Directors and Officers Discrimination Coverage

Adam Leitman Bailey & Colin E. Kaufman
Adam Leitman Bailey, PC

The Appellate Division decision titled *Fletcher v. The Dakota Inc.* held that the business judgment ruled does not protect individual condominium and cooperative board members from some personal tort liability. This alarming result has caused real estate and insurance attorneys to review directors and officers policies and the law to try determine whether their clients will be protected in the event of a claim of discrimination. This article answers the question in the negative and although the individual board members may receive a legal defense from the insurance carrier, any award against a board member may not be indemnified.

Insurance spreads the risk of loss from fortuitous events

The purpose of insurance is to allow risk-spreading. A pool of insureds each contribute premiums. Each insured has a small but calculable likelihood of experiencing a substantial loss which is covered by the insurance contract. Upon the happening of a covered event which results in loss, the carrier is obliged to indemnify the insured for the covered portion of its loss. Because the events insured against must be dependent to a greater or lesser degree on chance, one cannot insure against a known predictable loss, such as normal wear and tear on one's machinery, or the near-certainty that known seepage will destroy the wallboard in one's cellar. See, generally Am Jur Insurance ¶ 2.

An obvious exception is that of life insurance, but while the death insured against is certain, its timing is not; life insurance proceeds on the theory that life spans in the population are statistically predictable and thus premiums, taken as a whole, will exceed dispensation of insurance awards. Carriers also predict that many term life insureds will drop their coverage after having paid in premiums and, obviously, not yet dying.

The types of insurance which may be written in New York are set forth generally in § 1113 of the Insurance Law. The insurance industry in New York (and throughout the US) is heavily regulated; see, generally, NY Insurance Law.

Except for matters of public policy, insurance is totally a creature of contract

An insurance contract is just that – a contract. No coverage exists unless it is specifically set forth in the policy. There are no rights arising by implication from the policy. The policy will define its terms (e.g., “insured”, “loss”), its coverage (i.e., that which it insures against), exclusions from coverage (e.g., pre-existing conditions), exclusions from coverage (too numerous even to start), duties of the parties in the event of a loss (e.g., notice to the carrier, protection of insured property), rights of the parties in the event of a loss (e.g. right of the carrier to inspect, right of the insured to contest carrier’s appraisal), the term of the policy and, in some instances, the geographic reach and limitations of the policy. The Courts are reluctant to intrude on the contract between a carrier and its insured: “…when statutes and Insurance Department regulations are silent, we are reluctant to inhibit freedom of contract by finding insurance policy clauses violative of public policy.” *Slayko v. Security Mutual Ins. Co.*, 98 N.Y.2d 289, 295, 774 N.E.2d 208, 212 (2002).

A failure to abide by the terms of the contract may well vitiate coverage (e.g., not allowing the carrier’s adjuster to inspect, failure to report a claim as soon as practicable resulting in prejudice to the carrier). As with any contract, an ambiguity is normally construed against the drafter (i.e. the carrier).

As Determined by the Legislature and the Courts Some Events Cannot Be Insured Against As a Matter of Public Policy

Public policy in New York does not permit insurance coverage against punitive damages. *Home Ins. Co. v Am. Home Prods. Corp.*, 75 N.Y.2d 196, 200, 551 N.Y.S.2d 481 (1990), and Circular Letter No. 6 (1994) of the Insurance Department.

In general, one cannot insure against intentional acts of the insured which bring about intended results (e.g. socking someone, causing injury or purposely

discriminating against a member of a protected class). The public policy in New York is that one cannot profit from its own wrongdoing and thus, for example, the well-known prohibition against killing one's spouse and collecting the life insurance proceeds. "As a matter of policy, conduct engaged in with the intent to cause injury is not covered by insurance." *Town of Massena v. Healthcare Underwriters Mutual Ins. Co.*, 98 N.Y.2d 435, 445, 779 N.E.2d 167, 171 (2002) [citations omitted].

Insurance companies cannot pay a judgment against an insured for punitive damages. The fact that punitive damages are sought in a lawsuit will not prevent an insured from receiving a legal defense paid by the insurer. However, if both actual and punitive damages are awarded, indemnification applies only to the actual damages awarded and not, as a matter of public policy (and generally as a matter of contract, also) to the punitive damages.

Department of Financial Services Anti-Discrimination Directive

One area in which the public policy of the state is clear is that of discrimination liability. Circular Letter No. 6 (1994) of the Insurance Department (now the Department of Financial Services) which is binding on carriers for policies written in New York discusses liability for discriminatory acts. It permits coverage for acts of discrimination based solely on disparate impact (but not disparate treatment) or vicarious liability. However, it goes on to state that

> Liability insurance coverage for intentional wrongs is, and has always been, prohibited on two related grounds: first, purposeful misconduct lacks the element of "fortuity" generally required of insurance contracts; and, second, indemnification of wrongful conduct that is intentional (and hence in theory may be deterred) is against public policy.
>
> ***
>
> Discrimination based upon disparate treatment is an intentional wrong whose resultant harm flows directly from the acts committed, and liability coverage for it is impermissible.

See,American Mgmt. Ass'n v.Atlantic Ins. Co., 168 Misc.2d 971, 641 N.Y.S.2d 802(N.Y.Sup.1996), *aff'd no op. ,* 234 A.D.2d 112, 651 N.Y.S.2d 301 (1st Dept. 1996), *leave to appeal denied,* 90 N.Y.2d 888, 661 N.Y.S.2d 832, 684 N.E.2d 282 (1997).

The duty to defend is broader than the duty to indemnify

If a claim is made against an insured under a liability policy, there are two issues to consider: whether the insured has a right to indemnification from the carrier and whether the insured has a right to a defense paid for by the carrier. The two issues are separable and as succinctly put by the Court of Appeals last year:

> An insurer's duty to defend is liberally construed and is broader than the duty to indemnify, "in order to ensure [an] adequate ... defense of [the] insured," without regard to the insured's ultimate likelihood of prevailing on the merits of a claim. As we have explained on multiple occasions, the insurer's duty to defend its insured "arises whenever the allegations in a complaint state a cause of action that gives rise to the reasonable possibility of recovery under the policy". Moreover, if " 'any of the claims against an insured arguably arise from covered events, the insurer is required to defend the entire action' ". It is "immaterial that the complaint against the insured asserts additional claims which fall outside the policy's general coverage").

Fieldston Property Owners Ass'n v. Hermitage Ins. Co., 16 N.Y.3d 257, 264–265, 920 N.Y.S.2d 763 (2011) [citations omitted].

As a practical matter, plaintiffs, including discrimination plaintiffs, nearly always allege or seek to allege facts or legal theories which bring the suit within coverage. As noted above in *Fieldston*, if one of the claims is arguably within coverage, the carrier is obliged to defend. Once the carrier is "at the table," settlement is much more likely; carriers have cash with which to settle and little interest in vindicating the acts or procedures of their insureds. See, e.g. *Bravo Realty Corp. v. Mt. Hawley Ins. Co.*, 33 A.D.3d 447, 823 N.Y.S.2d 360 (1st

Dept.2006) ("The record does not permit us to conclude, as a matter of law, that the damages claimed in the underlying action are barred by the policy's exclusions for known loss, expected or intended property damage, or discrimination…").

Definitions and Exclusions

Every policy contains definitions which may limit coverage for certain events or persons and exclusions which except certain events from coverage. In the attached exemplar Zurich policy, for instance, at the D & O coverage part, page 4 of 7, III H, the policy defines "Loss" in a manner which includes judgment and penalties only "…if such violation is not knowing or willful…" and goes on to say "Loss does not include "matters uninsurable under the law pursuant to which this policy is issued."

In the Exclusions section pages 5-7 of 7 of the D & O coverage part, the policy excludes from coverage at IV E ERISA violations, at IV I an act "…based upon, arising out of or attributable to … any willful violation of any statute or regulation committed by such Insured…"

It bears repeating that insurance is governed by contract. Even if the insured thought he, she or it was covered, if the loss is outside the definition of coverage in the policy, there is no coverage. If the loss is one which has been excluded, again there is no coverage.

One of the things we, as lawyers, should be doing is urging our clients to actually read their policies to see just what is covered and what is not. Except in very limited circumstances (e.g. *American Bldg. Supply Corp. v. Petrocelli Group, Inc.,* 19 N.Y.3d 730, --- N.E.2d ----, 2012 WL 5833969), policyholders will be conclusively presumed to have read and to know the contents of their policies, see *Metzger v. Aetna Ins. Co.*, 227 N.Y. 411, 125 N.E. 814 (1920).

Claims Made v Occurrence Policies

Liability policies can be either "claims made" policies or "occurrence" policies. An occurrence policy covers a loss which occurred during the policy period, whether or not reported during the policy period. Thus, if a plaintiff sustained an injury in 2011, but did not make a claim or bring suit until 2012, the occurrence policy in effect in 2011 would cover since the occurrence happened during the policy period. If the same plaintiff sustained the same injury in 2011, but the insured had a claims made policy and the claim was not brought either in the policy period or the extended reporting period, the 2011 policy would not offer coverage and hopefully the client had a claims made policy in effect when the claim was made. See, *Segal Co. v. Certain Underwriters at Lloyds, London*, 21 A.D.3d 138, 142, 798 N.Y.S.2d 30, 32 (1st Dept. 2005).

Claims made policies are generally less expensive for the same amount of coverage since the carrier knows exactly when its period of liability ends.

How to Review an Insurance Policy to Determine Coverage and to File a Claim

A lawyer consulted by a client who wants to make any insurance claim or against whom a claim is made or suit brought has to do several things.

You must review the policy (not just the declarations page, also known as the "dec sheet"). You have to ascertain coverage, i.e., was this policy in effect at the time of the loss, is this an arguably covered event, is there exclusionary language you have to consider. Review every policy which may potentially offer coverage, including excess or umbrella policies.

You (or the insured) have to notify the carrier(s) "as soon as reasonably practicable" – notice only to the client's independent insurance broker is generally <u>not</u> notice to the carrier (the notice address is generally in the "Duties in the Event of Loss" section). The most effective method of giving notice is via the appropriate Acord (yes, it's correctly spelled) form, see, www.acord.org. If you have a broker or agent give the actual notice, make sure you draft the events in the way most favorable to your client's coverage position, given the facts known

to you and make sure you are copied on everything sent to the carrier. You must urge the client to document everything – pictures, receipts, correspondence, etc.

Generally, in a third-party claim (one brought by someone who is not the insured), the carrier will assign counsel to defend. As private counsel for your client, the client may wish you to monitor any litigation. If there is a question of whether coverage will be sufficient given the nature of the claim, it may be advisable for you to seek to be (or to engage) co-counsel to protect the client's assets in excess of coverage. In the event of a declination of coverage, you and your client should consider whether a declaratory judgment action to seek to secure coverage is warranted. If the carrier denies coverage both for indemnification and a defense, you will have to defend the action, while, at the same time seeking a declaratory judgment.

As a plaintiff's lawyer for someone who says he or she has been discriminated against, you must be aware of the myriad of City, state and federal statutes in the discrimination area (an area beyond the scope of this article). Assuming your factual investigation confirms the claim, you should draft so as to ensure that at least some of the claims fall within permissible coverage, if the facts permit. As private counsel for a discrimination defendant, you should seek to ensure that the carrier picks up the defense. You should also advise your client of their evidence preservation responsibilities.

Conclusion

There is no good news in this article as far as coverage for board members who commit intentional torts and lose at trial as coverage will not be provided. Intentional discrimination cannot be covered as a matter of public policy, State Law and Departmental regulation.