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Employee Benefit Plan Review

U.S. Court of Appeals for the Eleventh Circuit Rules That Third Party Claims Are Unnecessary to Trigger Employee Benefits Liability Coverage

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A robust employee benefits program is critical to the success of any business. Of the types of benefits offered, a 401(k) retirement plan is as crucial as any. Businesses that administer such programs can protect themselves through employee benefits liability coverage which is intended to cover errors and omissions in the administration of employee benefit programs.

Recently, the U.S. Court of Appeals for the Eleventh Circuit issued a ruling in *North American On-Site, LLC v. Zurich Ins. Co.*,[1] that provides important guidance for businesses that provide or manage employee benefits programs who may be covered for losses under their employee benefits liability coverage. The court determined that such coverage extended to corrective payments made by North American On-Site LLC (North American), a 401(k) plan administrator, to maintain the plan's qualified status and tax-deferred benefits after having made critical clerical errors. These errors included the failure to include certain employees in the plan and to accurately withhold employees' contributions. North American incurred approximately $500,000 in legal and accounting fees to investigate and address the errors, corrective contributions for the employees, and late payments to the Department of Labor.

The Case

Before filing a claim with its insurer, Zurich American Insurance Company, North American sought its insurance broker's advice. The broker said its policies would not cover the claim or loss. North American then switched brokers, who advised otherwise, and filed a claim with Zurich.

Zurich denied the claim and North American sued Zurich for breach of contract and bad faith in a federal district court in Georgia. The court granted a summary judgment motion in favor of Zurich concluding that the employee benefits liability coverage's insuring agreement was not triggered. Its reason was that North American did not incur losses it was legally obligated to pay because a third party had not made a claim against it.

Significantly, the insuring agreement provided:

> We will pay those sums that the "insured" becomes legally obligated to pay as damages because of any act, error, or omission of the "insured" in the "administration" of the "insured's" "employee benefit programs." We will have the right and duty to defend the "insured" against any suit seeking those damages.

The Eleventh Circuit disagreed with Zurich's and the district court's interpretation of the insuring agreement. The court rejected the notion that a third party must have pursued a claim against North American in order for it to be "legally obligated" to pay damages. In fact, North American was advised by counsel that Internal Revenue Service (IRS) regulations required it to make corrective payments to avoid further increased costs and the risk of adverse action by the IRS. Zurich even conceded that federal law required North American to make those payments.

Further, Zurich's argument that a third-party claim was necessary to trigger coverage would effectively make the second sentence of the insuring agreement – the duty to defend – a pre-condition for the first sentence. But the first sentence, read on its own, only requires the insured become "legally obligated" to pay damages. It is not limited solely to circumstances where there is a third-party claim.

Under Georgia law, an insurance contract must be read as a whole and provisions susceptible to multiple reasonable interpretations must be construed in favor of coverage. By reading the second sentence, which articulated the duty to defend, as an additional basis that could trigger the insuring agreement and not the only basis, the court appropriately applied Georgia's rules of policy interpretation.

The court vacated the district court's summary judgment ruling and remanded the case for further consideration of other defenses Zurich raised that were not fully considered by the district court.

Conclusion

The court's decision serves as an important reminder to carefully review the policy's insuring agreement. While the specific language may vary, policyholders should ensure that they fully understand the scope of coverage. In this instance, the court properly applied bedrock principles of policy interpretation to come to the right result – the insuring agreement could be triggered without a third-party claim, particularly here where the 401(k) plan's qualified status was in jeopardy, which in turn made North American "legally obligated" to make the corrective payments.

North American's experience with its original insurance broker also highlights the reason a policyholder cannot always simply rely on its broker to determine whether coverage is owed. Instead, depending on the circumstances, a policyholder should consider seeking out coverage counsel. Had North American relied solely on its original broker's advice that there would be no coverage, North American would have deprived itself of the policy benefits it was entitled to when it obtained employee benefits liability coverage. When coverage issues arise, clear understanding and proper legal advice are key to navigating nuances in insurance policies and can help ensure adequate protection in case there is a coverage dispute.

Note

1. North American On-Site, LLC v. Zurich Ins. Co., No. 22-12495 (11th Cir. Oct. 28, 2024).

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