

Client Alert

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CGL Insurer Must Defend Alleged ERISA Violations Where Factual Allegations Create a Possibility of Coverage

In *Euchner-USA, Inc. v. Hartford Cas. Ins. Co.*, No. 13-2021-cv, 2014 U.S. App. LEXIS 10797 (2d Cir. June 10, 2014), the United States Court of Appeals for the Second Circuit found that an insurer must defend its insured in a case alleging ERISA violations because the facts alleged (as opposed to the embedded legal conclusions) created a reasonable possibility of coverage under the general liability policy's employee benefits coverage part. Central to the court's decision was its finding that Euchner's alleged misclassification of the plaintiff as an independent contractor rather than an employee arose from the Euchner benefit plan's administration, thereby bringing the allegedly improper conduct within the scope of the policy's employee benefits coverage.

Background

In 2011, Jada Scali ("Scali"), a former employee of Euchner-USA, Inc., sued Euchner and its CEO, Michael Ladd, for retaliatory discrimination after Scali was allegedly sexually harassed by Ladd. Scali later amended her suit to include claims against Euchner's 401(k) benefit plan under ERISA, alleging that Scali was improperly reclassified as an independent contractor following her allegedly retaliatory reassignment. The reassignment from employee status allegedly resulted in a loss of Scali's plan benefits.

Euchner was insured under a general liability insurance policy issued by Hartford Casualty Insurance Company ("Hartford"). The Hartford policy included an employee benefits programs ("EBP") endorsement that afforded coverage for liability caused by "employee benefits injury," defined to mean "injury that arises out of any negligent act, error or omission in the 'administration' of 'your employee benefits programs.'" The policy excluded coverage for liability arising out of "any dishonest, fraudulent, criminal or malicious act."

Euchner tendered the amended complaint to Hartford, and Hartford denied coverage, contending, among other things, that coverage afforded under the policy's EBP endorsement did not apply to Scali, an independent contractor. Hartford also later declined to participate in the settlement of Scali's claim.

Euchner filed suit against Hartford in the Northern District of New York, seeking reimbursement for defense fees and indemnification of part of the Scali settlement. The parties cross-moved for summary judgment. The trial court granted Hartford's motion, finding that Scali's complaint alleged intentional conduct, which was clearly excluded under the policy. The court denied reconsideration and Euchner appealed to the Second Circuit.

Appeal & Holdings

The Second Circuit reversed the trial court's ruling on the duty to defend. The court explained that under New York law, an insurer's defense obligations are "exceedingly broad." If there is potential for coverage based on factual allegations in a complaint, the insurer is obligated to defend, even if facts outside the complaint belie coverage, and even if the complaint states clearly noncovered claims in addition to potentially covered claims.

While coverage for Scali's claims clearly was not available under the policy's general liability form, the EBP endorsement potentially applied. The EBP endorsement extended coverage to injury arising out of "any negligent act, error or omission in the 'administration' of [Euchner's] employee benefits programs." A defense would be triggered, therefore, if the amended complaint alleged injury resulting from some "negligent act" during the "administration" of the benefit plan.

Analyzing the allegations of the amended complaint against the contours of coverage, the court determined that the allegations plainly sounded in negligence. Although the amended complaint alleged facts that could show "malice," the court concluded that none of Scali's ERISA claims alleged that Euchner improperly classified her with the *purpose* of interfering with her retirement benefits. The court further found that Euchner's classification of Scali as an independent contractor plainly fit with the policy's definition of plan "administration," rejecting Hartford's argument that the classification was something other than a ministerial act.

Finally, the court found that Hartford would have the burden of proving that a policy exclusion barring coverage for wrongful, unlawful, intentional or fraudulent conduct applied to every aspect of Scali's complaint. The ERISA claim alleged "improper" and "unlawful" misclassification of Scali's position, but it did not allege any legal theories based on malice. Furthermore, even if the amended complaint contained such allegations, the duty to defend inquiry focuses on the factual allegations, which do not include any embedded legal conclusions. The court concluded, therefore, that the exclusion did not unambiguously preclude coverage. Accordingly, the court found that a defense was owed and remanded the case for further proceedings on whether Hartford breached its duty to indemnify and whether Euchner was entitled to attorneys' fees for the coverage action.

Implications

Euchner underscores the breadth of a general liability insurer's duty to defend. The decision also reminds of the critical difference between factual allegations, on which an insurer's duty to defend is determined, and legal conclusions that do not factor into the defense analysis. Thus, as in *Euchner*, that the plaintiff also included noncovered conclusions of law among her factual allegations concerning her ERISA claims did not change the court's ultimate conclusion that the allegations sounded in negligence sufficient to trigger the insurer's duty to defend.

Euchner also reiterates the critical importance of reviewing all potentially available insurance when a loss occurs to ensure that any non-standard policy provisions or endorsements that might potentially afford coverage are not overlooked.

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