

Court: D&O Policy Covers Constructive Discharge Claim Premised on Existence of Employment Contract

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In an unreported decision, the United States District Court for the Eastern District of Pennsylvania, applying New Jersey law, has held that an insurer must advance defense costs under a D&O policy for a lawsuit alleging breach of the duty of good faith and fair dealing and constructive discharge, even though those counts were necessarily dependent on the existence of an employment contract and the policy excluded coverage for breach of contract. *Applied Tech Prods. v. Select Ins. Co.*, 2004 WL 945149 (E.D. Pa. April 28, 2004).

The insurer issued a D&O policy that provided coverage for employment claims to the insured company. The policy defined "Employment Claim" to include a claim by an employee for a "Wrongful Employment Practice," which was defined to include, among other things: "(1) wrongful demotion, dismissal, discharge or termination...of employment" and "(14) breach of an implied contract requirement relating to Wrongful Employment Practices as defined herein." The policy excluded coverage for "any Claim for any actual or alleged breach of an express written or oral contract or agreement; however, this exclusion shall not apply...to an Employment Claim if such liability would have attached to the Insured Company in the absence of the express contract in question."

Two of the company's former employees filed suits against the company. Both suits alleged breach of contract, breach of the duty of good faith and fair dealing and constructive discharge. After the insurer denied coverage based on the breach of contract exclusion in the policy, the company filed suit, seeking a declaration that it was entitled to coverage under the policy.

The district court agreed that the breach of contract exclusion barred coverage for the breach of contract counts in the complaints. However, the court held that the policy afforded coverage for the counts alleging breach of the duty of good faith and fair dealing and constructive discharge. The court agreed with the insurer's argument that under New Jersey employment law these two counts could not exist "in the absence" of an employment agreement. However, it explained that the insurer "overlooks the fact that its own policy covers wrongful Employment Practices" and any reasonable Insured reading the Policy would believe [that these two claims are] covered under the Policy." Thus, according to the court:

The breach of contract exclusion will not apply to Employment Claims if such liability would have attached to the Insured Company in the absence of an express contract. Rather than narrow the application of the exclusion, defendant's interpretation of the "absence of an express contract" language actually expands the exclusion contrary to its plain meaning.

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