Finding Coverage for Wage and Hour Class Actions

Better to Split Hairs, Than Pull Them

By David A. Shaneyfelt

Wage and hour class action lawsuits have been the gold rush in employment law over the past decade. Liquidated damages, punitive damages, huge attorney fee awards — combined with lenient class requirements — have combined to create a veritable stampede of class action lawsuits. And what began in California has now spread elsewhere in the nation where similar conditions exist.

Employers have faced this rush, thinking their employment practices liability (EPL) insurance companies would defend them against it. Alas, this is not always so. Few letters are more sobering than the one an employer receives, after tendering a class action wage and hour suit to its EPL insurance company, that says, "We regret to inform you we have no obligation to defend you against, or indemnify you for, this lawsuit."

But don't take your insurance company's word as gospel. Insurance policy language is everything and sometimes it's not what your insurance company wants you to believe.

Failure To Pay Overtime Wages

Often the heart of every class action wage and hour suit is the claim that the employer has failed to pay overtime wages as required by law. And it is this claim that allows most EPL insurers to assert that no coverage exists.

An exclusion in many employment practices liability insurance policies is that no coverage exists for any alleged violation of the federal "Fair Labor Standards Act . . . or any similar provision

of federal, state or local statutory law or common law." The Fair Labor Standards Act (FLSA) tends to create three kinds of liabilities for an employer: (1) failure to pay minimum wage, (2) failure to pay overtime wages and (3) wrongful classification of an employee as an exempt employee. A policyholder would be hard-pressed to find coverage for any state or federal claim that alleged any, and only, one of these three kinds of liabilities.

But note the limiting policy language apart from the reference to the FLSA: ". . . any *similar provision* of federal, state or local statutory law or common law." What is a "similar provision" of some non-FLSA law? By its terms, "similar" should refer to laws that, like the FLSA, also address *minimum wage, overtime wages*, or *wrongful classification* of employees. And that's as far as that limitation should go. Not only is this a reasonable construction of the policy language, it is narrow in scope. Courts are clear that policy exclusions must be read narrowly and construed against the insurance company that drafted them.

Thus, while the exclusion is bad news for a policyholder facing a claim for failure to pay overtime wages, that news does *not* extend to the many other so-called wage and hour claims that often appear in wage and hour class actions that do *not* relate to minimum wage, overtime wages, or wrongful classification of employees. For employers in states such as California and Florida that have an abundance of laws creating employment liability for claims *other than* minimum wage, overtime, or wrongful classification, this is *very* good news.

Non-FLSA-Type Claims

What, then, are non-FLSA-type claims? The California Labor Code offers several examples. Section 226 requires employers to provide accurate itemized wage statements. Mistakes in providing such statements will subject the employer to a variety of penalties. Section 2802 requires employers to reimburse employees for all work-related expenses. Failure to reimburse employees for uniforms, equipment, or mileage could subject an employer to other claims and penalties. Section 201 requires timely payment of wages at termination and imposes "waiting time" penalties.

None of these claims are arguably excluded from common EPL insurance policy language. In other words, an insurance company arguably has a duty to defend and indemnify an employer against such claims. And, according to settled law, if the insurance company has a duty to defend against *one* claim, it has a duty to defend against *all* claims, covered or not.

The operative word is "arguably," because this construction is largely untested in the courts. One California appellate court reached this conclusion, but is "unpublished" and therefore without precedential value in that state. See *SWH Corp. v. Select Ins. Co.*, Cal. App. Unpub. LEXIS 8694 (2006). More helpful is a recent decision from a California federal court which also followed this same reasoning and found such claims covered under the above policy language. See *California Dairies, Inc. v. RSUI Indemnity Co.*, 2010 U.S. Dist. LEXIS 64049 (E.D. Cal. July 25, 2010).

Meal and Rest Breaks Claims

Another common wage and hour class claim is for an employer's failure to provide proper meal and rest breaks for employees. The potential damages are staggering when claims extend to large numbers of employees over a previous four-year period.

Two aspects about such claims present thorny coverage questions. First, are these claims "similar" to FLSA claims? The court in *California Dairies* called this a close question and said yes; the court in *SWH Corp.* said no. No doubt further litigation of this issue remains to be seen.

Second, are penalties imposed for missed rest and meal breaks compensatory loss and therefore insurable damages? Insurance companies argue that such penalties are excluded from coverage either because they are "fines and penalties" of the kind generally excluded from coverage, or because they amount to "restitution" of wages, which is also non-insurable.

But au contraire. The fines and penalties excluded in insurance policies are typically *criminal*-type penalties, which these are not. And liquidated damages for missed meal or rest breaks is not "restitution," because the employer is not returning to the employee something it wrongfully kept, which is what makes restitution uninsurable. Thus, strong arguments can be made for the coverage of missed meal or rest breaks.

Unfair Business Practice Claims

Wage and hour class actions in California typically include a claim under section 17200 of the Business

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and Professions Code, which, essentially, allows "unfair business practice" claims against employers for violations of the Labor Code. The inclusion of such a claim is critical for insurance purposes, because it tends to obligate the insurance company to defend against the entire lawsuit. Such claims are *not* FLSA-type claims that would be excluded from coverage under standard policy language, and, as noted, if an insurance company has a duty to defend against this one claim, it has a duty to defend against all claims, even non-covered FLSA-type claims.

The downside to section 17200 claims is that remedies are generally limited to injunctive relief, not money damages, and insurance generally only covers money damages (absent, say, a definition of "loss" to include defense costs to resist equitable claims). This means class action settlements involving payment of money damages will be without recourse to insurance proceeds, if section 17200 is the sole basis for insurance defense. On the other hand, a defense is better than no defense if no other claims are available to trigger an insurance company's defense or indemnity obligations.

Conclusion

In short, it pays to parse the language of the policy. Wage and hour class actions may be covered under some EPL insurance policies. And, even if damages might not be covered, a defense of the suit might be covered, and that in itself could be a substantial benefit for the policyholder. ▲

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Common sense, not to mention custom and practice in the insurance industry, suggests that the TPA owes duties of care solely to its client, the policyholder — not to the insurance company with which the TPA is not in privity. In most states, breaches of duty to give notice to and cooperate with the insurance company under occurrence-based policies are valid coverage defenses only when the insurer has been substantially prejudiced. So, if a TPA has been dilatory in giving notice or by failing to cooperate, the policyholder would be the only party with standing to recover the portion of the loss that could have been avoided had notice been timely and cooperation been above reproach.

Traditionally, subrogation was the only route by which the insurance company could gain access to the assets (and professional liability coverage) of the TPA. The insurer would first pay the claim, becoming subrogated to the policyholder's right of action against the TPA, then sue the TPA in the name of the insured. The carrier could not compel the TPA and its malpractice insurer to participate in the process of settling the original insurance claim the carrier received a premium to cover. Reallocation according to relative fault was possible only after this process was concluded by the insurance company's payment of the claim. Nothing stood in the way of the policyholder's recovery of the covered claim from the insurer.

One court has now recognized a direct duty of care running from the TPA to the insurance company, jeopardizing the policyholder's ability to promptly recover a covered claim from its carrier. By asserting a direct malpractice claim against the TPA, the carrier can avoid having to pay the claim (a condition precedent to being subrogated to the insured's rights of action), refusing coverage based on the claim administrator's alleged mistakes. This gives the carrier a new way to avoid or postpone payment of an otherwise covered claim by involving a third party with whom it has no contractual relationship. See N*ational Union Fire Insurance Company of Pittsburgh, PA v. Cambridge Integrated Services Group, Inc.* (2009) 171 Cal.App.4th 35.

With this case in hand, insurance companies are demanding that TPAs and their carriers attend California mediations and settlement conferences ready to contribute toward payment of covered claims. This disrupts contractual relationships between TPAs and their corporate clients, and allows insurers to avoid covering risks they were paid to assume. The best way to avoid shifting to TPAs the coverage obligations of their clients' carriers is for administrator and client to foster a strong relationship impervious to triangulation by an insurer. This way, if there is ever an issue about how a claim was handled, it can be resolved privately between client and TPA, without cutting off the client's insurance company's duty to pay the policyholder's loss sooner rather than later. ▲

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