Client Alert

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California Supreme Court Rules That General Liability Insurer Must Defend Employer Against Employee Misconduct Allegations

The Supreme Court of California has ruled that a general liability insurer must defend an employer against allegations of employee misconduct, reinforcing the breadth of (1) what constitutes an "occurrence" under an employer's commercial general liability (CGL) policy and (2) the duty to defend regarding claims for negligent hiring, retention and supervision. The opinion in *Liberty Surplus Ins. Corp. v. Ledesma & Meyer Constr. Co., Inc.* can be found here.

Ledesma & Meyer (L&M), a construction company, was contracted by the San Bernardino Unified School District to manage a construction project at a middle school. The company assigned Darold Hecht as assistant superintendent on the project. In 2010, a 13-year-old student at the school (Jane Doe) sued in state court alleging that Hecht had sexually abused her during the course of his work on the job. The suit included a cause of action against L&M for negligently hiring, retaining and supervising Hecht.

L&M tendered the defense to its CGL insurers (Liberty), who defended under a reservation of rights while seeking declaratory relief in federal court. Liberty maintained that it had no obligation to defend or indemnify L&M because no "occurrence" was alleged under the policy, which defined the term "occurrence" as "an accident." The district court agreed, reasoning that the "alleged negligent hiring, retention and supervision were acts antecedent to the sexual molestation …. While they set in motion and created the potential for injury, they were too attenuated from the injury-causing conduct committed by Hecht." The district court therefore granted summary judgment to Liberty on the cause of action for negligent hiring, retention and supervision. L&M appealed to the Ninth Circuit, which sought guidance from the Supreme Court of California, posing the question: "When a third party sues an employer for the negligent hiring, retention, and supervision of an employee who intentionally injured that third party, does the suit allege an 'occurrence' under the employer's commercial general liability policy?" The Supreme Court of California held that it did.

The framework for the inquiry was whether Liberty had a duty to defend L&M against Doe's lawsuit. Under California law, "the insured must prove the existence of a *potential for coverage*, while the insurer must establish *the absence of any such potential*." Liberty argued that Hecht's intentional misconduct could not be covered because it was not accidental. The court found, however, that the existence of an "accident" under the policy must be evaluated from the perspective of the insured. Because the negligence of L&M, as distinct from the conduct of Hecht, did not involve intentional conduct, there was a possibility for coverage and therefore a duty to defend. As the court explained:

"Liberty's arguments, if accepted, would leave employers without coverage for claims of negligent hiring, retention, or supervision whenever the employee's conduct is deliberate. Such a result would be inconsistent with California law, which recognizes the cause of action even when the employee acted intentionally …. Absent an applicable exclusion, employers may legitimately expect coverage for such claims under comprehensive general liability insurance policies, just as they do for other claims of negligence."

Ledesma is a significant victory for employers and has implications for CGL coverage throughout the country. Insurers consistently challenge the availability of coverage under these broadly worded policies for "intentional conduct" based on the definition of "occurrence" or the Expected or Intended Injury exclusion. In such cases, they seek to narrow the available coverage by blurring the line between the policyholder's conduct and the wrongdoer's intentional misconduct. While the district court in *Ledesma* fell victim to this tactic, the Supreme Court of California accurately clarified that the focus must be on the insured party. Otherwise, employers would be stripped of coverage any time an accident involves some deliberate conduct by an employee.

As suggested by the court, insurers will likely react to *Ledesma* by incorporating exclusions directed at this type of situation. They may be narrowly tailored to preclude coverage for negligent hiring, retention and supervision claims involving sexual misconduct. Conversely, they could more broadly target any claim against an employer where the underlying conduct is intentional or deliberate. Company directors, officers and risk managers must be diligent when reviewing future CGL policies to ensure they do not contain exclusions or endorsements that strip away the very protections that they look to their general liability insurers to provide.

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