

# “Loss” or “Liability” under ERISA Fiduciary Policy Includes Amounts Paid to Establish and Fund Employee Accounts

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The Massachusetts federal court, applying Massachusetts law, held that "loss" or "liability" under an ERISA fiduciary policy includes amounts paid by a policyholder company to establish and fund profit-sharing accounts for eligible employees originally left out of the company's plan. *Pacific Ins. Co., Ltd. v. Eaton Vance Mgmt.*, No. 00-11128-JLT, 2003 WL 1989584 (D. Mass. Apr. 30, 2003). The court also held that the insurer was required to reimburse the company for pre-tender costs and prejudgment interest.

The insurer issued an ERISA Fiduciary Policy to a company. The policy provided coverage for "[l]oss or liability incurred by the Insured, from any claim made against the Insured during the Endorsement Period, by reason of any actual or alleged failure to discharge his or its duties or to act prudently within the meaning of the Employee Retirement Income Security Act of 1974."

The company determined that it had mistakenly failed to fund the accounts of a number of employees eligible for profit-sharing. It ultimately paid more than \$850,000, including interest, to fund the accounts. Four months after learning of the mistake and six weeks after acknowledging its obligation to fund the additional employees' accounts, the company notified the insurer. Coverage litigation ensued. In an earlier stage of the case, the court had determined that the policy afforded coverage for the company's claim. In this decision, the court addressed damages.

The court first held that the company was entitled to reimbursement for the costs it incurred to establish and fund the accounts for its employees. The insurer argued that the company did not incur a "loss" because the company should have funded the employees' accounts from the outset. Disagreeing, the court explained that the policy afforded coverage for "loss" or "liability" that the company incurs from claims made against it because of "an actual or alleged breach of fiduciary responsibility." The court noted that in an earlier stage of this case, it had found that the company breached its fiduciary duty to its employees when it failed to establish and fund the plan accounts and that the breach was covered by the policy.

Next, the court determined that the company was entitled to the reimbursement of pre-tender costs. The insurer argued that it was not required to reimburse the company for these costs because the company breached the notice provision of the policy. The court explained that, under Massachusetts law, an insurer "must prove both that the notice provision was in fact breached and that the breach resulted in prejudice to its position." The insurer contended that it did not need to show prejudice because the purpose of the rule requiring an insurer to show prejudice is to prevent a policyholder from experiencing total forfeiture of coverage, but where, as here, the insurer had already paid post-tender costs, the company would not suffer such a forfeiture. The company argued that because it was delegated the duty to defend, a showing of prejudice was required to justify releasing the insurer of its requirement to reimburse the company for litigation expenses. Agreeing with the company, the court explained that "where the insurer has a duty to defend the insured, there is an inherent prejudice when an insured makes decisions that impact the defense. Essentially, it is unfair to force the insurer, who might have made different choices, to pay for the defense prior to notification of a claim. This concern, however, is not present where the policy specifically absolves the insurer of any duty to defend." The court therefore concluded "absent a showing of prejudice, an insurance company is not absolved of its obligation to pay litigation costs merely because of an insured's failure to timely notify the insurance company of the claim." The court noted that it had already determined that the insurer suffered no prejudice in its earlier ruling, so the company was entitled to reimbursement for pre-tender costs.

The court also found that the company was entitled to prejudgment interest, reasoning that the company had not attempted to prolong the proceedings to obtain a larger damage award and that it would have had the benefit of these sums had the insurer not wrongfully refused to pay.

*For more information, please contact one of WRF's Professional Liability Attorneys at 202.719.7130*