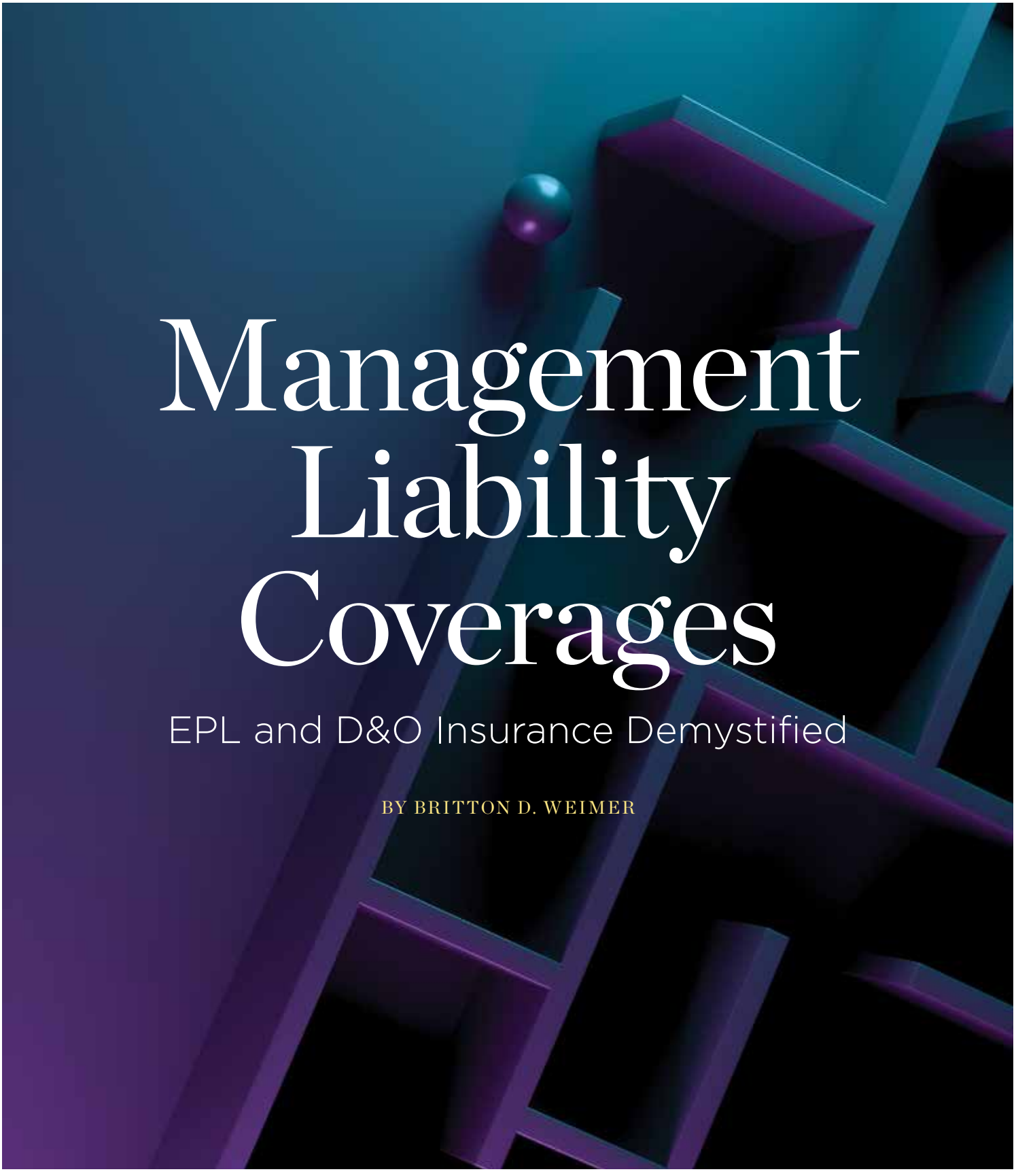

Management Liability Coverages

EPL and D&O Insurance Demystified

BY BRITTON D. WEIMER

This article describes similarities between employment practices liability and directors and officers insurance policies.

There is significant interplay and overlap between employment practices liability (EPL) and directors and officers (D&O) insurance coverages. Both provide liability insurance for business managers. EPL policies cover claims by past and present employees; D&O policies cover claims by outsiders. Thus, insurers increasingly underwrite and market EPL and D&O policies together in "management liability" package policies.[1]

This article examines both types of management liability policies, with a focus on Colorado law.[2] EPL and D&O coverages vary significantly from insurer to insurer. While there have been "standard" Insurance Services Office (ISO) EPL policy forms available since 1998, few insurers have used them. And there are no ISO D&O policies. Thus, it is essential to analyze the specific provisions in each insurer's policies.

Fortunately, the core principles underlying EPL and D&O insurance are straightforward. As set forth below, there is a general consistency in coverage triggers and exclusions in most management liability insurance policies, making it possible to quickly analyze particular policy provisions.

Coverage Triggers

Most EPL and D&O policies contain specific coverage triggers for wrongful acts, losses or damages, claims, and claims made.

"Wrongful Acts" Trigger

EPL and D&O policies normally cover a finite number of "wrongful acts" or "wrongful practices." This is conceptually similar to commercial general liability (CGL) Coverage B for advertising injury and personal injury, with its finite enumerated covered torts.[3]

Common EPL "wrongful acts" include:

- discrimination,
- harassment,
- wrongful termination,
- failure to hire and promote,
- defamation,
- invasion of privacy and breach of confidentiality,
- negligent hiring and supervision, and
- retaliation and reprisal.[4]

Common D&O "wrongful acts" are somewhat broader and frequently include:

- errors,
- omissions,
- misstatements,
- breach of duty,
- breach of trust, and
- neglect.[5]

Indeed, many D&O "wrongful acts" are so broadly written that "the exclusions in the policy in a sense define the coverage more than any other coverage provisions."[6]

Some management liability policies have separate wrongful acts or practices definitions for EPL and D&O insurance. For example, in *McCalla Corp. v. Certain Underwriters at Lloyd's*, the policy's EPL section covered "wrongful employment practices" that included "wrongful failure or refusal to adopt or enforce adequate workplace or employment practices, policies or procedures."[7] The D&O section had separate coverage for "wrongful acts," although the case did not include the definition for that coverage.

Other management liability policies combine their definition of wrongful acts for both EPL and D&O insurance. In *Beauvallon Condominium Ass'n, Inc. v. Granite State Insurance Co.*, the Great American nonprofit EPL and D&O policy defined "wrongful act" as "any actual or alleged error, misstatement, misleading statement, act or omission, neglect or breach of duty . . . ."[8]

Many EPL and D&O policies limit coverage for wrongful acts to an individual insured acting "solely in an insured capacity." For example, in *Nicholls v. Zurich American Insurance Group*, the Zurich American D&O policy limited "wrongful acts" to an error, misstatement, misleading statement, act, omission, neglect, or breach of duty actually or allegedly committed or attempted "by any of the Insured Persons, individually or otherwise, in their Insured Capacity, or any matter claimed against them solely by reason of their serving in such Insured Capacity."[9] The policy defined an "insured person" as a director or officer of the "company."[10] Thus, where joint officers and directors of the company and its corporate parent were acting in their capacity as officers and directors of the corporate parent, and not of the company, when they engaged in a sham stock transaction that formed the basis of trustee's claims, the D & O policy did not apply.[11]

Similarly, in *Denver Investment Advisors, LLC v. St. Paul Mercury Insurance Co.*, the EPL "employment practices act" coverage was limited to wrongful discharge "committed or attempted" by an insured or for which an insured was held liable.[12]

Some complex cases involve a mix of defendants in their insured capacities and defendants who are not insureds or not acting in their insured capacities, creating allocation challenges. In *Vicorp Restaurants, Inc. v. Federal Insurance Co.*, the Colorado federal district court addressed the allocation among insured directors and officers and the uninsured corporate employer in the D&O insurance policy context.[13] The court noted: "Courts that have addressed this issue have consistently held that allocation is appropriate between insured and uninsured wrongdoers.[14] Allocation, however, is not appropriate when an uninsured corporation's liability is wholly derivative from the insured officer's or director's acts."[15]

"Loss" Trigger

Coverage for most EPL and D&O policies is not triggered without a covered "loss" or "damage." Coverage for loss or damage is usually limited to monetary settlements and judgments. For example, in *Beauvallon*, the EPL policy defined

"loss" as "settlements and judgments, including punitive or exemplary damages or the multiple portion of any multiplied damage award . . . ."[16]

The definition of "loss" usually excludes things like fines, penalties, taxes, and uninsurable damages. For example, in *Genesis Insurance Co. v. Crowley*, "loss" excluded "criminal or civil fines or penalties imposed by law, multiplied portions of damages in excess of actual damages, taxes, or any matter which may be deemed uninsurable under the law pursuant to which this Policy shall be construed."[17]

In *McCalla*, the EPL policy covered all loss incurred for payments the insured was legally required to make in connection with wrongful employment practice claims against the insured during the policy period.[18] However, "loss" did not include "fines, penalties, or taxes" or "any relief, whether pecuniary or injunctive, imposed or agreed to in connection with criminal lawsuits or proceedings." In *Denver Investment Advisors*, the D&O policy excluded contract claims from its definition of "loss."[19]

In a D&O policy, the concept of "loss" can depend on the plaintiff's status as a shareholder, officer, or director. For example, in *ClearOne Communications, Inc. v. National Union Fire Insurance Co. of Pittsburgh*, the Tenth Circuit held that the dilution of a director's stock due to a shareholders' suit settlement was not a covered loss under the D&O policy because the loss was suffered in his capacity as a shareholder, not as a director.[20]

In a Seventh Circuit decision, *Level 3 Communications Inc. v. Federal Insurance Co.*, the court held that "loss" under a D&O policy does not extend to most claims for restitution: "An insured incurs no loss within the meaning of the insurance contract by being compelled to return property that it had stolen, even if a more polite word than 'stolen' is used to characterize the claim for the property's return."[21]

Though widely cited in other jurisdictions, it is unclear if the *Level 3* holding is consistent with Colorado law. In *Genesis Insurance*, Judge Miller acknowledged that case law from other jurisdictions supported the proposition that insurable damages do not include restitution of disgorgement of property wrongfully acquired.[22] However, he also observed that "none of the parties has directed me to any authority indicating that this is the law in Colorado and I have found none."[23]

"Claim" Trigger

In most EPL and D&O policies, a "claim" is defined to be broader than a civil lawsuit and extends to most legal proceedings. For example, in *McCalla*, the D&O policy defined "claim" as "a civil, criminal, administrative or regulatory proceeding commenced against any Insureds in which they may be subjected to binding adjudication of liability for damages or other relief . . . ."[24] Under that definition, the Kansas federal district court held that there was no "claim" for the underlying cause of action for a search warrant process or the filing of information related to the warrant.

Similarly, in *Beauvallon*, the EPL policy defined a "claim" as:

> (1) any proceeding initiated against an Insured, including any appeals therefrom, before (a) any governmental body which is legally authorized to render an enforceable judgment or order for money damages or other relief against an Insured, or (b) the Equal Employment Opportunity Commission, or any similar governmental body whose purpose is to address employment practices; or (2) any written demand seeking money damages for a Wrongful Act.[25]

The number of "claims" accrued under an EPL or D&O policy depends on the policy language. In *Genesis Insurance*, the policy stated that "[m]ore than one Claim based upon or arising out of the same Wrongful Act(s), or facts, circumstances, or situations, or one or more series of similar, repeated or continuous Wrongful Acts, shall be considered a single Claim . . . ."[26] Based on that language, the Colorado federal district court held that a continued conflict of interest and the directors' failure to cure it after the policy period ended were considered a single course of conduct, and the breach of fiduciary duty arising therefrom was covered by the D&O policy.[27]

Similarly, an EPL or D&O policy will often define as a single "claim" or "loss" all losses arising out of the same or related wrongful acts. For example, in *Barr v. Colorado Insurance Guaranty Ass'n*, the D&O policy stated that a single loss results from "[l]osses arising out of the same Wrongful Act . . . or interrelated Wrongful Acts" by one or more plaintiffs.[28] There, the wrongful act complained of was plaintiffs' decision to loan approximately $5 million without first checking the background of the borrower or the value of the collateral. Since the plaintiffs, as the board of directors, acted in concert to approve the loan, the Colorado Court of Appeals held they were deemed to have committed the same wrongful act. Thus, pursuant to the policy terms, any loss was a "single loss."[29]

EPL and D&O policies usually provide that "related claims" are a single claim made on the earliest date for purposes of determining coverage. For example, in *Atlantic Specialty Insurance Co. v. Blue Cross and Blue Shield of Kansas, Inc.*, under the D&O policy's related claims provision, the insured's claims for defense costs in a multi-district litigation (MDL) were deemed related to claims in a prior class action lawsuit.[30] Thus, the insureds were not entitled to coverage of the MDL action's defense costs because the prior class action lawsuit claim was made outside the policy's coverage period.

"Claims-Made" Trigger

Virtually all EPL and D&O policies are written as "claims-made" insurance. Coverage for most claims-made policies is triggered for the policy in effect when the claim is made against the insured. By contrast, coverage for the more traditional "occurrence" policy (such as CGL Coverage A) is triggered for the policy in effect at the time of the occurrence or accident, regardless of when the claim is made. A "prompt" notice provision in both types of policies protects the insurer's ability to investigate and defend the claim. A claims-made policy has an additional date-certain notice requirement (usually at the end of the policy period or shortly thereafter). The timing of the report or notice to an occurrence policy insurer is generally irrelevant unless the delayed notice prejudices the insurer.[31] Thus, liability for insurers under an occurrence policy could extend past the policy period, but liability under a claims-made policy ends at a specified date.

In the landmark D&O case of *Craft v. Philadelphia Indemnity Insurance Co.*, the Colorado Supreme Court thoroughly analyzed the notice requirements under claims-made and occurrence insurance policies.[32] In considering the purpose and function of the two notice provisions, the Court determined that applying the notice-prejudice rule in claims-made policies would alter the parties' agreement to limit claims to a specific time period.[33] The Court therefore held that the notice-prejudice rule does not apply to claims-made policies.[34]

Both insurers and insureds may have options to further protect their interests under claims-made policies. Insurers could further limit their liability in claims-made policies by adding a "retroactive date" that bars coverage for occurrences before a certain date, even if a claim is made during the policy period. Insureds may be able to purchase a "tail" to extend the reporting period, or "prior acts" coverage, which covers occurrences before the beginning of the policy period.

To satisfy the notice requirement, the insured must report the claim with enough specificity to enable the insurer to conduct an investigation. In *Genesis Insurance*,[35] the Colorado federal district court held that a corporate insured counsel's letter to a D&O insurer, reporting a Chapter 11 equity committee's allegations regarding a chief executive's conflict of interest and providing supporting documentation, satisfied the specificity requirement of the policy's notice provision, especially since it was received during the policy's reporting period.

Common Exclusions

EPL and D&O policies usually have a large number of exclusions, corresponding to other business policies and unanticipated risks. Some of the most common exclusions included in both types of policies are claims involving (1) prior knowledge of a potential claim, (2) professional services, and (3) wage-and-hour violations.

EPL policies also commonly exclude claims involving (1) fraudulent, malicious, and criminal acts; (2) contractual liability; (3) workers' compensation; (4) ERISA; (5) bodily injury; and (6) property damage.[36]

Likewise, D&O policies often also exclude claims involving (1) prior acts, (2) insured versus insured, (3) dishonesty, (4) personal profit, (5) professional liability, (6) contractual liability, and (7) regulatory violations.[37]

Prior Knowledge

Most EPL and D&O policies have a prior knowledge exclusion or condition, precluding coverage if the insured knew of a potential claim at the time of the application. As the Tenth Circuit explained: "Such prior-knowledge conditions are common in claims-made policies because they ensure that only risks of unknown loss are potentially [insured], and prevent an insured from obtaining coverage for the risk of a known loss, which would be unfair to the insurer."[38]

A subjective knowledge standard typically applies to determine whether particular factual allegations triggered the exclusion.[39] A court will determine whether the insured had a reasonable basis to believe that circumstances existed that could give rise to a claim or suit.[40]

However, an objective standard applies to the likelihood of claims based upon the corporation's financial condition. "As a general rule, an officer or director of a corporation is chargeable with knowledge of all matters relating to the affairs of the corporation which [they] actually know[] or which it is [their] duty to know."[41]

Professional Services

Many EPL and D&O policies contain a professional-services exclusion that corresponds to risks that would be covered by malpractice or errors and omissions policies. For example, in *Western Heritage Bank v. Federal Insurance Co.*, a D&O policy excluded coverage for claims "based upon, arising from, or in consequence of the performing or failure to perform professional services or lending services."[42] The policy's definition of professional services did not include the practice of law or services performed by any entity for which the insured bank acquired ownership or control as security for a loan, lease, or other extension of credit, and legal services and post-control actions were not considered subsets of lending services.

Similarly, in *Navigators Specialty Insurance Co. v. Beltman*, the D&O policy excluded any claim "based upon, arising from, or in any way related to the rendering of, or failure to render, any professional services for others, including, without limitation, services performed by the Insureds for or on behalf of a customer or client."[43]

Wage-and-Hour

Most EPL and D&O policies exclude coverage for wage-and-hour claims. In *Payless Shoesource, Inc. v. Travelers Companies*, an EPL wage-and-hour exclusion for the Fair Labor Standards Act (FLSA) and "other similar provisions" extended to state wage-and-hour laws similar to the FLSA, even though the state statute was not identical in every way to the federal statute.[44] Minor differences in the state statute, such as additional provisions for rest periods and meal periods, did not negate the "similarity" under the plain meaning of the exclusion.[45]

Insured Versus Insured

Most D&O policies include an "insured versus insured" exclusion. The principal purpose of this exclusion is to prevent "collusive" lawsuits between directors and officers.[46]

In *FDIC v. Bowen*,[47] the exclusion provided that there was no coverage for any loss that is "based upon or attributable to any claim made against any Director or officer by another Director or Officer or by the Institution . . . ." The Colorado Court of Appeals held the exclusion was ambiguous as to whether the FDIC was an "institution" for purposes of the exclusion. Therefore, the court construed the ambiguity in favor of coverage.

Often, however, exclusions unambiguously apply to FDIC lawsuits, such as in *Powell v. American Casualty Co. of Reading*. There, the D&O policy excluded claims based on "any action or proceeding brought by or on behalf of the Federal Deposit Insurance Corporation."[48] The US District Court for the Western District of Oklahoma enforced the plain language of the exclusion and found that the exclusion did not violate public policy.

Likewise, in *BancInsure, Inc. v. McCaffree*,[49] the insured versus insured exclusion barred

coverage in the underlying FDIC suit even though there was no collusion, which is arguably the primary purpose of the exclusion. When the exclusion's language is plain, the purpose of the exclusion is irrelevant.[50]

Some insured versus insured exclusions have an exception restoring coverage for regulatory claims. In *FDIC v. American Casualty Co. of Reading*,[51] the Wyoming federal district court that held the regulatory exception was enforceable and did not violate public policy. Other insured versus insured exclusions have exceptions for liquidator claims. However, in *Strong v. Prince, Yeates & Geldzahler*,[52] the Utah federal district court held that the liquidator exception did not apply when the liquidating trustee was appointed after the policy period, so the liquidator's claim was not covered.

Conclusion

EPL and D&O insurance provides important coverages for organizations and their leaders. Although each insurer has its own policy language, there are many common principles, as discussed in this article. Thus, carefully studying the policy language and case law is an excellent investment for Colorado counsel involved in commercial litigation.

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NOTES

1. Some management liability package policies also include fiduciary liability insurance; crime coverage; professional liability insurance; executive life and disability policies; and/or kidnap, ransom, and extortion coverages. Those additional coverages are beyond the scope of this article.
2. The article cites Colorado cases when available, but there are still many gaps in the decisions for some of the particular coverage issues in this article. The gaps are filled in with Tenth Circuit cases and other decisions that are consistent with Colorado law.
3. See the analysis in Weimer, "Colorado CGL Coverage B Demystified," 53 *Colo. Law.* 44, 44–47 (Mar. 2024), https://cl.cobar.org/features/colorado-cgl-coverage-b-demystified.
4. Weimer et al., *Employment Practices Liability* 21–22 (2d ed. National Underwriter 2012).
5. *See, e.g., Nicholls v. Zurich Am. Ins. Grp.*, 244 F.Supp.2d 1144, 1155 (D.Colo. 2003) (the D&O policy defined "wrongful act" as an "error, misstatement, misleading statement, act, omission, neglect, or breach of duty").
6. Hagglund et al., *Directors & Officers Liability* 111 (National Underwriter 1999).
7. *McCalla Corp. v. Certain Underwriters at Lloyd's*, No. 13-1317, 2014 U.S. Dist. LEXIS 60309, at *10 (D.Kan. May 1, 2014).
8. *Beauvallon Condo. Ass'n v. Granite State Ins. Co.*, No. 11-cv-00215, 2011 U.S. Dist. LEXIS 69606, at *12 (D.Colo. June 29, 2011).
9. *Nicholls*, 244 F.Supp.2d at 1155.
10. *Id.* at 1155 n.4.
11. *Id.* at 1157–58.
12. *Denver Inv. Advisors, LLC v. St. Paul Mercury Ins. Co.*, No. 17-cv-00362, 2017 U.S. Dist. LEXIS 114564, at *8–9 (D.Colo. July 24, 2017).
13. *Vicorp Rests., Inc. v. Fed. Ins. Co.*, No. 92-C-751, 1993 U.S. Dist. LEXIS 20294 (D.Colo. June 30, 1993).
14. *Id.* at *3 (citing *Harbor Ins. Co. v. Cont'l Bank Corp.*, 922 F.2d 357 (7th Cir. 1990)).
15. *Id.* at *4 (citing *Harbor Ins. Co.*, 922 F.2d at 367–68 and *Nodaway Valley Bank v. Continental Cas. Co.*, 715 F.Supp. 1458, 1466 (W.D.Mo. 1989)).
16. *Beauvallon*, 2011 U.S. Dist. LEXIS 69606, at *13.
17. *Genesis Ins. Co. v. Crowley*, 495 F.Supp.2d 1110, 1118 (D.Colo. 2007).
18. *McCalla*, 2014 U.S. Dist. LEXIS 60309.
19. *Denver Inv. Advisors*, 2017 U.S. Dist. LEXIS 114564, at *30.
20. *ClearOne Commc'ns, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh*, 494 F.3d 1238, 1253 (10th Cir. 2007) (Utah law).
21. *Level 3 Commc'ns Inc. v. Fed. Ins. Co.*, 272 F.3d 908, 911 (7th Cir. 2001).
22. *Genesis Ins.*, 495 F.Supp.2d at 1118.
23. *Id.*
24. *McCalla*, 2014 U.S. Dist. LEXIS 60309, at *13.
25. *Beauvallon*, 2011 U.S. Dist. LEXIS 69606, at *12.
26. *Genesis Ins.*, 495 F.Supp.2d at 1117.
27. *Id.*
28. *Barr v. Colo. Ins. Guar. Ass'n*, 926 P.2d 102, 104 (Colo.App. 1995).
29. *Id.* at 104.
30. *Atl. Specialty Ins. Co. v. Blue Cross and Blue Shield of Kan., Inc.*, 664 F.Supp.3d 1246, 1274 (D.Kan. 2023).
31. *Friedland v. Travelers Indem. Co.*, 105 P.3d 639, 641 (Colo. 2005).
32. *Craft v. Phila. Indem. Ins. Co.,* 343 P.3d 951, 953 (Colo. 2015).
33. *Id.* at 959.
34. *Id.* at 953.
35. *Genesis Ins.*, 495 F.Supp.2d at 1116.
36. Weimer, *supra* note 4 at 22–23.
37. *See, e.g.*, Hagglund, *supra* note 6 at 112–14.
38. *Cohen-Esrey Real Estate Servs., Inc. v. Twin City Fire Ins. Co.*, 636 F.3d 1300, 1303 (10th Cir. 2011) (Kansas law) (internal quotation and citation omitted).
39. *Rivelli v. Twin City Fire Ins. Co.*, 359 F.App'x 1 (10th Cir. 2009) (Colorado law).
40. *Davis & Assocs., PC v. Westchester Fire Ins. Co.*, No. 10-cv-03126, 2012 WL 202787, *20–21 (D.Colo. Jan. 24, 2012) (citing *Selko v. Home Ins. Co.*, 139 F.3d 146, 150–52 (3d Cir. 1998)); *Westport Ins. Corp. v. Lilley*, 292 F.Supp.2d 165, 171 (D.Me. 2003).
41. *ClearOne Commc'ns*, 494 F.3d 1238 at 1249 (Utah law).
42. *W. Heritage Bank v. Fed. Ins. Co.*, 557 Fed. Appx. 807, 812 (10th Cir. 2014).
43. *Navigators Specialty Ins. Co. v. Beltman*, No. 11-cv-00715, 2012 U.S. Dist. LEXIS 156666, *20 (D.Colo. Nov. 1, 2012).
44. *Payless Shoesource, Inc. v. Travelers Cos.*, 585 F.3d 1366 (10th Cir. 2009) (Gorsuch).
45. *Id.*
46. *T.D. Williamson, Inc. v. Fed. Ins. Co.*, No. 21-5043, 2022 U.S. App. LEXIS 10057, *6 (10th Cir. Apr. 14, 2022).
47. *FDIC v. Bowen*, 865 P.2d 868, 870–71 (Colo. App. 1993).
48. *Powell v. Am. Cas. Co. of Reading*, 772 F.Supp. 1188, 1190–91 (W.D.Okla. 1991).
49. *BancInsure, Inc. v. McCaffree*, 3 F.Supp.3d 904 (D.Kan. 2014).
50. *Id.* at 911—12.
51. *FDIC v. Am. Cas. Co. of Reading*, 814 F.Supp. 1021 (D.Wy. 1991).
52. *Strong v. Prince, Yeates & Geldzahler*, 416 F.Supp.3d 1300 (D. Utah 2019).