suits, most carriers now explicitly exclude coverage for any liabilities incurred on account of personnel policies and practices, specifically including discrimination and harassment.  

80 Courts have generally enforced these express EPL exclusions.  

81 Some courts have gone further and held that distinct causes of action not specifically enumerated in the exclusion but nevertheless premised on bodily injury are excluded from coverage, reasoning that collateral tort theories, such as intentional infliction of emotional distress, provide only a measure of the injury caused by discriminatory behavior, rather than an independent basis for assessing liability.  

82 Despite the seemingly broad sweep of this exclusionary language, there are substantial openings for judicial interpretation. A recent New Jersey case provides several theories for avoiding the EPL exclusion clause in an EL policy. In Schmidt v. Smith, the Appellate Division found that the exclusion was designed to exclude coverage only for intentional conduct by the employer that causes injury to an employee.  

83 Employing the doctrine of reasonable expectations to construe the policy language, the court held that the exclusion “does not specifically exclude coverage for vicarious liability resulting from hostile workplace sexual harassment.”  

Consequently, the court found that coverage existed for the corpo-


80 The standard exclusion developed by the National Council on Compensation Insurance, Workers’ Compensation and Employers’ Liability Insurance Policy (Apr. 1, 1992) provides that there is no coverage for “damages arising out of coercion, criticism, demotion, evaluation, reassignment, discipline, defamation, harassment, humiliation, discrimination against or termination of any employee, or any personnel practices, policies, acts or omissions.” This exclusion is likely to pass judicial muster in most cases. See General Star Indem. Co. v. Schools Excess Liab. Fund, 888 F. Supp. 1022, 1028 (N.D. Cal. 1995) (finding no duty to defend suit alleging conduct intended to humiliate, harass, and intimidate an employee, given clear exclusionary language).  


84 See id. at 72-73.  

85 Id. at 73.
rate employer to the extent that it was vicariously liable for the intentional harassment and assaults committed by the company president. However, the exclusion did work to deny coverage to the president, who was also an insured on the policy. The court relied on a federal court's interpretation of similar exclusionary language to support its reasoning.

Although the court [in Seminole Point Hospital Corp. v. Aetna Casualty & Surety Co.] found that the company's president was excluded from coverage under both exclusions because of his intentional acts of sexual harassment, a different result was reached for the corporation. The court found that since the individual defendants were not authorized to perform acts of sexual harassment, and were therefore outside the scope of their employment, "such acts did not constitute an intentional act as to the corporation." Nevertheless the court reasoned, the company could be liable for its supervisory employees' alleged wrongdoing on the basis of negligent supervision and/or failure to investigate. "Liability insurance policies are typically sold and purchased to provide indemnification for liability which may be imposed as a result of negligence." Accordingly, the court held that the insurer must defend and indemnify the corporation for its alleged negligence although not for its intentional or discriminatory acts.

The rationale expressed in this opinion would be difficult to refute if sexual harassment law was explicitly reconceived as imposing liability for negligently failing to maintain a workplace free from sexual discrimination.

Last year, the New Jersey Supreme Court affirmed the result in Schmidt, but adopted an entirely different rationale. The supreme court stated that the exclusion in question "might well" bar coverage in the case, suggesting that no reasonable insured could expect coverage for vicarious liabilities when the employment practices exclusion excluded coverage for damages "arising out of" harassment. Despite this dicta suggesting a broad interpretation of the

86. See id. at 75-76.
89. See id. at 1018. In a companion case, the New Jersey Supreme Court held that a CGL policy exclusion for bodily injuries arising out of the course and scope of employment precluded coverage for an age discrimination claim, notwithstanding the carrier's failure to endorse the policy with an EPL exclusion, thus lending additional suggestion that this court is very predisposed to enforcing the EPL exclusion in a broad
exclusion, the supreme court expansively construed public policy to preclude enforcement of the exclusion since New Jersey law mandates that employers carry employer's liability coverage for bodily injuries that fall outside the workers' compensation system. Of greatest importance, the New Jersey Supreme Court openly acknowledged that mandating coverage under EL policies for bodily injury caused by sexual harassment will pose a problem of coordinating coverage with EPL policies, but then merely commented that the Commissioners of Insurance and Labor "may wish to work with the insurance industry to resolve or address this overlap." This unanimous decision of the New Jersey Supreme Court squarely presented the problem of overlapping insurance coverages in cases involving claims of sexual harassment, but then remained silent about how to resolve this potential conflict.

Despite the widespread adoption of EPL exclusions in EL policy forms, employers would have a stronger argument to obtain coverage for such claims under an EL policy if the courts imposed liability on employers for hostile work environment sexual harassment according to negligence principles. Although the exclusion specifically mentions discrimination and harassment, an employer could rely on favorable interpretive maxims to argue that only actions by the employer, and not negligent failure to prevent others from committing these acts, are included within the scope of this clause. Alternatively, state courts may determine that EL carriers cannot exclude this risk, due to the regulatory requirement that bodily injury caused by the employer's negligence in keeping the workplace free of this injurious behavior must be covered by the policy. Under either rationale, EL policy coverage may be triggered, requiring insurers to address complex issues regarding coordination of multiple available coverages.

2. Coverage for Sexual Harassment Under the Commercial General Liability Policy

During the past twenty years, employers have regularly sought coverage for employment-related disputes under their general liability and "drop down" umbrella policies, but they have faced a

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90. See Schmidt, 713 A.2d at 1018.
91. Id. at 1018-19.
number of obstacles under the terms of these policies. Moreover, coverage disputes and litigation subsided dramatically as general liability insurers adopted an EPL exclusion. However, the changing character of sexual harassment liability suggests that employers may again have good reason to assert potential coverage under general liability policies.

a. Coverage A: bodily injury caused by an occurrence

The CGL policy provides coverage for bodily injury caused by an occurrence in Coverage A. Bodily injury generally is defined as "injury, sickness or disease," and an occurrence generally is defined as an "accident." Although many employment claims do not raise plausible allegations of bodily injury, sexual harassment cases are far more likely to involve physical contact that results in injury. The traditional rule that emotional upset resulting from an employment action does not constitute a bodily injury unless it is manifested as independent physical impairments (such as migraine headaches or sleeplessness) has largely given way. Some courts find that emotional distress caused by physical abuse is an outgrowth of a "bodily injury," thus providing an argument in favor of coverage in sexual harassment cases. A growing number of courts have rejected the limitation to physically manifested injuries altogether, reasoning that the policy definition of bodily injury does not require physical manifestation and concluding that emotional distress is as much an affliction of the body as a physically manifested symptom. Cases of sexual harassment that involve offensive

94. See, e.g., Wayne Township Bd. of Sch. Comm’rs v. Indiana Ins. Co., 650 N.E.2d 1205, 1211 (Ind. Ct. App. 1995) (ruling that allegations that a principal sexually molested a student in his office triggers coverage because a claim of emotional trauma caused by physical abuse comes within the policy definition of bodily injury).
touching and other physical activities that lead to harm are likely to be considered within the scope of the grant of coverage for bodily injury. As courts expand the definition of bodily injury to include mental distress, even hostile environment cases not involving physical contact with the victim may be within coverage.

The difficulty facing most employers claiming coverage for employment-related disputes centers on the requirement that the bodily injury be caused by an occurrence, defined as an "accident." The requirement that bodily injury be caused by an accident is mirrored by an exclusion of coverage for any injuries "expected or intended from the standpoint of the insured." In the words of the Oregon Court of Appeals: "We do not believe that an average person would consider intentional discrimination to be an 'accident' or a 'condition which results in bodily injury neither expected nor intended.' Therefore, we hold that there is no coverage." Along these lines, courts have construed claims alleging sexual harassment as also alleging intentional acts for purposes of insurance coverage as a matter of law, regardless of whether the wrongdoer had any subjective expectation of injury. Even when the insured did not

96. Industrial Indem. Co. v. Pacific Maritime Ass'n, 777 P.2d 1385, 1388 (Or. Ct. App. 1989). But see Griffin, 1997 WL 567958, at *3-4 (denying summary judgment for the insurer as to claims by the plaintiff that she suffered emotional distress as a result of discrimination on account of her disabilities, since the record did not make clear an intent by the defendant to cause those injuries); Maine State Academy of Hair Design, Inc. v. Commercial Union Ins. Co., 699 A.2d 1153, 1157 (Me. 1997) (reversing summary judgment for the insurer because, although there may be an expectation of harm when engaging in sexual harassment, "bodily injury is not necessarily expected or intended by the perpetrator of unwanted sexual advances and wrongful discharge").

personally harass or discriminate against the plaintiff, but nevertheless is legally liable for the actions of a non-insured, one court has held that alleged injury is not an "accident" and was "expected or intended from the standpoint of the insured" if the insured "knew or should have known there was a substantial probability that non-consensual sexual contact was likely to result" from referring clients to work with a third person.98 However, when the underlying complaint alleges that the employer negligently responded to the discriminatory situation, or when disparate impact discrimination is the source of the claim, most courts have concluded that discrimination can be an occurrence.99


98. American Family Mut. Ins. Co. v. M.B., 563 N.W.2d 326, 329 (Minn. Ct. App. 1997) (finding an agent liable for sending models to work with a photographer employed by a separate corporation under the control of the agent when she had reason to know that the photographer would sexually assault and harass the models).

If liability for sexual harassment premised on a hostile work environment claim is reconceived as a negligent failure to satisfy a statutory duty, the employer's argument that such liability arises from an accident would be considerably strengthened. For example, a federal district court recently held that a sexual harassment claim against an employer for permitting one worker to harass a co-worker was covered under a general liability policy as to the insured employer because liability was premised on the employer's negligence. The court reasoned:

It is correct that Gastineau did not expressly allege a count of negligence against Fleet in his complaint. However, this is irrelevant when the standard of liability for a hostile work environment claim against an employer is negligence and Gastineau properly alleged negligent behavior on the part of Fleet.

In sum, the Seventh Circuit has made clear that, in order for an employer to discriminate against an employee who objectively and subjectively has been the victim of a hostile work environment, it must have known... about the discrimination... If the employer is negligent in this way, it can be found to have discriminated in violation of Title VII. Because the standard for employer liability for hostile work environment claims is negligence, we hold that Gastineau's hostile work environment claim against Fleet qualifies as an occurrence pursuant to its insurance policy.

This rationale is persuasive. Courts have properly found that an individual who engages in sexual harassment is acting intentionally as a matter of law, even if he did not subjectively intend or expect bodily injury to occur. However, if the general liability policy contains a "separation of insureds" clause, the employer's coverage must be assessed independently. In many cases of hostile work environment, the employer will face liability arising out of a situation

Ity for failure to make religious accommodation for employee is an occurrence because it is not predicated on an intentional act); School Dist. of Shorewood v. Wausau Ins. Cos., 488 N.W.2d 82, 87 (Wis. 1992) (finding that allegations of indirect discrimination due to the discriminatory practices of other agencies is an occurrence).


101. Id. at 636, 638.
that can properly be regarded as an "accident" from the standpoint of the corporate insured.

However, it is important to remember that insurance coverage is triggered by the allegations made by the third party plaintiff in her complaint, rather than the allegations that might have been pleaded. If the employee alleges only intentional wrongdoing and does not raise the possibility of recovery against the employer on a negligence theory, the carrier is within its rights to deny coverage. The Court of Appeals for the Fourth Circuit recently rejected the district court's determination that allegations of creating a hostile work environment as a matter of law cannot be an "accident" for purposes of triggering insurance coverage. 102 Nevertheless, the court affirmed summary judgment for the carrier because the complaint simply alleged that the supervisor was the agent of the employer and pleaded no facts to sustain a finding of negligence by the employer. 103 Because the allegations involved a supervisor who raped, assaulted, and harassed an employee, ending with the termination of her employment, negligence was unnecessary for prevailing on her claim.

In a similar case, the Ninth Circuit recently determined that an employer was not entitled to coverage when it was sued by an employee for sexual harassment because the complaint alleged only intentional wrongdoing by the employer. 104 The employee alleged that she was the victim of intentional discrimination that was "confirmed, ratified, approved and authorized" by the employer, that the employer acted "oppressively, fraudulently, and maliciously, in willful and conscious disregard" of her rights, and also that the employer was liable for "negligent supervision." 105 The court held that the allegations raised only claims of intentional wrongdoing, since negligent supervision under Oregon law requires proof that the employer knew of the wrongful conduct by its employees but failed to act. 106 The court concluded that the strongly worded complaint did not plead a negligence-related employment tort, even as a "lesser included offense." 107 Although the court's reasoning is persuasive

103. See id. at *4-5.
105. Id. at *1-2.
106. See id. at *2.
107. See id.
in light of the pleading before the court, the court erred by suggesting that vicarious liability for sexual harassment is not a covered occurrence as a matter of public policy.\textsuperscript{108}

Even if an employer satisfies the requirements of the insuring agreement by demonstrating that it is subject to a suit seeking damages for bodily injury caused by an occurrence, Coverage A contains an exclusion of coverage for suits seeking damages for bodily injury to an employee arising out of, and in the course of, employment. Most courts hold that bodily injury caused by discrimination "[arises] out of and in the course of employment by the insured" by definition, reasoning that the harm cannot occur without the existence of an employment relationship.\textsuperscript{109} Courts frequently note that the language of the exclusion is broad and unqualified, and does not, by its terms, exclude only those claims subject to the exclusive jurisdiction of the workers' compensation system. Obviously, under this interpretation the employer faces the possibility that a discrimination suit will not trigger coverage under the employer's CGL or

\textsuperscript{108} See id. The Ninth Circuit adopted a negligence standard for imposing liability on an employer for sexual harassment in the workplace when the employer "knew or should have known" of the behavior, but then proceeded to assess the potential for insurance coverage by assuming that the employer must act intentionally to some degree. "Thus, the rationale for denying coverage under a negligent supervision theory applies here as well: if the employer knew of the harassment and failed to take action, the resulting injury could not have been "unforeseen, unexpected, or unintended."" \textit{Id.} (emphasis added).

EL policies. On the other hand, by virtue of this potential gap in coverage, an employer can utilize the favorable maxims of insurance contract interpretation to limit the scope of the exclusion to the coverage otherwise provided by WC/EL policies if the CGL form was marketed in this manner. But, as the EPL market continues to grow rapidly, courts undoubtedly will become more predisposed to enforce the exclusion in light of the ready availability of insurance specifically designed for this risk.

Arguments for coverage of hostile work environment sexual harassment claims, notwithstanding the exclusion, have centered on the fact that harassing behavior often occurs both inside and outside the workplace. A majority of courts, nevertheless, have found that the liability of the employer arises out of the fact of the plaintiff's employment relationship. However, some courts have adopted a more narrow reading of the exclusion that permits coverage if the underlying suit seeks damages against an insured that is not the employing entity, or if the wrongdoer is acting outside the scope and course of their employment when they caused injury to the plaintiff. In any event, the employer may insist that its insurer provide a defense against an employment-related claim until


114. See, e.g., Maine State Academy of Hair Design v. Commercial Union Ins. Co., 699 A.2d 1153, 1158 (Me. 1997) (reversing summary judgment for insurer because the plaintiff did not allege that the acts of discrimination arose out of and occurred within the course of her employment); Bond Builders, Inc. v. Commercial Union Ins. Co., 670 A.2d 1388, 1391 (Me. 1996) (finding that the duty to defend is triggered, and not excluded, because there is a possibility that the assault by the plaintiff's fellow workers was not in the course of their employment); see also Western Heritage Ins. Co. v. Magic Years Learning Ctrs. & Child Care, Inc., 45 F.3d 85, 90 (5th Cir. 1995) (ruled that exclusion only applies to corporate employer, but husband and wife "owners" who were sued in their individual capacities for harassment are entitled to coverage as named insureds on the policy). In Western Heritage, however, the court noted that the

Although an employer's liability for hostile work environment sexual harassment is premised on the existence of an employment relationship with the injured party, the bodily injury suffered by the plaintiff does not necessarily arise out of and in the course of employment. As courts are now acknowledging, the agency rationale for imposing liability in hostile work environment sexual harassment cases is rather weak because the offensive conduct in question is rarely within the course and scope of the wrongdoer's employment. Therefore, it appears logical from the standpoint of the insured that the injury to the complaining employee does not arise in the course or scope of her employment. Moreover, courts view bodily injuries resulting from sexual harassment as outside the quid pro quo of the employment relationship, and therefore noncompensable under workers' compensation laws. Given this context, employers can plausibly argue that the scope of the exclusion is ambiguous, and therefore the exclusion should not apply to liability for hostile work environment claims.\footnote{116}{The United States District Court for the Southern District of New York recently held that an employer is entitled to coverage of sexual harassment that included rape, since the rape did not "arise out of the insureds' business" as required under the policy. Nevertheless, the court held that the employer was not entitled to coverage for other harassing conduct by its employee because those injuries arose out of the employment relationship and therefore were excluded. See Collins Bldg. Servs., Inc., 1999 WL 259519, at *6.}

\textit{b. Coverage B: personal injury caused by an offense}

The insuring agreement of Coverage B provides coverage for damages resulting from a "personal injury" or "advertising injury," without limiting coverage to accidental occurrences. The policy definition of "personal injury" makes clear that Coverage B provides coverage for non-bodily injuries arising out of one or more of the listed torts, including invasion of privacy by publication, libel, and slander. Given the many obstacles to asserting coverage under Coverage A, and the increasing frequency of defamation claims being added to employment discrimination claims, many employers rely upon Coverage B to demand a defense of the suit.
The primary advantage of pursuing coverage under Coverage B is that this coverage is triggered by certain intentional "offenses" rather than by "occurrences," thus eliminating the requirement that the injuries in question be the result of an accident.\textsuperscript{117} Many older umbrella policy forms expanded the coverage for personal injuries by specifically adding "discrimination" to the list of covered torts, thereby providing an obvious trigger of coverage.\textsuperscript{118} However, newer policies are either unlikely to contain this express coverage of discrimination or to include the coverage only with explicit and substantial limitations.\textsuperscript{119} Consequently, employers often use alle-

\textsuperscript{117} This distinction between Coverage A and Coverage B is sometimes ignored by insurance carriers seeking to avoid coverage obligations by arguing that the suit concerns intentional wrongdoing. \textit{See Missouri Property \& Cas. Ins. Guar. Ass'n v. Petrolite Corp.}, 918 S.W.2d 869 (Mo. Ct. App. 1996). In \textit{Missouri Property}, the insurance carrier refused to defend or indemnify the employer once a determination was made that the employer's actions constituted a "willful" violation of the ADEA. \textit{See id.} at 870. The insurer claimed that the employer's behavior was intentional and therefore could not be an occurrence, but the court properly found that the employer was seeking coverage under Coverage B which pertains to personal injuries caused by intentional torts. \textit{See id.} at 873. The court noted the absurdity of the insurer's interpretation: "Reading the 'personal injury' definition and the 'occurrence' definition together, the policy apparently provides coverage for 'unintentional intentional torts' not committed by or at the direction of the insured . . . the result of such language is 'complete nonsense.'" \textit{Id.} The easy answer to this apparent dilemma is that in a carefully drafted policy, Coverage B does not require an occurrence, but instead provides coverage for personal injuries caused by an "offense." In some policy forms the underwriters have not paid attention to the different character of these coverages, resulting in an incoherent grant of coverage that must be interpreted in favor of the insured. \textit{See Lesser v. State Farm Fire and Cas. Co.}, No.CV-95-4154-KMW, 1996 WL 339854, at *6 (C.D. Cal. June 14, 1996).

Of course, a particular carrier may draft its policy form to preclude coverage of liability for intentional torts even under the personal injury coverage. \textit{See Edquist v. Insurance Co. of N. Am.}, No. C6-95-1111, 1995 WL 635179, at *2-3 (Minn. Ct. App. Oct. 31, 1995) (unpublished opinion) (ruling that a business auto portion of the insured's liability package collapsed bodily injury and personal injury into one designation (personal injury) that was covered only if caused by an "occurrence" and arising out of the use of the auto, rendering intentional torts committed by a supervisor against a female employee while in the company car uninsured).

\textsuperscript{118} \textit{See Solo Cup Co. v. Federal Ins. Co.}, 619 F.2d 1178, 1182 (7th Cir. 1980); Clark-Peterson Co., v. Independent Ins. Ass'n, 492 N.W.2d 675, 677 (Iowa 1992) (en banc); \textit{see also} United States Fire Ins. Co. v. Caulkins Indiantown Citrus Co., 931 F.2d 744, 749-50 (11th Cir. 1991) (denying an attempt by an umbrella carrier to obtain contributions from the employer's CGL carriers because the CGL carriers had more carefully drafted their policies to exclude discrimination from coverage); \textit{cf. American Motorists Ins. Co. v. Allied-Sysco Food Servs., Inc.}, 24 Cal. Rptr. 2d 106, 112 (Cal. Dist. Ct. App. 1993) (finding that personal injury defined to include "racial or religious discrimination" must be read according to its plain meaning as not including all Title VII liabilities).

gations of defamation made in connection with the underlying discrimination allegations to trigger the duty to defend.\textsuperscript{120}

Given the broad duty to defend any action that could potentially result in a covered verdict, some courts will construe sexual harassment complaints alleging sexist comments about the plaintiff as triggering this duty, even if no cause of action for defamation has been formally pleaded.\textsuperscript{121} Coverage in these circumstances is not assured, however, since many courts will not read into the complaint defamation allegations that are not raised explicitly, nor will they construe discriminatory behavior as defamatory in and of itself.\textsuperscript{122}

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limited by exclusion of personal injury arising on the basis of race, creed, color, sex, age, national origin, or termination of employment did not encompass allegations of sexual discrimination); Kline v. Kemper Group, 826 F. Supp. 123 (M.D. Pa. 1993), aff'd, 22 F.3d 301 (3d Cir. 1994); Transport Ins. Co. v. Lee Way Motor Freight, Inc., 487 F. Supp. 1325, 1327 (N.D. Tex. 1980) (describing the carrier's change in umbrella policy forms between 1972 and 1973, which stopped including discrimination in the definition of personal injury). One limitation is to include coverage only for discrimination not committed by the insured or at its discretion, in an attempt to provide coverage only for liabilities incurred by an employer on account of the acts of its agents. See Town of South Whitley v. Cincinnati Ins. Co., 724 F. Supp. 599, 604 (N.D. Ind. 1989) (finding that exclusion of discrimination "committed by you" in an umbrella policy is enforceable because the alleged discriminatory refusal to hire was an action by the insured Town Board of Trustees, rather than by an agent of the Town), aff'd, 921 F.2d 104 (7th Cir. 1990). Another limitation provides coverage for discrimination liabilities generally, but excludes liabilities for employment discrimination. See Teague Motor Co., Inc. v. Federated Serv. Ins. Co., 869 F.2d 1130, 1132-33 (Wash. Ct. App. 1994) (finding that limited coverage for non-employment discrimination in umbrella policy is neither ambiguous nor illusory, even though all sexual harassment claims would necessarily be excluded).

120. See, e.g., EEOC v. Southern Publ'g Co., 894 F.2d 785, 790-91 (5th Cir. 1990) (finding that allegations of defamation against employer president regarding his remarks about the reasons why the plaintiffs were terminated falls within the coverage of slander); Maine State Academy of Hair Design Inc. v. Commercial Union Ins. Co., 699 A.2d 1153, 1159 (Me. 1997) (finding allegations of damage to professional reputation creates at least the potential for coverage under Coverage B of the policy).

121. See, e.g., United States Fire Ins., Co., 931 F.2d at 751 (finding that allegations of harassment and discrimination by means of false and defamatory (sexist) comments about the plaintiff fall within the coverage of slander); Duff Supply Co., 1997 WL 255483, at *6-8 (finding that allegations that the plaintiffs were generally referred to as "sluts" and "whores" raised the potential for a recovery for defamation, even though not separately pleaded); American Guar. & Liab. Ins. Co. v. Vista Med. Supply, 699 F. Supp. 787, 793 (N.D. Cal. 1988).

122. See Farr's Stationers, Inc. v. State Farm Fire & Cas. Co., 114 F.3d 1194 (9th Cir. 1997). The court stated that:

Under California law, however, where, as here, the complaint does not expressly contain a cause of action for defamation, a duty to defend can be triggered only where the extrinsic facts clearly put the insurer on notice that there is potential for defamation liability. There is no indication in this case that, by asserting in her supplementary declaration that she had been called a "bitch"
Additionally, plaintiff employees often include allegations of false imprisonment in their sexual harassment complaints, another enumerated intentional tort under the definition of "personal injury" in Coverage B. However, not every unwelcome physical encounter amounts to a false imprisonment, and so the facts, as pleaded in the complaint, will trigger coverage only if they constitute the tort of false imprisonment.123 Finally, the exclusions in Coverage B are generally less pertinent to employment litigation, but the exclusion of personal injury "arising out of the willful violation of a penal statute or ordinance committed by or with the... consent of the insured" designates an uninsurable risk that may be relevant to some discrimination claims.124

in front of other sales representatives, the plaintiff was seeking damages on account of injury to her reputation as a result of a false statement of fact.

*Id.* at 1195; *see also* Moore *v.* Continental Ins. Co., 51 Cal. Rptr. 2d 176, 182 (Cal. Ct. App. 1996) (finding no potential coverage because the plaintiff did not plead independent allegations of defamation or false imprisonment, and factual descriptions of acts of sexual harassment, such as being backed into a corner and fondled, are insufficient to trigger these coverages since "the allegations in question do no more than reflect the reality that such harassment can take place behind closed doors or in the presence of coworkers"); American Motorists Ins. Co. *v.* Allied-Sysco Food Servs., Inc., 24 Cal. Rptr. 2d 106, 112 (Cal. Ct. App. 1993) (finding that personal injury, defined to include "humiliation," is not triggered by discrimination complaint, since any humiliation experienced by the employee was a result of sex discrimination, a non-covered risk); Fieldcrest Cannon, Inc. *v.* Fireman's Fund Ins. Co., 477 S.E.2d 59, 68-70 (N.C. Ct. App. 1996). A complaint alleging sexual harassment does not automatically trigger personal injury coverage for libel and slander. *See* Lindsey *v.* Admiral Ins. Co., 804 F. Supp. 47, 52 (N.D. Cal. 1992); Omak Indus., Inc. *v.* Safeco Ins. Co., 590 F. Supp. 114, 120 (D. Or. 1984).

123. *See, e.g.*, Cornhill Ins. PLC *v.* Valsamis, Inc., 106 F.3d 80, 85 (5th Cir. 1997) (finding that allegations that a supervisor attempted to force himself on plaintiff employee in a supply room do not trigger coverage because there was no allegation that the door was locked or that the supervisor detained her in the room for any period of time by use of physical force or threats).

124. This exclusion is likely intended to exclude civil liabilities arising out of illegal actions. *See* MGM, Inc. *v.* Liberty Mut. Ins. Co., 855 P.2d 77, 80 (Kan. 1993) (enforcing exclusion by denying coverage to an employer that subjected its employees to wiretaps that were illegal under the federal criminal code). It seems unlikely that this exclusion would apply to any violation of a statutory scheme. *See, e.g.*, American Justice Ins. Reciprocal *v.* Cates, No. 95-5038, 1996 WL 711516, at *6 (D.S.D. Feb. 13, 1996) (holding that the employer could obtain coverage even though its employee, a jailer who sexually assaulted an inmate, was convicted of criminal charges, since the activity also constituted an independent violation of the inmate's civil rights); Bensalem Township *v.* Western World Ins. Co., 609 F. Supp. 1343, 1350 (E.D. Pa. 1985) (finding that a willful violation of the ADEA does not bring the matter within the exclusion because "willful" is defined differently in the two usages).
c. The ISO exclusion of employment-related practices liability

During the past ten years, employers have been able to trigger the duty to defend when Coverage A is ambiguously drafted, when Coverage B expressly includes discrimination, or when the underlying complaint raises other torts included within the definition of personal injury. In response to this rapidly expanding source of liability, the Insurance Services Office, Inc. ("ISO") prepared an "Employment-Related Practices Exclusion" endorsement designed to amend both Coverage A and Coverage B, by removing employment discrimination litigation from the scope of basic coverage provided by the CGL policy. Generally, insurers have been successful in enforcing this type of exclusion, and so it should be expected that general liability policies will include such clauses with increasing frequency. In Frank & Freedus v. Allstate Insurance

125. Insurance Services Office, Inc. is a national insurance industry service organization that develops and files coverage forms, promulgates advisory loss costs, and performs other services for and on behalf of its member companies.

126. See Joseph P. Monteleone, Coverage Issues Under Commercial General Liability and Directors' and Officers' Liability Policies, 18 W. New Eng. L. Rev. 47, 69-70 (1996). The new provision excludes coverage of bodily injury or personal injury arising out of any refusal to employ that person, termination of that person's employment, or "employment-related practices, policies, acts or omissions, such as coercion, demotion, evaluation, reassignment, discipline, defamation, harassment, humiliation, or discrimination directed at that person." Id.

Co., the California Court of Appeals adopted a traditional “plain meaning” approach in applying the ISO clause to a case involving allegations of defamation:

Nor is the term “employment-related” ambiguous because it is not specifically defined in the policy. The term is not technical in nature. It is used in its ordinary sense, i.e., related to employment. As a term, it modifies the specified acts (including defamation) as well as the terms “practices, policies, acts or omissions.” The clear meaning of subdivision (2) of the exclusion is coverage for practices, policies, acts or omissions which are related to employment, including employment-related defamation.

However, in light of the time-honored rule that exclusions are to be narrowly construed against the insurer, the comprehensive employment-related practices exclusion will be subject to judicial interpretation that may limit its application to sexual harassment liability.

Lawson v. Strauss provides a good example of the “holes” that may remain in the exclusion. In Lawson, the Louisiana Court of Appeals held that the new ISO exclusion did not defeat coverage when women employees sued several doctors and their Eye Center employer for assault and battery and intentional infliction of emotional distress on account of harassing behavior. The court found that the doctors were not carrying out their employment duties when engaged in this harassing behavior. The court reasoned

129. Id. at 684; see also Oak Ridge Park, Inc. v. Scottsdale Ins. Co., No.Civ.A. 98-3348, 1999 WL 731417, at *4 (E.D. La. Sept. 17, 1999) (finding that when an employee who explains discriminatory criteria for showing real estate to prospective purchasers (while secretly being filmed for television) later sues his employer for allegedly defamatory comments made by the employer’s attorney, the defamation suit is excluded from the employer’s coverage because “but for” the defense of the underlying discrimination suit, the defamatory comments would not have been made); International Bhd. of Elec. Workers, Local 1357 v. American Int’l Adjustment Co., 955 F. Supp. 1218, 1222-23 (D. Haw. 1997) (summarizing the scope of the exclusion as applicable to any claims arising from the “employment relationship” in the course of entering summary judgment for the carriers).
that the "mere fact that an employee is involved does not mean that a 'personnel practice,' etc. is at issue or the exclusion would have been written to simply state that no claims by employees are covered."\(^{133}\) This rationale subsequently was adopted in a case involving an employee who was driven to a hotel, questioned about inventory shortages, and then terminated. The court held that the allegation of false imprisonment "arose solely in the context of loss prevention" efforts rather than as a personnel practice.\(^{134}\)

Additional problems arise if the insurer simply adds an employment practices exclusion to an existing policy without carefully integrating it into the other provisions. For example, where an insurer specifically provided coverage for "discrimination," but later in the policy excluded liabilities for personal injuries "directly or indirectly related to the dismissal of any employee of the Insured," a California court found that the apparent effort to disclaim all liabilities related to employment practices was unsuccessful:

The claims of Smith in the underlying action have no relation at all to a dismissal from employment; she alleged, in fact, that she resigned after being harassed. . . . The mere act of unintentionally

\(^{133}\) Id.; see also HS Servs., Inc. v. Nationwide Mut. Ins. Co., 109 F.3d 642 (9th Cir. 1997). The court held that "for an act or omission to be 'employment-related' the relationship must be direct and proximate." Id. at 647. The court further found that an allegation by a terminated employee now competing with the insured, that the insured defamed him three months after the termination of employment, is potentially within coverage because "the statements were not made in the context of [his] employment." Id.; see also Weinstein Supply Corp. v. Home Ins. Co., No. CIV.A. 97-7195, 1999 WL 310590, at *4 (E.D. Pa. May 10, 1999) (holding that suit for post-termination defamation was excluded from coverage because the employee specifically pleaded that the defamatory statements were made for the purpose of covering up the insured employer's discriminatory reasons for firing him); Berman v. General Accident Ins. Co. of Am., 671 N.Y.S.2d 619, 623 (N.Y. Sup. Ct. 1998) (finding that post-termination defamation against former employee, who is now competing against the insured, is barred by the exclusion because, irrespective of the insured's motivation for making the defamatory statements, they "constituted an assessment of Dr. Attas's performance as an employee of the clinic and an explanation of why she was discharged. As such, these statements fall squarely within the policy exclusion"); Barnes v. Employers Mut. Cas. Co., No. 03A01-9812-CIV-00403, 1999 WL 366587, at *3 (Tenn. App. June 8, 1999) (holding that a suit for malicious prosecution that was brought by a former employee who was terminated for theft and then arrested and charged after the employer reported the case to police was within the personal injury coverage and was outside the scope of the EPL exclusion because the injury "did not arise out of a refusal to employ a person, nor did it arise out of termination of employment, because [the former employee] brought suit against the plaintiff for malicious prosecution due to his arrest and subsequent prosecution, not his termination of employment").

discriminating against someone in violation of the law cannot be
an "offense" negating the very coverage granted to the insured
for claims of "discrimination" by the policy itself. This interpre-
tation by Zurich of its policy would result in an entirely fictional
grant of coverage . . . . If Zurich desires to market and sell a
policy which provides coverage for claims of discrimination, but
excludes all claims of discrimination by employees of any in-
sured, it must say so in clear, unambiguous policy language
. . . .

This rationale is particularly persuasive with regard to "discrimina-
tion" coverage since discrimination essentially is a liability that
arises only in the employment context. In contrast, this rationale
may not be adopted by courts assessing whether the duty to defend
is triggered by allegations of another enumerated tort in Coverage
B.

In a related vein, the ISO EPL exclusion does not specifically
enumerate all torts included within the scope of Coverage B. In
light of this curious drafting oversight, a federal district court re-
cently held that the exclusion does not preclude coverage for allega-
tions of false arrest and imprisonment arising out of the
employment of the plaintiff, despite the "catch-all" language at the
end of the exclusion.

That is, the policy defines "personal injury" coverage (Coverage
B) as including "false arrest, detention or imprisonment" and
other specifically enumerated conduct. The exclusion then spe-
cifically excludes employment-related conduct, such as defama-
tion, from Coverage B, but does not specifically exclude false
arrest or imprisonment from Coverage B. Thus, false arrest or
imprisonment is not specifically excluded in the employment-re-
lated context, and the insured . . . undoubtedly had a reasonable
expectation of coverage for claims of false arrest or
imprisonment.

Although harassment and discrimination are specifically mentioned
in the exclusion, victims of hostile work environment sexual haras-

136. See, e.g., Frank & Freedus v. Allstate Ins. Co., 52 Cal. Rptr. 2d 678, 684 (Cal.
    Ct. App. 1996) (finding no ambiguity in providing coverage for defamation and then
    later excluding coverage only for defamation that is related to employment).
137. See supra note 125 and accompanying text for an explanation of the ISO and
    Employment-Related Practices Exclusion.
139. Id.
ment often allege subsidiary causes of action, such as false arrest or false imprisonment, thereby potentially triggering coverage.

If an employment practices exclusion is more narrow than the ISO language, it is more susceptible to interpretations that benefit the insured. For example, in *Connecticut Interlocal Risk Management Agency v. Town of West Hartford*, the trial court held that an exclusion of claims "arising out of your official employment policies or practices (including but not limited to claims due to demotion, selection, dismissal, failure to promote, and similar activity)" did not absolve the insurer of the duty to defend a complaint that alleged defamatory comments about an employee that in part were unconnected with any personnel action. The court noted that the exclusion language "contrasted sharply" with the ISO language. Moreover, the court opined that even defamatory comments in connection with an investigation of the employee's alleged sexual harassment would trigger the duty to defend, because such a claim "is not similar to a claim arising from a change in employment status."

In conclusion, the ISO employment-related practices liability exclusion is far-reaching, but not all-encompassing. An employer can always argue that the carrier could easily have used broader exclusionary language, such as "any and all claims for damages made by an employee, applicant for employment or former employee," and that the carrier's effort to limit the exclusion more precisely creates ambiguities that must be construed against the carrier. Nevertheless, the cases finding coverage despite the ISO exclusion tend to involve odd fact situations or complaints with multiple causes of action. As a general rule, the courts construe the exclusion as precluding coverage for employment-related disputes. Because the exclusion was drafted with the specific goal of excluding coverage of allegations of sexual harassment, and lists both harassment and discrimination as excluded claims, it would appear highly unlikely that a court would find coverage for claims of sexual harassment.

A recent case demonstrates how an employer can argue for coverage despite the ISO exclusion when the injured employee alleges facts that essentially constitute sexual harassment but pleads

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141. See id. at *3-4.
142. See id. at *4.
143. Id.
alternative causes of action. In *Mactown, Inc. v. Continental Insurance Co.*, an employee sued a co-worker for battery, alleging that he placed his hands on her neck and made sexual comments about her. The employee also sued her employer, under respondeat superior liability, for the battery and negligent retention of the wrongdoer. The employer's insurer contended that it was absolved of liability due to a specific exclusion of liabilities arising out of battery. However, the court found that only the respondeat superior claim arose out of the battery, and that "the negligent retention claim does not fall under the language of this" exclusion. The court then considered and rejected the carrier's claim that coverage under a different policy was precluded by an employment-related practices exclusion. The court stated:

> These provisions are not applicable in this case. Aside from the fact that Continental is relying on the "harassment" exclusion in both provisions, even though none of the claims of [the employee's] complaint are for "harassment," there is a severability clause in the policy which governs. . . . The effect of the severability clause is that allegations of battery by [a co-employee] are not imputed to [the employer] so as to bar coverage. . . . Thus, [the employer's] liability, if any, under the negligent retention count is separate and apart from [the co-employee's] alleged intentional act.

The court plainly interpreted the exclusion to apply only to intentional acts by the employer, implicitly finding that the scope of the exclusion was ambiguous with respect to claims of direct negligence against the employer.

This position is surely correct, although some courts have refused to draw the distinction between the intentional acts of the wrongdoer and the entirely distinct negligent acts of the employer. The refusal to draw this distinction, especially in light of

145. *See id.* at 290.
146. *See id.*
147. *See id.* at 291.
148. *Id.*
149. *See id.*
150. *Id.* at 292.
151. *See id.* at 291.
152. *See Gisentaner v. United States Fire Ins. Co.*, No. 01-96-00466-CV, 01-97-00233-CV, 1999 WL 339326, at *8 (Tex. App. May 24, 1999) (unpublished opinion). In several cases the Appellate Division of the New York Supreme Court has construed all allegations arising out of intentional sexual abuse or harassment as being outside the scope of occurrence coverage. In *Public Service Mutual Insurance Co. v. Camp Raleigh*,
the clear imperative to interpret insurance policies in favor of coverage, amounts to an unarticulated decision that public policy precludes insurance coverage when sexual harassment or sexual abuse is involved. In the next section I demonstrate that a negligence-based imposition of liability for hostile work environment will also affect the public policy analysis of insurance coverage.

B. *The Public Policy Defense to Coverage No Longer Will be Viable if Liability for Hostile Work Environment Sexual Harassment is Governed by Negligence Principles*

Although employers may have stronger arguments for coverage under CGL and EL policies if employer liability for hostile work environment sex discrimination is analyzed in terms of negligence, carriers may argue that public policy precludes such coverage.\(^{153}\) It is well established that courts will not enforce contracts that are contrary to public policy, regardless of the parties’ clear intent to be bound to the contractual terms.\(^ {154}\) Insurance contracts are clearly subject to this general rule.\(^ {155}\) This limitation on the parties’ freedom to contract is premised on the fact that a contract is never entirely a private matter, especially if the contract is a liability insurance policy.\(^ {156}\) By definition, a contract of liability insurance affects the injured third party seeking compensation from the insured by providing a source of funds to satisfy a judgment. Obviously, there is a strong public policy in favor of ensuring that

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Inc., 650 N.Y.S.2d 136, 137 (N.Y. App. Div. 1996), the court found no potential for coverage when a camp was sued for negligent hiring and retention, since the camp counselor was sued for intentional acts of sexual molestation. For other cases discussing negligent hiring claims, see Mattress Discounters of New York, Inc. v. United States Fire Ins. Co., 674 N.Y.S.2d 106, 107 (N.Y. App. Div. 1998) (finding that assault and battery by co-employee precludes coverage of employer for claims of negligent hiring and supervision); Green Chimneys Sch. for Little Folk v. National Union Fire Ins. Co., 664 N.Y.S.2d 320, 321 (N.Y. App. Div. 1997) (holding that sexual harassment and retaliatory discharge precludes coverage of employer for claims of negligent hiring and supervision); see also SCI Liquidating Corp. v. Hartford Fire Ins. Co., 181 F.3d 1210, 1216 (11th Cir. 1999) (finding that allegation of negligent retention arising out of claims of intentional sexual harassment, assault, and battery is not an “occurrence” under Georgia law).

153. See, e.g., B&E Convalescent Ctr. v. State Compensation Ins. Fund, 9 Cal. Rptr. 2d 894, 910 (Cal. Ct. App. 1992) (finding that the EL policy did not exclude coverage for bodily injury that is caused by discrimination, but holding that coverage is precluded for reasons of public policy despite the policy terms).


156. *See Farnsworth, supra* note 154, § 5.1.
injured parties are compensated to the fullest extent possible. The contract might also affect other persons, however, if the existence of insurance encourages an insured to intentionally harm others by absolving the insured of financial accountability.\textsuperscript{157} It is equally obvious that there is a strong public policy in favor of reducing injurious behavior and requiring that certain wrongdoers bear the full consequences of their actions.

The public policy defense, when used as a limitation on promised coverage in an insurance policy, amounts to a decision on the facts of a particular case that the public policy in favor of compensating injured parties is outweighed by the public policy in favor of preventing future injuries.\textsuperscript{158} Thus, courts deem certain claims to be uninsurable, despite the undesirable effect of eliminating a source of funds to satisfy any judgment obtained by an injured third party claimant. The general rule in this regard, known as the principle of "fortuity," is that "a contract of insurance to indemnify a person for damages resulting from his own intentional misconduct is void as against public policy and courts will not enforce such a contract."\textsuperscript{159} As recently explained by one court, among "the rationales for the public policy [against coverage for harms resulting from intentional acts] is the principle that an insured should not profit from his own wrongdoing. Another important rationale is to prevent wrongful conduct which may be more likely to occur because the activity is covered by insurance."\textsuperscript{160} Thus, when courts invoke public policy to bar coverage, the decision involves moral condemnation of the actor causing harm, or a pragmatic focus on reducing harmful behavior, or both.

When assessing the availability of insurance coverage it is important to read "intentional" narrowly in light of these public inter-

\textsuperscript{157} See Ranger Ins. Co. v. Bal Harbour Club Inc., 549 So. 2d 1005, 1007 (Fla. 1989) ("The rationale underlying . . . [the public policy doctrine] is that the availability of insurance will directly stimulate the intentional wrongdoer to violate the law."). Based upon this rationale, for example, courts will not permit a party to insure against liabilities it incurs by engaging in criminal conduct. See, e.g., State Farm Fire & Cas. Co. v. Baer, 745 F. Supp. 595, 597-98 (N.D. Cal. 1990), aff'd, 956 F.2d 275 (9th Cir. 1992).

\textsuperscript{158} See Ranger Ins. Co., 549 So. 2d at 1007.

\textsuperscript{159} Dixon Distrib. Co. v. Hanover Ins. Co., 641 N.E.2d 395, 401 (Ill. 1994). This public policy doctrine may be judicially acknowledged, or in some cases, directly stated in legislation. See, e.g., CAL. INS. CODE § 533 (West 1993); MASS. GEN. LAWS. ch. 175, § 47 (1994).

ests. Many courts recognize that public policy does not prohibit insurance coverage for all liabilities incurred due to intentional torts, but instead precludes coverage only for liabilities arising out of conduct intended to cause harm. Put differently, public policy is implicated only when an employer seeks indemnification for injuries that it intended to inflict, and not when an employer seeks coverage for intentional actions that have resulted in injuries.\textsuperscript{161} It should be apparent that a revised understanding of the grounds for attributing liability to employers for hostile workplace sex discrimination should have an impact on the public policy analysis of the availability of insurance coverage.

The circumstances under which courts will void coverage on the grounds of public policy have been carefully considered in a number of cases involving discriminatory employment practices. These cases exemplify the fundamental tension between the two important public policies at stake: leaving third-party plaintiffs without recourse to funds contractually owed by the defendant employer, and permitting an employer to purchase insurance against prospective liability for discrimination against employees and applicants for employment. Title VII poses subtle issues in light of two salient features of the statute. First, liability may exist even in the absence of a specific intent to cause harm by discrimination.\textsuperscript{162} Second, the statute is structured as a public civil rights act rather than a purely compensatory scheme to aid injured parties. Although the courts have had little difficulty in concluding that insurance coverage for unintentional “disparate impact” liability is not precluded by public policy, the insurability of disparate treatment discrimination has proved to be more difficult to resolve satisfactorily.

When the underlying complaint against the employer alleges “disparate impact” discrimination, courts generally hold that the

\textsuperscript{161} This distinction was drawn in Lumbermens Mutual Casualty Co. v. S-W Industry, Inc., 39 F.3d 1324 (6th Cir. 1994), where the court interpreted the policy language defining a covered occurrence as being neither “expected nor intended” as preserving “the element of ‘fortuity’” by preventing insureds from using liability coverage as a shield for the consequences of their anticipated intentional conduct. See id. at 1331. The court distinguished this narrow limit on coverage from the “broader range of losses” constituting intentional torts and held that the employer’s insurer must indemnify the employer for compensatory damages paid to an employee after suffering a jury verdict for an intentional tort. See id.

\textsuperscript{162} See Griggs v. Duke Power Co., 401 U.S. 424, 431 (1971) (holding that Title VII was directed against discriminatory effects in the workplace, as well as intentionally discriminatory actions by employers). In the lexicon of discrimination law, the former cases involve “disparate impact,” whereas “disparate treatment” is involved in the latter cases.
existence of liability insurance does not undermine the strong public policy against discrimination embodied in Title VII. The court stated:

We do not think that allowing an employer to insure itself against losses incurred by reason of disparate impact liabilities will tend in any way to injure the public good, which we equate here with that equality of employment opportunity mandated by Title VII. To the contrary, the fact of insurance may be helpful toward achieving the desirable goal of voluntary compliance with the Act.


166. See Andover Newton Theological Sch., Inc. v. Continental Cas. Co., 930 F.2d 89, 93 (1st Cir. 1991). The court found that "intent" under the ADEA included a recklessness disregard of the employee's civil rights, and therefore concluded that "Massachusetts public policy does not bar insurance coverage of an employment action solely because it is found to violate the ADEA in an individual disparate treatment case." Id. As explained by the court, "Massachusetts law only proscribes coverage of acts committed with the specific intent to do something the law forbids." Id. at 92 n.3; see also Ron Tonkin Chevrolet Co., Inc. v. Continental Ins. Co., 870 P.2d 252, 254 (Or. Ct. App. 1994) (holding that liability for failing to make a reasonable religious accommodation does not require a finding of intentional actions, and so insurance coverage was permitted); BLaST Intermediate Unit 17 v. CNA Ins. Co., 674 A.2d 687, 690-91 (Pa. 1996) (holding that negligent violations of the Equal Pay Act could not be conditioned, but that public policy did not preclude insurance coverage of the damage award).

167. See Texas Dept' of Community Affairs v. Burdine, 450 U.S. 248, 252-53
for intentional discrimination would undermine the strong public policy against discrimination. A leading case adopting this view in the context of housing discrimination is *Ranger Insurance Co. v. Bal Harbour Club, Inc.*

The Florida Supreme Court held that a complaint alleging that a country club discriminated against Jewish applicants, by precluding them from purchasing a home in an area that required club membership, could not trigger the coverage provisions of the club’s liability policies for reasons of public policy. The court employed a two-part test for weighing the public policies at stake, first inquiring whether the existence of insurance coverage stimulates discrimination, and second, assessing whether the underlying anti-discrimination statute is intended primarily to compensate the victim or to deter wrongdoing. Because religious discrimination, unlike other intentional wrongdoing such as assault and battery, does not yield substantial deterrents independent of civil liability, the court found that the existence of insurance would insulate those persons wishing to “indulge their own preference for discrimination at little risk to themselves.” Moreover, the court found that anti-discrimination statutes primarily are intended to deter discriminatory behavior as a matter of civil rights law, and that aggrieved persons would not be left without adequate remedy in the absence of insurance coverage since most suits are brought against commercial enterprises.

Consequently, the Florida Supreme Court held that permitting insurance coverage of religious discrimination in housing would violate the public policies and underlying purposes of the statutes in question. Although *Ranger* does not directly consider the insurability of liabilities arising under employment discrimination statutes, other courts have adopted the *Ranger* court’s analysis when considering whether disparate treatment employment discrimination is insurable.

 Courts also have interpreted state statutes precluding (1981) (noting that under a “disparate treatment” claim, the employee has an affirmative burden of production and the ultimate burden of proof regarding the employer’s discriminatory intent).

168. 549 So. 2d 1005 (Fla. 1989).

169. See id. at 1009.

170. See id. at 1007.

171. Id. at 1008 (quoting Western Cas. & Sur. Co. v. Western World Ins. Co., 769 F.2d 381, 385 (7th Cir. 1985)).

172. See id. at 1009.

insurance coverage for intentional wrongdoing, such as section 533 of the California Insurance Code, as a direct statement of public policy that precludes coverage for sexual harassment liability. This public policy interest is construed broadly, such that coverage is precluded even if the employee alleges negligent causes of action arising out of allegations of sexual harassment.

Despite the *Ranger* line of authority, some courts have

charge was excluded from coverage under the terms of the policy, the court declared (in dicta) that insurance coverage for intentional discrimination is void as against public policy:

Aetna argues, and this court agrees, that the public policy of the State of Rhode Island as articulated in the Fair Labor Practices Act, militates against judicial creation of a safe harbor within which Foxon may presumably violate the law at will with impunity. Such a result would do violence to the public policy of the state and eviscerate the statute’s intended guarantee of a workplace free of discrimination.

Foxon comes before this court to seek, in essence, insulation from its own wrongdoing. . . . It would be a clear violation of public policy if businesses and individuals could insure themselves against liability for committing intentional acts of discrimination. This result would promote, rather than deter discriminatory behavior. . . . Foxon’s knowing failure to address the blatantly discriminatory acts of its employees should not be condoned by shifting the burden of satisfying Hernandez’s damage awards to Aetna.

*Id.* at 1145-46. Some courts summarily hold that public policy precludes insurance coverage of “disparate treatment” liabilities without providing any detailed justification. See, e.g., Jefferson-Pilot Fire & Cas. Co. v. Sunbelt Beer Distrib., Inc., 839 F. Supp. 376, 381 (D.S.C. 1993) (“The discrimination that Ms. Pressley complains of is not the type of action that an employer should be able to insure against.”).


175. In a recent case, the California Court of Appeals emphasized that *Coit* and *B&E* make clear that allegations of sexual harassment are uninsurable even if the allegations of the complaint might raise the potential for liability for otherwise covered claims such as defamation or false imprisonment. “Since wrongful termination because of sex harassment is intentional as a matter of law . . . an allegation which merely labels such conduct as negligent is entirely ineffectual” to create insurance coverage. Moore v. Continental Ins. Co., 51 Cal. Rptr. 2d 176, 184 (Cal. Ct. App. 1996) (opinion decertified for publication); see also Horace Mann Ins. Co. v. Barbara B., 71 Cal. Rptr. 2d 350, 356 (Cal. Ct. App. 1998) (holding that insurer is not liable for negligence verdict against teacher guilty of child molestation since the negligent acts were inseparable from the molestation, “part and parcel of a design” to molest the student).
forced insurance coverage even for intentional "disparate treatment" of employees, finding that such coverage is not necessarily contrary to public policy.176 These cases often involve variations of D&O or E&O policies written for public school districts, which provide insurance for liabilities arising out of "wrongful acts," and generally do not exclude intentional wrongs. Because the very purpose of many of these types of policies is to protect the public school from substantial losses that it may incur vicariously, and also by defending and indemnifying its employees for their intentional wrongful acts, insurers must rely on public policy arguments in an effort to avoid coverage obligations. In School District for the City of Royal Oak v. Continental Casualty Co.,177 the Sixth Circuit expressly rejected the Ranger analysis by holding that an insurance carrier is fully able to protect itself from unwanted exposure by excluding discriminatory conduct from coverage, and that an empirical inquiry into the actual "stimulative" effect of liability insurance on wrongdoing is too cumbersome to employ as a legal test.178 The


The proposition that insurance taken out by an employer to protect against liability under Title VII will encourage violations of the Act is based on an assumption that is speculative and erroneous. . . . Where a class of employees is entitled to back pay under a court order and the employer is financially unable to comply with the same, insurance would provide the mandated compensation.

Id. at 567-68. The court also noted that the insurer remains free to exclude such liabilities from coverage, and emphasized that intentional discrimination was excluded from coverage by the policy terms in that case. See id. at 568; see also Clark-Peterson Co., Inc. v. Independent Ins. Assoc., 492 N.W.2d 675, 677-78 (Iowa 1992) (en banc) (utilizing the doctrine of reasonable expectations to extend coverage beyond the precise terms of the policy with respect to intentional discrimination on account of disability).

177. 912 F.2d 844 (6th Cir. 1990).

178. See id. at 847-50. The court explained:

Perhaps the existence of liability insurance might occasionally "stimulate" such a contretemps, but common sense suggests that the prospect of escalating insurance costs and the trauma of litigation, to say nothing of the risk of uninsurable punitive damages, would normally neutralize any stimulative tendency the insurance might have.

Pace Professor Willborn, moreover, we do not believe that most courts would wish to encourage litigation over the question whether particular insurance policies did or did not have a stimulative effect in particular cases. The insurability of "intentional" discrimination in a given state is likely to be decided categorically, we think, rather than case-by-case.

Id. at 848. The Royal Oak court cited an article by Professor Willborn with approval, concluding that the presumption that liability insurance might "stimulate" future discriminatory conduct is unfounded. See Steven L. Willborn, Insurance, Public Policy, and Employment Discrimination, 66 Minn. L. Rev. 1003 (1982). Professor Willborn argued that insurance coverage should generally be enforced to effectuate the public
analysis in *Royal Oak* recently was reaffirmed in *North Bank v. Cincinnati Insurance Cos.*\(^{179}\) with the court reasoning that the risks of hefty premiums, bad publicity, and uninsurable punitive damages would deter intentional discrimination, and that the public interest might be better served by making funds available to victims of discrimination.\(^{180}\) Other courts have followed the *Royal Oak* analysis that there is no public policy bar to coverage of intentional discrimination.\(^{181}\) Of course, if the policy limits coverage applies only to negligent acts, then disparate treatment discrimination will fall outside the coverage, even if public policy would otherwise permit such coverage.\(^{182}\)

The different results in these cases are not explained by the courts' use of different tests, but rather by using a different applica-

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policy favoring compensation unless the insured displays a "calculating intent" to engage in discrimination based on the existence of insurance. See *id.* at 1027-30. Thus, Willborn's proposal would appear to strike a middle ground between the presumption in *Ranger* that insurance will have a stimulative effect, and the presumption in *Royal Oak* that it will not, or at least that carriers can avoid adverse selection by excluding intentional discrimination.

179. 125 F.3d 983 (6th Cir. 1997).
180. See *id.* at 988.
181. See *New Madrid County Reorganized Sch. Dist. No. 1 v. Continental Cas. Co., 904 F.2d 1236, 1241-43 (8th Cir. 1990); see also *University of Ill. v. Continental Cas. Co., 599 N.E.2d 1338, 1351 (Ill. App. Ct. 1992).* The court explained that it could find no Illinois public policy prohibiting insuring for damages caused by one's intentional acts except to the extent that the insured wrongdoer may not be the person who recovers the policy proceeds. The fact that many insurance policies contain an exclusion for intentional conduct demonstrates insurers have not relied on any broad public policy. Defendant could have included such an exclusion in its BEL policy, but did not. This court will not rewrite the BEL policy to create an exclusion.

*Id.* In *Independent School District No. 697, Eveleth v. St. Paul Fire & Marine Insurance Co., 515 N.W.2d 576* (Minn. 1994), the court similarly reasoned that "[w]e do not believe that a school district will discriminate against its employees simply because it carries wrongful act insurance coverage; nor do we believe that school districts carrying this type of insurance coverage have a license to commit intentional wrongs. Accordingly, we enforce the contract as it is written." *Id.* at 580; cf. *Continental Cas. Co. v. Canadian Universal Ins. Co., 924 F.2d 370, 375* (1st Cir. 1991) (finding that coverage for sexual harassment is unambiguous under the "wrongful acts" trigger and offering no discussion of any potential public policy bar to enforcement).

182. See, e.g., *Golf Course Superintendents Ass'n of Am. v. Underwriters at Lloyd's, London, 761 F. Supp. 1485, 1491* (D. Kan. 1991) (providing that the D&O policy restricting coverage to negligent "wrongful acts" provides no coverage for intentional discrimination, even though the Kansas common law precluding insurance for intentional acts was modified by a statute permitting coverage of punitive damages assessed against an insured vicariously for the intentional acts of its agents); *School Dist. No. 1 v. Mission Ins. Co., 650 P.2d 929, 943* (Or. Ct. App. 1982) (finding that there is no need to reach the public policy issue when "wrongful act" is defined in terms of negligent acts only).
tion of an agreed upon balancing test: weighing the benefit to the plaintiff (permitting insurance coverage) against the harm to society (encouraging future intentional wrongdoing).\textsuperscript{183} Courts permitting coverage reject the hypothesis that discrimination will be reduced by denying coverage, and they emphasize the desirability of compensating victims of discrimination. In short, public policy does not prohibit an employer sued for discrimination from ever obtaining a defense and indemnification under liability insurance. In fact, recent court decisions evidence a willingness to permit insurance coverage even for intentional discrimination by agents of the employer. Still, if the wrongful act amounts to a purposeful effort by the employer to cause injury to the employee, courts generally will refuse to enforce otherwise available insurance for reasons of public policy. In such cases, however, the insurance policy will often preclude coverage in unambiguous terms in either the insuring agreement or the exclusions; thus, the public policy doctrine should only rarely place an additional limitation on the scope of coverage.\textsuperscript{184}

Even when a court determines that insurance coverage of intentional employment discrimination is precluded by public policy, the carrier's duty under the policy to defend the action is not neces-

\textsuperscript{183} For example, the dissent in \textit{Ranger} questioned the court's analysis in the application of the rule rather than in the formulation of the rule itself. \textit{See} Ranger Ins. Co. v. Bal Harbour Club, Inc., 549 So. 2d 1005, 1010-12 (Fla. 1989) (Ehrlich, C.J., dissenting). Judge Ehrlich first argued that an important part of anti-discrimination legislation is providing financial redress to injured parties, stating the following:

\begin{quote}
From the point of view of the insured, protection is the primary function of insurance. From the standpoint of the victim, insurance affords financial responsibility. Both of these are respected, desired consequences of insurance in our society. \ldots To say that the primary purpose of the imposition of liability is to deter wrongdoers is unreal in this world of ours.
\end{quote}

\textit{Id.} at 1011 (Ehrlich, C.J., dissenting). He went on to claim that discriminatory behavior would not be stimulated by the availability of insurance coverage, especially in light of the possibility of verdicts beyond policy limits and the imposition of uninsurable punitive damages. \textit{See id.} at 1012 n.3 (Ehrlich, C.J., dissenting). The \textit{Royal Oak} court cited Judge Ehrlich's opinion in holding that public policy permitted coverage of intentional discrimination. \textit{See} School Dist. for the City of Royal Oak v. Continental Cas. Co., 912 F.2d 844, 848-49 (6th Cir. 1990).

\textsuperscript{184} In most cases, the intentional nature of the conduct will remove the case from coverage under the terms of the policy, and so the public policy issue need not be reached. \textit{See}, e.g., American Guar. & Liab. Ins. Co. v. Vista Med. Supply, 699 F. Supp. 787, 789-90 (N.D. Cal. 1988) (holding that California law permits insurance coverage unless there is a "preconceived design to inflict injury," but that the policy in that case restricted coverage of intentional act to a much greater degree); Intermountain Gas Co. v. Industrial Indem. Co., 868 P.2d 510, 515 (Idaho Ct. App. 1994) (holding that intentional discrimination is excluded under the policy); Rideout v. Crum & Forster Commercial Ins., 633 N.E.2d 376 (Mass. 1994); Daly Ditches Irrigation Dist. v. National Sur. Corp., 764 P.2d 1276, 1278 (Mont. 1988).
sarily unenforceable. Courts have found that the duty to defend does not raise the same public policy concerns as the duty to indemnify for damages awarded pursuant to an anti-discrimination statute.\textsuperscript{185} Other courts have held that there is no enforceable duty to defend when coverage is precluded for reasons of public policy, since the insured could have no reasonable expectation of being defended in a suit that raises uninsurable claims.\textsuperscript{186} If the complaint potentially raises claims of unintentional discrimination or other acts that fall within coverage, the insurance carrier will be obligated to provide a defense of the action even if the case ultimately ends with a finding of liability premised on intentional discrimination for which coverage is unavailable as a matter of public policy.\textsuperscript{187}

If liability for hostile work environment sex discrimination is reconceptualized as negligently failing to maintain a workplace free of such behavior as required by Title VII, then it seems clear under the public policy analytical framework that insurers will have much weaker arguments that such liabilities are uninsurable. In effect, such a change in hostile work environment liability would make these cases similar to “disparate impact” liability for purposes of

\textsuperscript{185} See Andover Newton Theological Sch., Inc. v. Continental Cas. Co., 930 F.2d 89, 95 (1st Cir. 1991); American Management Ass’n v. Atlantic Mut. Ins. Co., 641 N.Y.S.2d 802, 808 (N.Y. App. Div. 1996). See generally Venture v. LMI Ins. Co., 78 Cal. Rptr. 2d 142, 160 (Cal. Ct. App. 1998) (holding that “while indemnification of [the intentional tort of malicious prosecution] is precluded by section 533, that conclusion does not apply to [the insurer’s] defense commitment which, in this policy, is a specific and distinct commitment. . . . Obviously, the public policy concerns applicable to an insurer’s indemnification do not extend to the provision of a defense”).


\textsuperscript{187} Therefore, even in the face of an express statute defining the public policy interest, courts have found no bar to the duty to defend when coverage potentially is triggered by a complaint. See Lesser v. State Farm Fire and Cas. Co., No. CV-95-4154-KMW, 1996 WL 339854 (C.D. Cal. June 14, 1996) (denying summary judgment for the insurer and holding that section 533 does not preclude the duty to defend where the complaint alleged covered causes of action distinct from the sexually harassing behavior); see also Horace Mann Ins. Co. v. Barbara B., 846 P.2d 792, 799 (Cal. 1993) (en banc) (finding that the statutory bar applies only to indemnification for the intentional conduct, and not to the duty to defend, in a case that may involve some non-intentional acts giving rise to liability); Melugin v. Zurich Canada, 57 Cal. Rptr. 2d 781, 784-85 (Cal. Ct. App. 1996) (clarifying the Coit and B&E decisions by noting that the policy before the court specifically included coverage for discrimination, and the complaint did not preclude an ultimate finding of liability under a disparate impact theory); Republic Indem. Co. v. Superior Court, 273 Cal. Rptr. 331, 334 (Cal. Ct. App. 1990) (interpreting CAL. INS. CODE section 533 as permitting a carrier to assume the defense of an action that potentially could result in liability for a non-willful failure to make a reasonable accommodation for an employee’s medical condition).
determining insurability. Nevertheless, it is plausible that a public policy defense to coverage would continue to be relevant in cases where the wrongdoer is the alter ego of the insured entity and he engages in clearly malicious and intentional behavior by abusing his position of authority. Thus, under circumstances such as those in a leading case involving a closely-held corporation president who raped and sexually assaulted his female employees as a condition of their continued employment, a court might reasonably “pierce the corporate veil” and find, for purposes of insurance coverage, that the employer had committed intentional wrongs.\textsuperscript{188}

A student author has suggested that the different applications of the general public policy balancing test might be captured in a secondary general rule that would synthesize existing case law and provide reasonable guidance for future cases. Sean Gallagher argued that an employer should be permitted to insure against employment discrimination if its liability is premised on negligently supervising the offending employee or is imposed vicariously.\textsuperscript{189} This principle of decision-making could explain the difference between \textit{Ranger} (in which a private club controlled by the discriminating members was denied coverage for its official policies) and \textit{Royal Oak} (in which a public school sought coverage with respect to liabilities imputed to it for discrimination committed by an employee) by directing attention to the nature of the insured’s culpability. The assumption at work in this proposal is that the presence of insurance will stimulate wrongful behavior only when the insured entity (or its alter ego) is implicated directly in the intentional and wrongful behavior. If courts scrupulously assessed the culpability of the different persons and entities, most cases involving employer liability for hostile work environment sex discrimination would be deemed insurable as to the employer.

This reasoning was adopted in a recent case involving the sexual assault of a female inmate by a male jailer. The district court concluded that an intent to harm is inferred as a matter of law with regard to the jailer, but that the jailer’s intent is not imputed to the employer so as to trigger the public policy bar to coverage.

\textsuperscript{188} See Coit Drapery Cleaners, Inc. v. Sequoia Ins. Co., 18 Cal. Rptr. 2d 692, 698 (Cal. Ct. App. 1993); see also Moore v. Continental Ins. Co., 51 Cal. Rptr. 2d 176, 184 n.2 (Cal. Ct. App. 1996) (opinion decertified for publication) (noting that there was no claim of negligent supervision against the employer, and that no such claim could trigger coverage in this case since the wrongdoer was the owner and president of the employer).

\textsuperscript{189} See Gallagher, \textit{supra} note 160, at 1262.
The public policy argument is not applicable to this case. Here, Cates, the wrongdoer, was not the individual who secured the insurance policy; Cates' employer, Fall River, obtained the policy. . . . Holding Fall River liable for Cates' wrongful acts would not serve a deterrent effect nor would it punish Cates. Thus, public policy would not be furthered in this case [by barring coverage for the employer]. An employer can insure itself against the intentional acts of its employees without violating public policy.190

The court simply acknowledged that the public concern behind the public policy bar to insurance coverage does not exist when the employer is not directly engaging in intentional harmful behavior.

One important consideration remains. Even if the public policy argument against insurance coverage for hostile work environment liability is weak, when the public policy at stake is the tendency of insurance coverage to stimulate further wrongdoing, courts can utilize a public policy analysis as a means of morally condemning the underlying behavior. This seems apparent in the decisions of many courts that have held that all liability incurred due to sexual harassment in the workplace is uninsurable, even if the plaintiff has couched her suit in terms of negligence. It is possible that courts may hold that insurance coverage is precluded for any person or entity on account of hostile work environment sex discrimination, even if the employer's liability is assessed under a negligence analysis. The reasoning underlying this position would be to withhold any manner of insurance coverage in hostile work environment cases due to the morally repugnant nature of the wrongful acts.

For example, some courts have determined as a matter of law that sexual abuse of children cannot be an occurrence for purposes of insurance coverage, regardless of whether the insured intended to harm the child or knew that such harm was substantially certain to follow.191 A number of courts have expanded what began as a reasonable rule by holding that coverage is unavailable even for an "innocent spouse" of the abuser, apparently reflecting "repugnance for sexual molestation, and courts' understandable reluctance to

find that such acts, or derivative claims based upon them, are within the coverage afforded by liability policies. In effect, courts are deviating from traditional rules of policy interpretation to express strong public condemnation against child abuse by withholding insurance coverage regardless of the rationale for imposing liability. This form of moral condemnation has now carried over to the employment context. In *Public Service Mutual Insurance Co. v. Camp Raleigh, Inc.*, the New York Supreme Court Appellate Division held that a suit against a camp for negligent supervision of camp counselors who sexually molested children in their care did not trigger coverage because the underlying actions were intentional in nature. The court held that even if the liability of the employer is predicated on the employer's negligence, there simply was no occurrence in light of the underlying intentional behavior at issue.

The rationale in the *Camp Raleigh* decision, highly questionable in its own right, has also been extended to employment cases that do not involve the abuse of children. This narrow reading of the "occurrence" requirement in general liability policies plainly reflects a decision by these courts that any liabilities relating to certain intentional acts may be uninsurable as a matter of public policy. Such a position makes no sense in the employment context, however, where the employer is often an entity that is factually and legally distinct from the wrongdoer. There is no good reason to deny an employer the ability to protect itself from liabilities that it may incur due to the actions of its employees. Moral condemnation

193. See id. at 483-84.
195. See id. at 137.
196. See id.
of sexual discrimination is not furthered by preventing employers from protecting themselves in a manner that provides resources for plaintiffs who prevail in suits against them, except perhaps in those cases where the wrongdoer effectively is the alter ego of the corporate entity. If an insurance carrier is willing to underwrite the risk of employment-related liabilities, whether intentionally or through the use of ambiguous policy language, there is no good reason to withhold enforcement of the policy according to ordinary principles of interpreting insurance contracts.

The unpersuasive case for invoking the public policy defense for negligence-based liabilities is underscored by the burgeoning EPL market, in which seventy or more insurance carriers are now writing policies that specifically provide coverage for sexual harassment and discrimination. If it is against public policy for a CGL carrier to provide coverage for these liabilities, it would be no less against public policy for EPL carriers to provide this coverage. In light of the tremendous expansion of this form of coverage with the blessing of state regulators, one must assume that courts will not be predisposed to find public policy bars to coverage. Even in states where public policy is embodied in a statute, the reconceptualization of employer liability for hostile work environment in terms of negligence principles will provide sufficient reason to view this exposure as falling outside the scope of the statutory bar on insurance for intentional wrongdoing.

CONCLUSION

EPL underwriters are in an unenviable position. They are riding the uncertain wave of insurance coverage law while trying to hit the moving target of employment law. Liability for sexual harassment, now one of the most important concerns for employers, provides a perfect example of the complex issues that face EPL carriers. As EPL products continue to mature and employment law continues to develop, there is only one thing that remains certain: carriers that fail to adjust to the changing environment will rapidly find it difficult to maintain a profitable book of business. If an EPL carrier begins to feel a profitability pinch, it is more likely to raise coverage defenses with its policyholders, thereby bringing EPL coverage to the next level of complexity. Employment lawyers and insurance coverage lawyers must remain poised to represent their various clients in this volatile environment.