INSURANCE COVERAGE FOR EMPLOYMENT CLAIMS

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I. INTRODUCTION

The past decade has seen a dramatic increase in the number of claims alleging torts arising in the workplace. Legislative efforts to increase workplace diversity, to enforce equal opportunity and to encourage "politically correct" management practices have contributed to this increase. These legislative enactments frequently provide for some administrative oversight by governmental agencies. However, the primary responsibility for implementing these important government-initiated social reform measures has been placed in the hands of employers. Even though government agencies do take some role in enforcement, the ultimate enforcement mechanism created by these laws is found in trial lawyers taking grievances to court.

Many of the claims statistics available on the issue of employment claims are provided by those in the business of selling products and services meant to deal with the increased risk and exposure associated with this increase in suits. These statistics must, therefore be viewed with some caution. While there are conflicting statistics, the average compensatory loss for wrongful termination in general has been reported to be as low as $532,000.00 and as high as $780,000.00. The average award for sexual harassment claims has been reported to range from $120,000.00 to $250,000.00, while age discrimination claims have been reported to average as high as $2,000,000.00. One insurance consulting firm estimates that there are in excess of 200,000 wrongful employment practices complaints on file at state agencies and with Equal Employment Opportunity Commission at any given time. The same service estimates a 2,000% increase in discrimination suits since 1974. Their research indicates that there are somewhere around 450 employment tort law suits filed in the United States every day. Approximately 20% of the total civil litigation in the United States involves employment issues. These issues are also frequently emotionally charges issues. Another consulting firm indicates that more than a third of women in the United States believe they have suffered on-the-job sexual harassment or discrimination. By the same token, they report that 80 % of all employers who have been defendants in employment tort cases believe that they were victims of unfair or frivolous allegations. Again, some of the statistics may be exaggerated for the purposes of selling "employment practices liability" insurance, they probably are instructive regarding the trend in employment related claims.

This trend is not a merely national phenomenon. Recent filings in the state courts in Dallas County have shown a similar trend. For example, on March 17, 2006, the Dallas District Clerk's office reported twenty-four total cases filed on that day. Of those twenty-four cases, thirteen were tort cases seeking damages for injuries. Of those thirteen tort cases, seven were employment related torts. Two cases were insurance bad faith claims. There were two car wreck cases, one medical malpractice case, and one legal malpractice case. While it is unusual that a single days tort filings were more than half employment cases, this day is representative of a significant trend.

In order to understand the insurance coverage implications of employment torts, some discussion of the substantive employment law in Texas is appropriate. This paper will be begin with a general overview of Texas employment law and the various causes of action for employment related which can arise under Texas and Federal laws. The paper will then discuss some of the issues which can arise in evaluating insurance coverage issues under both CGL and Workers Comp insurance policies. Finally, the paper will discuss in general terms the nature of employment practices liability insurance coverage and common coverage provisions found in these contracts.

II. OVERVIEW OF TEXAS EMPLOYMENT LAW

A. Employment at Will

Any discussion of employment law in Texas must begin with the general discussion of the nature of the employment relationship in Texas. In the absence of an express agreement to the contrary, the employee/employer relationship in Texas is said to be "at-will." Under this "at will"doctrine, absent a contractual or statutory to the contrary, either the employer or employee may terminate the employment relationship at any time with or without cause. *Eastline & Red River Railway Company v. Scott*, 72 Tex. 70, 10 S.W. 99 (1888). Both employers and employees enjoyed a near unfettered right to terminate their employment relationship for any reason for almost a century.

After the Texas Supreme Court set out the employment-at-will doctrine in the *Eastline* decision, this remained the law for almost a hundred years. Texas Supreme Court carved out an

exception to the employment-at-will doctrine in 1985. In *Sabine Pilot Service, Inc. v. Hauck*, 687 S.W.2d 733 (Tex. 1985), the Supreme Court held that , as matter of public policy, an employer may not discharge an employee because of his or her refusal to commit an illegal act. This narrow exception to the at-will doctrine applies where the employee's refusal to perform an illegal act is the sole reason for their discharge. In general, courts have construed the *Sabine Pilot* exception to the at-will doctrine very narrowly. In order to have a viable claim under this "public policy", the employee must prove that he or she was required to engage in an act that carried criminal penalties or faced termination. *Burt v. City of Burkburnett*, 800 S.W.2d 625 (Tex. App.–1990, writ denied); *Hancock v. Express One International, Inc*., 800 S.W.2d 634 (Tex.App.– Dallas 1990, no writ).

The Texas Supreme Court has also refused to extend and expand the at-will relationship based on oral assurances of job security. This is true based both on the at-will-employment doctrine and on the doctrine of statute of frauds. Under that doctrine, oral promises not capable of being performed in one year or less are unenforceable under the Texas Business & Commerce Code. See, *Schroeder v. Texas Ironworks, Inc.*, 813 S.W.2d 483, 489 (Tex. 1991).

Creative litigants have repeatedly tried to encourage the courts to recognize other exceptions to the employment-at-will doctrine above and beyond the *Sabine Pilot* exception. While the Texas Whistle Blower Act does provide some protection to public employees who report a violation of law by their employers, there is no Texas common-law "whistle blower" protection against private employers. *Austin v. Health Trust, Inc.*, 967 S.W.2d 400 (Tex. 1998). In that case, the Texas Supreme Court stated that because the Texas Legislature and the United States Congress have actively adopted numerous specific statutes which prohibit retaliation against whistle blowers in specific situations, it would be inappropriate for the court to adopt a broad whistle blower exception to the common-law doctrine of employment-at-will. Thus, "whistle blower" retaliation cases are limited to specific statutes which create that cause of action, either under Texas or Federal law. Several of these provisions are discussed later in this paper.

In addition, the Texas Supreme Court has repeatedly refused to adopt an implied covenant of good faith and fair dealing in the context of the employment relationship. Adopting such a tort duty above and beyond the nature of the employment relationship would be very close to the destruction of that employment-at-will doctrine. See, *Federal Express Corporation v. Dutschmann*, 846 S.W.2d 282, 284 (Tex. 1993).

While there is no general duty of good faith and fair dealing, there are numerous other legal doctrines which have limited the applicability of the employment-at-will doctrine. These consist of contract law theories, federal and state legislation touching on the employment relationship, as well as common-law intentional tort theories.

B. Contractual Limitations On Employment-At-Will

If the parties have entered into a written contract that specifies the circumstances under which an employee may be discharged or states that the employee may be discharged only for good cause, the employer's right to at-will termination is replaced by the contractual provisions. See, *Langford v. Home for Aged Masons*, 617 S.W.2d 778 (Tex.App.–Fort Worth 1981, no writ). Some written employment agreements can specifically retain the at-will-employment doctrine while simultaneously adding other contractual provisions to the relationship. The key in evaluating whether the contract has some effect on the at-will relationship is the issue of the circumstances of termination. For example, an employment contract that specifies an annual salary may be construed as constituting a contract of employment for one year that transforms the employer's right of termination at-will into a more limited right to terminate only for cause during that one-year term. See, *Winograd v. Willis*, 789 S.W.2d 307 (Tex.App.–Houston [14th Dist.]1990, writ denied). As a general rule, written representations contained in an employee handbook generally do not give rise to contractual obligations under Texas law, particularly if the handbook includes some disclaimer of such an effect. See, *Federal Express Corporation v. Dutschman*, Id. at 283. On the other hand, if an employee handbook or policy manual contains detailed procedures for discipline and discharge and creates a clear impression that discharge is appropriate for good cause only, such provisions may be found to modify the at-will employment rule. See, *Hicks v. Baylor University Medical Center*, 789 S.W.2d 299, 302 (Tex.App.– Dallas, 1990 no writ).

Under the Texas Business & Commerce Code, an employee may only bring a breach of contract claim based on an oral promise if that promise would be

enforceable under the statute of frauds. TEXAS BUSINESS & COMMERCE CODE Section 26.01(b)6. This is somewhat complicated by the doctrine of indefinite term contracts. Such contracts can be considered performable within one year and therefore may not fall within the statute of frauds. See, *Gerstacker v. Bloom Consulting Engineers*, 884 S.W.2d 845 (Tex.App.– Dallas 1994, writ denied). The Texas Supreme Court has made clear that whatever the situation, an employers oral statements do not modify an employee's at-will status absent a definite, stated intention to the contrary. See, *Montgomery County Hospital v. Brown*, 965 S.W.2d 501 (Tex. 1998).

In general, specific circumstances can cause an implied promise, or the doctrine of promissory estoppel to modify the employment-at-will relationship. See, *Goodyear Tire & Rubber Company v. Portilla*, 879 S.W.2d 47 (Tex. 1994) and *Levine v. Loma Corp.*, 661 S.W.2d 779 (Tex.App.– Fort Worth 1983, no writ). However, these contractual exceptions to the employment-at-will doctrine are very fact-specific and are thus dependent upon the specific evidence developed in each case. As a general rule, unless there is some very specific intent to the contrary, employment in Texas remains an at will proposition.

C. Employment Torts Based on Common Law Theories

The employment-at-will doctrine and the related contractual theories on which employment is based will determine the issue of whether an employer can terminate the employment relationship. This means that absent some common-law, statutory, or contractual restriction on the right of discharge, that discharge is not a tort. The Texas cases have been relatively clear that there is no generalized tort of wrongful termination or wrongful discharge. See, *Barry v. Doctors Health Facilities*, 715 S.W.2d 60 (Tex.App.–Dallas 1986, no writ). There may, however, be numerous other torts which may arise in the workplace, but which are not necessarily related directly to the employment relationship. In other words, there may be conduct which can occur between an employer and employee, or between co-employees, which would still be tortious conduct even if such an employment relationship did not exist. Common examples of these intentional torts which occur within the workplace, but not necessarily because of the workplace are torts such as assault, battery, intentional infliction of emotional distress, false imprisonment, malicious prosecution, and invasion of privacy.

In addition, tortious interference with contractual relationships can arise in the circumstances of an employment relationship as well. The existence of the employer/employee relationship may be a circumstance which placed the parties in contact with one another, but the underlying tortious nature of the conduct would be governed by the common-law relating to each individual tort rather by the law relating to the employer/employee relationship. For example an assault that occurs by a supervisor would be governed by the nature of tort law and not by the fact that it is the supervisor.

As a general rule, an employer may be liability for the torts of its employees under the doctrine of *respondeat superior*. Agency law in Texas provides that an employer will be liable for an employee's tortious conduct to the extent that it is committed within the scope of his or her employment. There are numerous cases in Texas which stand for the general proposition that intentional torts are generally not within the course and scope of employment. However, such intentional acts can sometimes be connected by direct negligence doctrine such as negligent hiring, negligent retention, negligent training, and negligent supervision. In such a case, the plaintiff alleges that the employer acted negligently in hiring, retaining, training, or supervising the employee. Thus, while the act committed by the employee may be an intentional tort, the employer can be held liable for that employee's actions on a negligence theory. Under this theory, plaintiffs assert that the employers owe a duty to the public and to their employees to inquire into the qualifications, competence, and potential dangerous tendencies of persons they employ. See, *Carney v. Roberts Investment Company, Inc.*, 837 S.W.2d 206-211 (Tex.App.– Tyler 1992, writ denied). This kind of claim frequently arises in the context of the hiring and retention of persons who have previously been involved with sexual misconduct and later engage in similar acts after the employer is on notice of such actions. These claims should be evaluated carefully in the context of preemption. It may be that such claims are preempted by specific state or federal statutes that govern cases arising out of the same facts. See, *Cook v. Fidelity Investments*, 908 F.Supp. 438, 442 (N.D. Tex. 1995) and *Mackey v. U.P. Enterprises, Inc.*, 935 S.W.2d 446 (459-60) (Tex.App.–Tyler 1996, no writ). Examples of such cases where an alleged negligent act by the employer

places a person at risk of being the victim of an intentional tort are discussed later in this paper in connection with the issue of whether the conduct in question is an accidental occurrence under an insurance policy.

D. Employment Torts Based on Statutory Theories

In addition to the theories of intentional tort and negligence which can arise within the workplace, there are a number of statutory provisions which can lead to various kinds of employment claims that can lead to tort liability. Some claims allege damage as the result of actual discrimination. However, many claims also allege damage as the result of retaliation in response to a complaint of discrimination. The list of potential statutory discrimination and retaliation claims is extensive and seems to grow with each session of Congress. A general discussion of some of the more common provisions which lead to litigation will follow.

1. The Americans With Disabilities Act

The Americans With Disabilities Act was passed in 1990. It prohibits employment discrimination against disabled persons who are otherwise qualified for a given job. Disabled individuals under the ADA may be entitled to some reasonable accommodation in order to allow them to perform the essential functions of their job. ADA litigation frequently revolves around the question of whether a given condition qualifies as a disability under a disability under the ADA and what accommodation is reasonable on behalf of that employer. The ADA applies to all employers with 15 or more employees. The ADA is found at 42 U.S.C. Sections 12101 through 12213.

2. The Age Discrimination and Employment Act

The ADEA protects employees over the age of 40 from discrimination on the basis of their age. It applies to employers with 20 or more employees. The ADEA is found at 29 U.S.C. Sections 631 through 634.

3. The Family and Medical Leave Act

The Family and Medical Leave Act of 1993 requires employers to grant 12 weeks of unpaid leave to an eligible employee for certain significant family issues. This Act also requires that after that leave, the employee has the right to be restored to the same of equivalent upon his or her return to work. The FMLA is generally applicable to employers with more than 50 employees and is available to employees who have been employed for at least the last 12 months. The Family Medical Leave Act is found at 29 U.S.C. Section 2601.

4. Title VII of the Civil Rights Act of 1964

Perhaps the most prolific source of employment related litigation in all federal law is Title VII, the Civil Rights Act. This is found at 42 U.S.C. Section 2000(e), *et seq.* This Act prohibits employment discrimination, including termination or retaliation on the basis of race, color, natural origin, religion, or gender. It also prohibits discrimination based on pregnancy, and also prohibits sexual harassment or other harassment based on one of the protective characteristics under Title VII. Title VII applies to all employers with 15 or more employees. Texas Labor Code Chapter 21, the Texas Commission on Human Rights Act is the state law equivalent of Title VII. Both Title VII and the Texas Commission on Human Rights Act contain administrative provision which require an employee to exhaust administrative remedies with a state or federal agency prior to instituting a lawsuit. The federal agency charged with this responsibility is the Equal Employment Opportunity Commission. The Texas state agency is the Texas Commission on Human Rights.

5. Other Anti-retaliation Statutes

A partial list of other statues which provide causes of action for discharge and retaliation to the exercise of certain rights are as follows:

(a) Chapter 451.001 of the Texas Labor Code prohibits retaliation for filing a Workers Compensation claim. Other provisions of the Texas Labor Code prohibit employers from using termination to avoid legitimate unemployment compensation obligations (Section 214.004) and retaliation against an employee for complying with a valid subpoena (Texas Labor Code § 52.051).

(b) Union Related Activities: The Texas Right To Work Law (Texas Labor Code § 101.051) and the National Labor Relations Act (29 U.S.C. Section 151 through 169), prohibit employment discrimination including termination based on membership or non-membership in a union or other participation in union activities. In general, any employment action which is intended to retaliate against, or discourage employees from union activities or membership are improper under one or more of these statutes.

(c) Pensions: The Employment Retirement Security Act of 1974 (ERISA), provides that an employer may not discharge or take other adverse employment action against the employ that is intended to interfere with that employee's "vesting" in retirement benefits under a benefit plan. (ERISA is found at 29 U.S.C. Section 1001, *et seq.).*

(d) OSHA: The Occupational Safety and Health Act prohibits discrimination or retaliation against an employee for filing a complaint or testifying as to violations of OSHA regulations. There is a similar provision in the Texas Labor Code regarding a report for violation of health and safety laws. (Texas Labor Code § 411.082). The OSHA anti-retaliation provision is found at 29 U.S.C. Section 660(c).

(e) Fair Labor Standards and Equal Pay: The Fair Labor Standards Act establishes the right to overtime pay and the right to a national minimum wage. This Act also prohibits an employer from retaliating against an employee for filing a complaint with an agency or with the employer about a wage and hour violation. This provision is found at 29 U.S.C. Section 215. In addition 29 U.S.C. Section 2906, the Equal Pay Act, provides that equal work must be rewarded by equal pay unless the pay differential is based on a bona fide system of seniority, merit, or productivity. Disparities in pay cannot be based on an employee's gender. The Act also provides that an employee may not be the subject of retaliation for making an Equal Pay Act claim.

(f) Other Anti-retaliation Provisions: Federal Law provides that an employee may not be discriminated against on the basis on the fact they have filed a bankruptcy case (11 U.S.C. Section 525(b)). In addition, the Texas Family Code prohibits an employer from discriminating an employee based on employee's withholding order for child support. In addition, both Texas and federal law prohibit adverse actions against an employee based on jury service, political activity and military service.

(g) Sarbanes-Oxley: The newest, and perhaps most significant anti-retaliation provision relates to the Corporate and Criminam Fraud Accountability Act of 2002, The Sarbanes-Oxley Act. The anti-retaliation provisions are found at 18 U.S.C.§ 1514A (a). Under this Act, there is broad protection against whistle-blowing employees who report broad categories of ethical and financial violations that the employee believes may violate the laws that govern publicly traded corporations. This is a statute that was created in response to Enron and other corporate scandals.

A common thread to most of the statutory employment torts is the fact that the actions which constitute violations are usually intentional actions by some person, even if it is not some member of management of the employer that makes the intentional act. The Dallas Court of Appeals recently held that sexual harassment of an employee in the form of supervisor displaying his genitals, asking to see a female employee's breasts, offering to pay a female employee's rent is exchange for sex, placing his tongue in a female employee's ear and giving unwelcome "body hugs" while discussing his sexual prowess were all intentional acts. *Folsom Investments v American Motorists Insurance Company,* 26 S.W. 3rd 556, 561 *(*Tex. App.- Dallas 2000, no pet.)

III. INSURANCE COVERAGE FOR EMPLOYMENT RELATED CLAIMS

Analysis of the insurance coverage questions requires that three general types of policies be evaluated. First, is the commercial general liability coverage form, or CGL policy. Second, is the employer's liability portion of a worker's compensation/employer's liability policy. Finally, the employment practices liability insurance policy is a relatively new coverage vehicle which can be specifically directed at the risks associated with these kinds of claims.

A. Commercial General Liability Coverage

The commercial general liability (CGL) policy form grants a wide range of coverage for the operations of a commercial enterprise. However, at the outset, it is important to remember that CGL policies are not intended to cover all liability that is incurred by modern businesses. In particular, the CGL policy is not intended to provide coverage of any kind for injuries to the employees of the insured. These bodily injuries are more appropriately covered by worker's compensation policies governed by the Texas Worker's Compensation Act. In order to analyse the potential coverage implications of employment claims, a detailed discussion of the CGL policy is appropriate.

1. The CGL Coverage Grant

The current CGL policy form evolved in 1986 from the prior 1973 policy form as well as the "broad form property damage endorsement" which was attached to the 1973 form. The current CGL policy form casts a broad net of coverage in the insuring agreement which is more narrowly-tailored in the exclusions that follow. This broad grant of coverage is evident in the current CGL policy form insuring agreement which generally provides something similar to the following:

(a) Insuring Agreement

(1) We will pay those sums that the insured becomes legally obligated to pay as damages because of bodily injury or property damage to which this insurance applies. We will have the right and duty to defend any suit seeking those damages. We may at our discretion investigate any occurrence and settle any claim or suit that may result. But:

(1) the amount we will pay for damages is limited as described in LIMITS OF INSURANCE, SECTION III, and

(2) our right and duty to defend end when we have used up the applicable limit of insurance in the payment of judgments or settlements under Coverages A or B or medical expenses under Coverage C.

No other obligation or liability to pay sums or perform acts or services is covered unless explicitly provided for under SUPPLEMENTARY PAYMENTS, COVERAGES A AND B.

Two prerequisites to coverage under this insuring agreement are (1) the insured must be legally obligated to pay damages because of bodily injury or property damage; and (2) such damages must arise out of an occurrence. What constitutes "bodily injury" is typically more clear and in any event is not the general scope of this paper, as construction defect cases are primarily focused on property damage. However, what constitutes an "occurrence" and "property damage" is far from conclusively determined by the language of the policy. The first two angles one must consider in interpreting the standard form CGL policy are (1) what constitutes an occurrence, and (2) did the occurrence result in "bodily Injury" or "property damage" under the terms of the policy.

2. What constitutes "Bodily Injury."

Bodily Injury: CGL policies typically define bodily injury as including "bodily injury, sickness or disease." There are differing views among the various states as to whether mental anguish which occurs without a physical manifestation is included within bodily injury or not. Texas falls squarely within the majority view that absent physical manifestation, purely emotional distress or mental anguish allegations are insufficient to qualify it as bodily injury. The Texas Supreme Court held that mental anguish is not "bodily injury" within the meaning of commercial general liability policy. Further, allegations of mental anguish and emotional injuries alone do not assert "bodily injury" by implication and do not invoke an insurer's duty to defend under a CGL policy. *Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819, 821 (Tex. 1997). Most employment related claims and workplace torts involve assertions of emotional distress, mental anguish and related mental or emotional injuries. When unaccompanied by medically-proved physical manifestations, most employment related torts in Texas would not be within the CGL coverage grant, because they would not qualify as bodily injury.

Some states do recognize an exception to this doctrine where the emotional distress relates and results from physical sexual contact. This would be a sexual assault case or a sexual harassment case in which there is actual sexual contact involved. See, *Fielder Road Baptist Church v. GuideOne Elite Ins.* Co., 139 S.W.3d 384, 390 (Tex.App.– Ft. Worth 2004, no pet.)

3. What constitutes "Property Damage"?

Property Damage: In addition to bodily injury, the CGL coverage grant can cover claims for property damage. Generally, the definition of property damage requires physical injury to tangible personal property and the loss of use of tangible property that has not been physically injured. Economic losses alone are generally not considered to be property damage, because they do not involve either physical injury or tangible property. See, *State Farm Loyds v. Kessler*, 932 S.W.2d 732 (Tex. App. -- Ft. Worth 1996, writ denied) and *Nutmeg Ins. Co. v. Proline Co.*, 836 F.Supp. 385, 388-89 (N.D. Tex. 1993). In the employment context, cases which make this distinction between the economic loss and property damage are instructive. See, *Lamar*

Homes, Inc. v. Mid-Continent Gas Co., 335 F. Supp. 2d 754 (W.D. Tex. 2004) and *Houston Petroleum Co. v. Highlands Ins. Co.*, 830 S.W.2d 153, 156 (Tex. App. – Houston [1st Dist.] 1990, writ denied). A number of cases from other jurisdictions have specifically held that economic claims relating to employment torts are not property damage. See, *Waller v. Truck Ins. Exchange*, 900 Pacific 2d 619 (Cal. 1995); *Lapeka, Inc. v. Security Nat'l Ins. Co., Inc.*, 814 F.Supp. 1540 (D. Kan. 1993); *Jefferson Pilot Fire & Casualty Co. v. Sunbelt Beer Dist., Inc.*, 839 F. Supp. 376 (D.S.C. 1993).

4. What Constitutes an "Occurrence" ?

Underlying the determination of whether an employment claim constitutes an occurrence are the principles of "accident" and "fortuity," which lay the foundation for all insurance in general. It is well-settled that insurance is not designed to cover inevitable results which predictably and necessarily emanate from deliberate actions. See, *Meridian Oil Production Co. v. Hartford Accident & Indemnity Co.*, 27 F.3d 150, 152 (5th Cir. 1994). Beginning with the 1966 comprehensive general liability form, CGL coverage turned away from the relatively-undefined and anomalous concept of "accident" and based coverage on whether an "occurrence" had occurred. In 1973, a revision of the CGL form redefined "occurrence" to include continuous and repeated exposure to conditions resulting in injury or damage, thus further defining the concept of "accident." The 1986 CGL form and its subsequent iterations deleted the phrase "neither expected nor intended from the standpoint of the insured" from the 1973 CGL form, choosing to incorporate this language in the intentional injury exclusion of that form. Presently, the term "occurrence" is defined as follows:

> "Occurrence" means an accident including continuous or repeated exposure to substantially the same general harmful conditions.

Despite its revisions, the term occurrence remains less than self-defined. Reference to the older concepts of "accident" and "fortuity" still are necessary in determining coverage.

The term "accident" means an unexpected, unforeseen, or undesigned happening or consequence from either a known or unknown cause. See, *Travelers Ins. Co. v. Volentine*, 578 S.W.2d 501 (Tex. Civ. App.–Texarkana 1979, no writ); *Employers Casualty Co. v. Brown-McKee, Inc.*, 430 S.W.2d 21 (Tex. Civ. App.–Tyler 1968, writ ref'd n.r.e.). More specifically, the term "accident" encompasses acts of the insured which are negligent, unintentional or unexpected. See, *Massachusetts Bonding & Ins. Co. v. Orkin Exterminating Co.*, 416 S.W.2d 396 (Tex. 1967). *See, CU Lloyd's of Texas v. Main Street Homes*, 79 S.W.3d 687 (Tex.App.–Austin 2002, no pet.) (Homeowners' allegations that general contractor built homes after learning that foundation designs were inadequate for soil conditions and failed to disclose that knowledge to purchasers stated an accident and thus an occurrence within the meaning of the general liability policy where the homeowners alleged negligence and did not limit their claims to intentional tort or shoddy workmanship, but claimed loss from erroneous soil surveys and faulty or inadequate design by the engineering firm.). In further defining this concept, the Federal Court of Appeals for the Fifth Circuit has particularly focused its attention on whether the insured's injury was the natural and probable consequence of intentional conduct. In pertinent part, the Fifth Circuit stated in *Meridian Oil Production Co. v. Hartford Accident & Indemnity Co.*, 27 F.3d 150 (5th Cir. 1994):

> Texas courts afford coverage for fortuitous damages but deny coverage when damages are the natural and probable consequence of intentional conduct. Regardless of whether the policies involved are worded to cover "accidents" or "occurrence," all offer minor variations of the same, essential concept; coverage does not exist for inevitable results which predictably and necessarily emanate from deliberate actions.

Id. at 152 (footnote omitted).

Thus, at the heart of the accident/fortuity analysis, the focus is not on whether the policyholder's acts were intentional, but instead on whether the resulting injury or damage was expected or intended. See, *Hartford Casualty Co. v. Cruse*, 938 F.2d 601, 604-05 (5th Cir. 1991); *Bituminous Cas. Corp. v. Vacuum Tanks, Inc.*, 75 F.3d 1048 (5th Cir. 1996). Therefore, to determine whether an occurrence has taken place, it is imperative to analyze the acts of the insured that lie beneath the particular construction defect at issue. To aid in this analysis, Texas courts have handed down several analogous decisions illustrating circumstances involving negligent acts and unintentional results and deliberate or intentional acts and expected or

foreseen results. These contrasting lines of decisions provide substantial guidance for the occurrence analysis.

a. Unintentional Acts and Unintended Consequences Qualify as an Occurrence

Cases involving unintentional or negligent acts leading to unintentional results are the easy cases, as these clearly constitute an occurrence. It is those involving more intentional or deliberate acts that demand a more careful analysis. Since it is well established that Texas law focuses not on whether the insured's conduct or actions are intentional, but on whether the insured intended the damages or injuries which are the subject of the underlying claims, it should come as no surprise that coverage is often afforded despite the fact that the policyholder's actions may appear rather deliberate. In an important decision, the Texas Supreme Court declared that the term "accident" as used in a pre-1966 liability policy includes the negligent acts of the insured causing damage which is undesigned and unexpected. See, *Massachusetts Bond & Ins. Co. v. Orkin Exterm. Co.*, 416 S.W.2d 396 (Tex. 1967). In this case, a jury in the underlying cause of action found Orkin was negligent in the application of lindane in August of 1955 to the rice and premises of Gulf Coast Rice Mills. Orkin paid the judgment and demanded reimbursement from Massachusetts Bonding under the general liability policy issued for the period January 1, 1955 to January 1, 1956. Within this policy, "Coverage C—Property Damage Liability—Except Automobile" set forth Massachusetts Bonding's intention to pay on behalf of Orkin all sums which Orkin "shall become legally obligated to pay as damages because of injury or destruction of property caused by an accident." Massachusetts Bonding attempted to argue that the application of lindane was not an accident as it resulted from a gradual application of the pesticide from 1964 to 1965. The court summarily rejected this argument binding Massachusetts Bonding to the underlying Gulf Coast litigation which was predicated on a single application of lindane in August of 1955. Furthermore, Massachusetts Bonding attempted to argue that the application of lindane constituted gross negligence bringing the allegations outside the scope of an "accident" as used in the policy. Again, the Supreme Court held Massachusetts Bonding was bound by the underlying result, as the jury in the Gulf Coast litigation had found that Orkin's application of lindane was mere negligence.

When the negligent acts of an insured cause damage which is unexpected, this constitutes an "accident." *Id*. at 400 (citations omitted). This finding of an accident extends to where the insured defectively performs work but does not intend the full range of damages to occur. In *Travelers Ins. Co. v. Volentine*, 578 S.W.2d 501 (Civ. App.—Texarkana 1979, no writ), the court considered the liability of a garage owner for the defective performance of valve work. In the underlying lawsuit, a customer brought his automobile to Volentine to perform a valve job in Volentine's garage. Volentine rendered defective performance in that the valve keeper failed to function, resulting in the destruction of the entire engine. Volentine turned to Travelers Insurance Company, his liability insurer, to defend him in the underlying lawsuit. Travelers rejected coverage, arguing that the defective performance did not constitute an "occurrence" under the terms of its CGL form. The court disagreed with this argument, holding that the term "accident" as used in a policy of this type means an unexpected, unforeseen or undesigned happening or consequence from either a known or unknown cause. *Id.* at 503 (citations omitted). Further, although the alleged defective performance of the work might or might not be considered an accident, the destruction of the entire engine as a result of the malfunction of one of the repaired valves certainly was unexpected and unintended and therefore constituted an accident within the meaning of the policy provisions.

The Fifth Circuit further addressed this issue in *LaFarge Corp. v. Hartford Cas. Ins. Co.*, 61 F.3d 389 (5th Cir. 1995). In *LaFarge*, suit was filed against LaFarge and various other defendants by All American Pipeline Company as a result of a defect in the construction of a pipeline to run from Santa Barbara, California to McCamey, Texas. Some time around February 1988, All American discovered that the protective coating supplied by a subcontractor to the project, Leonard Pipeline—Anchor Wate (LAC), had failed to protect the pipeline from corrosion. As LAC was LaFarge's alter ego, LaFarge applied to Hartford under its CGL policy which was in effect from April 1, 1987 through April 1, 1988. Among other reasons for denying a defense and coverage to LaFarge, Hartford argued that the failure of the LAC pipe coating did not constitute an occurrence. Citing Cruse and Volentine, the Fifth Circuit declared the

failure of the coating caused unintended damage to the pipeline and therefore constituted an occurrence.

In addition, false misrepresentations do not constitute an occurrence under a liability policy in Texas. In *State Farm Lloyds v. Kessler*, 932 S.W.2d 732, 737 (Tex.App.–Fort Worth 1996, writ denied), the claimants alleged that the Kesslers knowingly made false statements concerning the condition of a home they were selling. These statements were in violation of the DTPA. The State Farm policy at issue in Kessler defined "occurrence" as "an accident, including exposure to conditions, which results in . . . property damage during the policy period." *Id.* at 739. The Forth Worth Court of Appeals held that there was no occurrence because all of the allegations involved the Kesslers' intentional acts and because a misrepresentation is not a condition that the claimant is exposed to as required under the definition of occurrence. *Id.* at 738-739 citing *Columbia Mut. Ins. Co. v. Fiesta Mart, Inc.*, 987 F.2d 1124, 1128 (5th Cir. 1993) (Alleged inducement to invest through false representations was not exposure to conditions and therefore not an occurrence.); *Metropolitan Prop. & Cas. Co. v. Murphy*, 896 F.Supp. 645, 648 (E.D.Tex. 1995) (Any alleged misrepresentations or failure to disclose under the DTPA is not an occurrence.). See also, *Freedman v. Cigna Ins. Co.*, 976 S.W.2d 776 (Tex.App.–Houston [1st Dist.] 1998, no pet.) (The court held that no occurrence was alleged because the lawsuit was based on misrepresentations and nondisclosure.).

b. Intentional Acts and Consequences That Do Not Qualify as an Occurrence

There has been some controversy with regard to what qualifies as an occurrence when a policyholder's actions necessarily lead to certain consequences and damages. This jurisprudence began with well reasoned decisions holding that intentional torts which lead to intended injuries fall outside the scope of an occurrence under a CGL policy. Subsequent decisions have viewed the occurrence requirement from a diffent perspective, holding that intentional acts which lead to unintentional, yet necessary and probable consequences, also fall outside the definition of occurrence in a CGL policy. Most recently, controversy surrounding the occurrence analysis has focused on whether injuries which result from a breach of contract qualify as an occurrence. These recent decisions have held that there is no occurrence where injuries result as a natural and probable consequence of a breach of contract. This trend of cases has led to the often-cited notion that there is "no coverage for breach of contract," which is not necessarily the case, as explained more fully below.

c. No Coverage for Damages That Ordinarily or Naturally Flow from a Deliberate Act

Public policy dictates that the courts and insurers take the term "accident" seriously. "To hold otherwise would inappropriately enhance rather than minimize the moral hazard inherent in insurance." *Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819 (Tex. 1997). Because insuring agreements are based upon principles of fortuity, they are not meant to provide coverage for intentional torts of their policyholders which result in intended consequences. In many cases, it is obvious why public policy dictates that no coverage should be provided. The claim itself often arises out of deviant or criminal activity. See, *State Farm Fire & Cas. Co. v. S.S. & G.W.*, 858 S.W.2d 374 (Tex. 1993) (Excluding coverage for intentional transmission of genital herpes by insured); *Maayeh v. Trinity Lloyds Ins. Co.*, 850 S.W.2d 193, 197 (Tex. App.–Dallas 1992, no writ) (No occurrence where insured's sexual molestation of child was intentional because such conduct was so extreme and outrageous that intent to injure could be inferred as a matter of law.); *American States Ins. Co., et al. v. Bailey, et al.*, 133 F.3d 363 (Fifth Cir. 1998) (No occurrence where pastor perpetrated sexual misconduct upon church member he was counseling.); *New York Life Ins. Co. v. Travelers Ins. Co.*, 92 F.3d 336 (5th Cir. 1996) (No occurrence where life insurance agent engaged in fraudulent and misleading conduct relating to the sale of an insurance policy.).

A closer question exists where the insured's acts are voluntary and intentional, but the insured did not intend the specific injury to be visited upon a third party. Despite the insured's subjective intent not to cause the specific injury, when the insured's acts are voluntary and intentional, results and injuries even if unexpected, are not caused by an "accident" and therefore the event is not an "occurrence." *State Farm Lloyds v. Kessler*, 932 S.W.2d 732, 738 (Tex. App.–Fort Worth 1996, writ denied). Instead, the standard is subjective; a person intends the natural and probable results of the person's acts, even if he or she did not subjectively intend or anticipate those consequences. *Wessinger v. Fire Ins. Exchange*, 949

S.W.2d 834, 837-841 (Tex. App.–Dallas 1997, no writ) (Insured's action in hitting companion was intentional and not accidental despite fact that insured was drunk and did not intend to injure companion.).

Where an insured knowingly violates a state or local code, especially one dealing with public safety, no occurrence results and no coverage is afforded by virtue of unintended damages to public areas. *Baldwin v. Aetna Cas. & Sur. Co.*, 750 S.W.2d 919 (Tex. App.–Amarillo 1988, writ denied). Baldwin was a trucking company that admitted it had knowingly overloaded its trucks and repeatedly and intentionally violated the state regulating vehicle size and weight limitations for Texas highways. Baldwin was advised that he was going to be sued by the State of Texas for causing damage to state highways as a result of this violation. Baldwin negotiated a settlement and sought indemnification from Aetna based upon a CGL policy issued by Aetna. Aetna pointed to the petition that would have been filed in the underlying State v. Baldwin action in which it would have been alleged that "Defendant's repeated criminal law violations have created a nuisance per se and public nuisance . . ." and that damages would have resulted "as a direct result of this Defendant's deliberate overloading said trucks." *Id.* at 921. Based upon Baldwin's knowing violation of state statute, Aetna argued and the court agreed that no occurrence had taken place and thus no coverage was afforded. Further, in response to Baldwin's denial that he "knowingly" overloaded his trucks, the court cited Argonaut Southwest Ins. Co. v. Maupin for the idea that the intent of the insured is immaterial.

Baldwin has potentially far-reaching application and should not be read restrictively to focus upon intentional violations of state statutes regulating vehicle size and weight limitations on Texas highways. Instead, it may be argued that Baldwin stands for the proposition that any knowing violation of statute or code meant to protect public safety could fall outside the realm of an occurrence. Thus, it may be argued that even unintentional or unknowing violations of state statutes, including workplace discrimination laws, could place an insured's actions outside the scope of an occurrence.

5. Cowan - The Supreme Court's Take on "Occurrence"

The Supreme Court of Texas defined the extent to which an occurrence may be found where an insured's intentional act leads to unintended consequences. *Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819 (Tex. 1997). Gregory Gage, the insured, was working as a grocery store photolab clerk when a roll of film containing somewhat revealing pictures of Nicole Cowan was delivered for developing. Gage made extra prints of four of these pictures and later showed them to some friends. Eventually the photos were shown to an acquaintance of Cowan who advised Cowan that the pictures had been distributed. Cowan sued Gage and Gage sought coverage from his homeowner's policy issued by Trinity Universal Insurance Company. Ultimately Trinity denied coverage because Trinity argued that the facts of the case were not an "accident" such as to invoke an "occurrence." It was undisputed that Gage intentionally made copies of Cowan's photographs and showed them to his friends. However, Gage testified that he did not intend for Cowan to learn of his actions. Therefore, Gage argued, he accidently caused Cowan to suffer severe mental anguish, among other damages. In response, Trinity argued that no "accident" could arise where an actor intends to engage in the conduct which gave rise to the injury. The court, citing Maupin, took an approach that was somewhere in the middle of these two extremes that resulted in precluding coverage for Gage based on the lack of an occurrence. The court reaffirmed that the actor's subjective intent or awareness of the potential for resulting injury was not the test in determining an "accident." Rather, Gage's conduct was not an "accident" because the damages naturally flow from Gage's intentional acts.

Because the injury to Cowan was the type of injury that "ordinarily follows" from Gage's conduct and the injuries could be "reasonably anticipated from the use of the means or an effect" that Gage can "be charged with . . . producing." *Id.* at 828 citing *State Farm Fire & Cas. Co. v. S.S.*, 858 S.W.2d 374, 377 (Tex. 1993) (no occurrence or intentional transmission of genital herpes). Further, the court rejected Trinity's argument that there is never an occurrence when the insured's acts are intentional, finding that Trinity's approach would render coverage illusory for many of the things for which insureds commonly purchase insurance. Specifically, the Court held that Trinity's approach would directly conflict with their earlier holdings that an "accident" includes the "negligent" acts of the insured causing damage which is undesigned and unexpected. *Id.* at 828 citing *Massachusetts Bonding & Ins. Co. v. Orkin Exterminating Co.*, 416

S.W.2d 396 (Tex. 1967). At least one court has seized on this comment by the Supreme Court in Cowan to note that the mere fact that the insured intended to engage in the act or conduct that gave rise to the alleged damage does not mean that there can be no accident or occurrence. See, *E&L Chipping v. Hanover Ins. Co.*, 962 S.W.2d 272, 276 (Tex. App.–Beaumont 1998, no writ)(Holding that the intentional spraying of contaminated water to put out a fire resulting in damage to adjacent property was an accident or occurrence and was not excluded by the "expected and intended" exclusion.).

6. Negligence and Intentional Torts Combined

One difficult issue which can arise with regard to the question of whether there is an occurrence under the policy is the interplay of allegations of intentional tort and allegations of negligence. This arises in the context of a plaintiff asserting that an employer was negligent in hiring, retaining or supervising an employee who ultimately commits an intentional tort. Some cases revolved around an analysis of whether the alleged negligence of the employer was related to and inter-dependent on the employee's tortious activities. Under this line of cases, if the negligence was related to an intentional tort, courts found that there was not an occurrence. See, *Folsom Investments, Inc. v. American Motorist Ins. Co.*, 26 S.W.3d 556 (Tex.App.–Dallas 2000, no pet.).

However, the Texas Supreme Court addressed this issue in *King v. Dallas Fire Ins. Co.*, 85 S.W.3d 185 (Tex. 2002). In that case, the plaintiff asserted that the defendant was negligent in hiring, training and supervising an employee with a criminal background where that employee attacked the plaintiff. The Supreme Court analyzed this issue in detail and found that the "separation of insureds" provision of the policy prohibited the application of the "related and inter-dependent" rule. The court concluded that that rule improperly imputed the actor's intent to the insured. The court made it clear that the question of whether one who contributes to an injury is negligent is an inquiry independent from whether another who directly causes the injury acted intentionally. The Supreme Court expressly said that one actor's intent is not imputed to the insured in determining whether there is an occurrence. *King*, 85 S.W.3d at 192. The Corpus Christi Court of Appeals followed this opinion in the context of a sexual assault case in *Acceptance Ins. Co. v. Life Care Corp.*, 89 S.W.3d 773 (Tex.App.–Corpus Christi 2002, no pet.). The court in that case found that the employer's negligence in connection with the background investigation was an unintentional act which qualified as an accidental occurrence under the policy. Accordingly, it appears that for the limited purpose of determining whether an employment tort state an occurrence or not, negligent hiring, retention and supervision could state circumstances which qualify as an occurrence. However, it us likely in most cases that additional provisions of the policy, such as exclusions, will take the allegations out of the ambit of the policy. In fact, this likelihood was noted by the Supreme Court in *King* as support for its interpretation of the word "occurrence" under the policy. The court noted that if it read occurrence as narrowly as the insurer suggested in that case, many of the other standard exclusions contained in CGL policies would be meaningless. If occurrence could never include anything related to an intentional act, there would be no reason for exclusions covering assault, battery or sexual misconduct claims. *King*, 85 S.W. at 193.

7. "Coverage for Breach of Contract" - Negligent or Intentional Breach

The question of whether the insuring agreement of a CGL policy applies to liability resulting from a breach of contract has never actually been answered under Texas law. However, the Fifth Circuit as well as the Federal District Court for the Northern District of Texas have addressed the issue with some interesting results. It appears, at least based on federal law interpreting what a Texas court would do, that the whole question turns on how the claim against the insurer is pled.

The Fifth Circuit began its foray into this area in *Data Specialties, Inc. v. Transcontinental Ins. Co.*, 125 F.3d 909 (5th Cir. 1997). In *Data Specialties*, the plaintiff was an electrical contractor which had installed an electrical switchboard as part of its subcontract with Haggar Clothing Company. During the testing of this electrical switchboard, the switchboard and other property in the Haggar plant were damaged as a result of an explosion caused by a short circuit in the switchboard. As a result, Data Specialties completed its contract by hiring a local electrical contractor to repair and rebuild portions of the electrical system.

No one contended that Data Specialties was responsible for the accident, but Data Specialties nonetheless incurred additional overhead expenses for its supervision of the repair. Data Specialties applied to its CGL insurer, Transcontinental, for the

expenses it incurred to complete its contract with Haggar. Transcontinental denied coverage because Data Specialties was seeking to recover out-of-pocket expenses arising from the explosion and no one claimed that Data Specialties was potentially at fault for the explosion. In light of the fact that Data Specialties was not accused of committing a tort, the issue boiled down to whether Transcontinental could be obligated to pay so that Data Specialties could avoid breaching its contract.

The Fifth Circuit found no Texas authority for the proposition that a standard CGL policy was designed to cover a contractual obligation triggered by an event for which the insured was not at fault. In its analysis, the court reviewed cases in which liability of the insured was based upon allegations of negligence and tortious conduct. Further, in light of decisions by other states' highest courts, the Fifth Circuit determined that the insuring agreement encompassed liability that the law imposed on all insureds for their tortious conduct and not liability that a particular insured may choose to assume pursuant to contract. *Id.* at 912, citing *Action Ads, Inc. v. Great American Ins. Co.*, 985 P.2d 42 (Wyo. 1984). This led to the Fifth Circuit's conclusion that in the absence of Texas authority to the contrary, Texas courts would not require an insurer to pay under a CGL policy unless its insured had tort based liability. Instead, the coverage requested by Data Specialties would have been more appropriately provided by a builder's risk policy.

This case is particularly important in the area of employment law. As discussed earier, there is no general tort based theory of wrongful termination in Texas. Without tort-based liability, there is no CGL coverage. Instead, as Data Specialties indicates, claims arising out of the alleged breach of an employment contract would not be included within CGL coverage.

In *Federated Mut. Ins. Co. v. Grapevine Excavation, Inc.*, 197 F.3d 720 (5th Cir. 1999), the Fifth Circuit purported to summarize Texas law interpreting the definition of "occurrence" and then found that a claim for negligent breach of contract constitutes an "occurrence" in the construction context. *Grapevine* involved a contractor, Grapevine Excavation, Inc. ("GEI"), who subcontracted to provide foundation services in the construction of a Wal-Mart parking lot. According to the terms of the subcontract, GEI was responsible for furnishing and installing materials which had a California Bearing Ratio ("CBR") of 15. Allegedly, GEI supplied materials in the range of 3.7 to 4.9 CBR. As a result, the Wal-Mart parking lot fell below the specifications and the foundation allegedly was weaker than required. The general contractor for the project sued GEI for breach of contract and GEI sought CGL coverage from Federated Mutual and Maryland Casualty. The Court then drew its conclusion of what it thought a Texas court would do when presented with the question of whether a breach of contract constitutes an "occurrence." The Court segregated Texas cases on the issue of what constitutes an "occurrence" into two lines of cases, one in which coverage is precluded and the other in which coverage is afforded. The whole question therefore becomes, according to the Fifth Circuit, which line of cases a particular claim for breach of contract falls into. The first line of cases identified by the Fifth Circuit are those cases involving coverage for claims against an insured for damages caused by an alleged intentional tort. The Court notes that cases that fall within this line of cases are not covered because the act for which the insured is being sued is a voluntary and intentional act and damages that are a result of such a voluntary and intentional act are not caused by an occurrence, no matter how unexpected, unforeseen, and unintended those damages may be. The Court identifies *Argonaut Southwest Ins. Co. v. Maupin* as the first case in which the Texas Supreme Court enunciated this line of cases. The *Maupin* case is a construction case and the facts and the Court's holding in that case are described more fully above. The claims in that case against the insured, Maupin Construction Company, were for trespass and were brought by the owner of some property from which Maupin had removed dirt pursuant to a contract with the owner's tenant. The Court found that even though Maupin had not intended to injure the plaintiff and the damages in question were caused by mistake or error, the insured nevertheless voluntarily and intentionally engaged in the act of removing the dirt from the property belonging to the owner and in the process was guilty of trespassing on the owner's property. The Fifth Circuit noted that trespass in Texas is a strict liability tort without a scienter requirement and surmised that the Texas court therefore concluded that an inquiry into whether Maupin expected or intended to cause damage to the owner was not relevant.

The Fifth Circuit then identified a second line of cases concerning what constitutes an "occurrence" under Texas law following the Texas Supreme Court's opinion in *Massachusetts Bonding and Ins. Co. v. Orkin Exterminating Co.*, 416 S.W.2d 396

(Tex. 1967). In *Orkin*, coverage was sought for a claim against the exterminating company for damage to rice caused by the application of a pesticide in a rice mills facility. The plaintiff claimed that Orkin was negligent in its application of the pesticide and the Court found that the claim constituted an occurrence because it was one for a negligent act of the insured causing damage that was undesigned and unexpected. The Court then cites a number of cases finding coverage under Texas law that it claims fall within the Orkin line and involve damage that is the unexpected, unforeseen, or undesigned happening or consequence of an insured's negligent behavior.

The Fifth Circuit's decision in *Grapevine* appears to focus exclusively on the tort alleged. If the claim against the insured alleges that the insured negligently breached its contract, then there will be a duty to defend under the policy. This is true regardless of whether the claim also alleges that the insured intentionally breached his contract. In fact, those were the actual allegations in *Grapevine*. The claim against Grapevine initially alleged that Grapevine breached its contract by substituting lesser grade select fill. The negligence claim was made in the alternative and was not raised by the plaintiff until it filed its Fourth Amended Petition in the underlying action. The Fifth Circuit actually goes beyond the appropriate analysis under established Texas insurance law and misreads the facts in the underlying complaint in order to reach its conclusion. The Court notes that Grapevine denies intentionally substituting inferior materials. An insured's denial of the claims made against it is irrelevant to any analysis of whether the complaint against the insured gives rise to a duty to defend. The duty to defend is determined under the eight corners rule and the only thing that is relevant to that analysis is the insurance policy and the complaint itself, not the insured's answer or any other pleadings or facts. The insured's position on the issue is not supposed to come into play.

Further, the Court in *Grapevine* found that nothing in the facts alleged by the plaintiff against Grapevine supported a claim of knowing or intentional breach of contract by substituting inferior fill matter. The facts from the complaint itself specifically asserted that Grapevine breached its contract and the claim for negligence is only asserted in the alternative. At the very least, the facts alleged in the complaint could be read to include a claim for intentional or knowing breach of the contract in addition to or in the alternative to the claim for negligence. The Court summarily dismissed the allegation of knowing conduct made by the plaintiff elsewhere in the complaint where it noted in conjunction with its claim under the Texas Deceptive Trade Practices Act ("DTPA") that all of Grapevine's acts complained about were committed knowingly.

The Fifth Circuit's delineation of Texas cases concerning the issue of what constitutes an "occurrence" into two distinct lines of cases is probably a bit too simple of an answer to the question. The cases that the Fifth Circuit groups under the *Maupin* line of cases are primarily cases involving intentional torts that have been committed by the insured. The vast majority of these cases involve some sort of claim for inappropriate behavior, primarily sexual in nature. See, *State Farm Fire & Cas. Co. v. Brooks*, 43 F. Supp. 2d 695, 702 (E.D. Tex. 1998); *Metropolitan Prop. & Cas. Co. v. Murphy*, 986 F. Supp. 645, 648 (E.D. Tex. 1995); *Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819, 828 (Tex. 1997). See also, *State Farm Fire & Cas. Co. v. S.S.*, 858 S.W.2d 374, 377 (Tex. 1993).

These cases establish the rule, most recently pronounced in *Cowan*, that damages that naturally flow from an insured's intentional acts are not covered, regardless of whether the insured intended such damages. The question becomes far more muddy when the "intentional act" that is alleged to have occurred involves the fulfillment of an insured's obligations pursuant to a contract that the insured has entered into. The Fifth Circuit has now held that so long as those acts by the insured in fulfilling that contract are labeled as "negligent breach of contract," then there will be a duty to defend under the policy.

It is unclear how a claimant under a contract of employment could contend that a breach an employment contract could be accidental. There are, however some circumstances in which courts have been asked to determine whether other acts of employers constituted an "occurrence" under this analysis.

8. Personal Injury

In addition to the coverages for "bodily injury," some CGL policies also contain coverage for "personal injury" or "advertising injury" which need not be caused by an occurrence. One commonly used ISO form defines personal injury to include false arrest, detention or imprisonment, malicious prosecution, wrongful eviction, oral or written

publication or slanderous or libelous material, or oral or written publication of material that violates a person's privacy. It is unlikely that employment related causes of action such as wrongful termination, harassment or discrimination would be construed to be within this definition of personal injury. See, *Fieldcrest Cannon, Inc. v. Firemen's Fund Ins. Co.*, 477 S.E.2d 59, 68 (N.C. App. 1996) and *Stanford Ranch, Inc. v. Maryland Casualty Co.*, 89 F.3d 618, 624-26 (9th Cir. 1996). In most cases, the addition of "personal injury" as a defined covered event probably has little bearing on the coverage for employment claim based on other provisions of the policy of the employment related practices exclusion.

9. Exclusion

Even if the hurdles placed by the terms of the CGL coverage grant are met in a particular case, the single strongest bar to coverage for an employment related claim under a CGL policy may relate to exclusions from coverage. The standard form CGL coverage agreement contains an exclusion excluding liability for bodily injury to an employee of the insured arising out of and in the course and scope of employment by the insured. Thus, even if an event does qualify as bodily injury to an employee, it is likely that this exclusion would apply.

In addition to the standard bodily injury exclusion for injuries to employees, the ISO has promulgated the "employment related practices exclusion" endorsement. Under this endorsement, both "bodily injury" and "personal and advertising injury" are excluded where that injury arises out of a refusal to employ the person, termination of that person's employment, or out of employment related practices, policies, acts or omissions, such as coercion, demotion, evaluation, re-assignment, discipline, defamation, harassment, humiliation or discrimination directed at that person.

It is very clear from the text of this employment related exclusion that conduct that occurs during an employee's tenure would likely be excluded under the employment related practices exclusion. There are, however, some claims which may not be inherently employment related and, thus, not excluded by the policy. There are no clear Texas cases on this point. However, there are cases from other jurisdictions which point out that there may be some claims that survive this exclusion. In particular, some claims such as false arrest and assault and battery may not be excluded by the employment related practices exclusion. See, *Mactown, Inc. v. Continental Ins. Co.,* 716 So.2d 289, 292-93 (Fla. App. 1998) and *David Kleis, Inc. v. Superior Court*, 44 Cal. Rptr.2d 181, 190 (Cal. App. 1995). In addition to specific torts which may be outside of the exclusion, the time at which the event occurs may also take the conduct out of the exclusion. In *HS Services, Inc. v. Nationwide Mutual Ins. Co.*, 109 F.3d 642 (9th Cir. 1997), the Ninth Circuit Court of Appeals in California found that a post-employment statement that was alleged to be defamatory was not barred by this exclusion. The Court read this exclusion and found that an event which occurred after employment could not "arise out of" that employment. There have, however, been other cases applying California law which have reached the opposite conclusion. See, *Loyola Marimount University v. Hartford Accident & Indemnity Co.,* 219 Cal. App.3d, 1217 (Cal. App. 1990); and *Frank and Freedus v. Allstate Ins. Co.*, 45 Cal. App.4th, 461 (Cal. App. 1996).

In summary, it appears that it would be rare for an employment related tort to come within the indemnity provisions of a CGL policy with the usual provisions and endorsements. There are, however, other types and categories of insurance which may become implicated in employment torts.

B. Worker's Compensation Policies

The National Council on Compensation Insurance has promulgated a model worker's comp/employer's liability policy that many insurance carriers use as their basis for worker's compensation coverage. In general, the worker's compensation policy itself covers bodily injury claims made by employees for on-the-job injuries. The employers liability component in the policy may be applicable to other types of employment related claims. As the general rule, the worker's compensation policy does not allow compensation for purely emotional distress. Most of the issues related to employment related claims would be raised under the employer's liability coverage found in "part 2" of the standard worker's compensation policy. This provision applies to bodily injury by accident or disease. Again, this insurance applies only to bodily injury caused by an accident. The case law previously discussed regarding the definition of bodily injury and the definition of accident would be equally applicable to these kinds of claims. It would appear unlikely that most employment related claims would result from a "accident" as opposed to from some intentional event. In addition, provisions of the standard

employer's liability coverage includes exclusion of injuries which were intentionally caused or aggravated. Note that the wording of this extension is somewhat different than the "expected or intended" exclusion found in some CGL policies. While there is no clear Texas case on point, it appears that this exclusion would only apply to injuries that were actually intended by the actor, not just injuries that resulted from an intentional act. Accordingly, any employment related tort that carries with it an element of intent would be excluded by this provision. In addition, most employer's liability policies contain an employment related practices exclusion that is very similar to the previously-discussed endorsement on the CGL policy. Because of this, it appears very unlikely that a standard worker's compensation insurance policy including the employment practices endorsement could be read to include indemnity coverage for most employment torts. The supreme court of New Jersey held in the case of *Schmidt v. Smith*, 155 N.J. 44 (1998) that in spite of these provisions, a sexual harassment claim was covered by the worker's compensation insurance policy. The court grappled with the question of whether the emotional injuries alleged in the case, coupled with the physical manifestation of those injuries, constituted bodily injury. There were claims of negligent infliction of emotional distress and claims of negligent failure to train or supervise contained within the allegations in the *Smith* case. The supreme court of New Jersey found that because the jury's verdict did not differentiate between injuries which were caused by negligence and injuries which were caused by intentional conduct, the jury's verdict was within the policy's indemnity obligation. In addition, the court found that enforcement of the employment practices exclusion in the worker's comp context violated the public policy of New Jersey, which was to insure coverage of all types of physical bodily injuries suffered by employees. See, *Schmidt*, Id. at 52.

Texas cases make it appear unlikely that the courts of Texas would follow the path started by the *Schmidt* case. There are a number of cases from other jurisdictions which have refused to apply a similar standard. In addition, the Dallas Court of Appeals found in *Folsom Investments, Inc. v. American Motorist Ins. Co.,* 26 S.W.3d, 556 (Tex.App.– Dallas 2000, no writ) that sexual harassment was not a "accident." While this result would likely be reached in most cases where there is an element of intent, there is somewhat more of an issue as to whether statutory discrimination claims which have a lower standard, such as the "recklessness" standard under the ADA or the pure disparate impact claims under Title VII may not qualify as intentional acts. Of course, the other referenced exclusions for claims arising out of employment practices would be equally applicable to these kinds of claims.

C. Employment Practices Liability Coverage

In the absence of coverage under commercial general liability policies or worker's compensation/employer's liability policies, the insurance market has developed some specialty insurance products which are meant to deal specifically with employment practice claims. There are very few published cases regarding the interpretation of the provisions of employment practice liability policies. In addition, unlike CGL and worker's comp policies, there are no widely recognized and accepted coverage forms in use across the industry. Most employment practice liability insurance policies are "manuscript" policies that vary in terms of coverage form from carrier to carrier. In spite of the ever-increasing risk associated with employment claims, it appears that employment practice liability insurance remains quite rare. This may be because it has not been a traditionally accepted insurance product for long enough to become a standard in the insurance marketplace. In addition, employment practice liability coverage remains very expensive in the marketplace. The author's own survey of employment practice liability policies available on the marketplace based on a review of Internet resources indicates that most employment practice liability policies are claims-made policies with defense costs built into the policy limits. These policies are offered either as stand-alone policies or as endorsement to directors and officers insurance coverages. In addition, rather than defining a coverage triggering event in broad terms, most employment practice liability policies take the approach of insuring "named perils" which specifically enumerate covered acts. Finally, most policies contain exclusions for purely economic damages which should be ordinary costs of doing business. This category of excluded losses usually includes wages arising from violations of the Fair Labor Standards Act, violations relating to employee benefits, occupational health and safety laws or plant closing notification laws. These kinds of exclusions are meant to prevent companies from purchasing

insurance to cover losses which are exclusively within the insured's control.

It remains to be seen whether the increasing risk of employment torts forces the industry to consider the implementation of risk management planning approaches which include employment practice liability insurance.

IV. CONCLUSION

In summary, the number of employment related tort claims has continued to rise. As this claim volume increases, it is likely to place more emphasis on insurance coverage related issues concerning these claims. The current state of insurance coverages available has not kept pace with the changes in the employment claims volume. Accordingly, many of the existing policies of insurance are unlikely to cover these kinds of claims. It remains to be seen if industry will respond to these insurance coverage challenges by embracing insurance products specifically designed to cover these increasing risks.