

City's Liability Policies Provide Civil Rights Violations Coverage

March 2004

In a lengthy opinion addressing a myriad of coverage issues, the United States District Court for the Eastern District of Michigan, applying Michigan law, has held that insurers that issued professional liability policies to a city had certain obligations to provide a defense and indemnity for underlying litigation alleging due process and equal protection violations, as well as defamation and slander. *City of Sterling Heights, et al. v. United Nat'l. Ins. Co., et al.*, 2004 WL 252091 (E.D. Mich. Feb. 11, 2004).

In the underlying litigation, the operators of an amphitheater filed state and federal lawsuits against the insured city and its city manager. These lawsuits alleged that city officials harassed the operators and conspired to violate their due process rights by revoking a special land use permit. The complaints alleged, among other things, substantive and procedural due process violations, equal protection violations, business libel and slander and breach of express and implied contract. The city filed the instant declaratory judgment action against three insurers that issued its primary and excess liability coverage.

Employment Practices Liability

The first insurer had issued two primary and excess claims-made, public officials and employment practices liability policies to the city, including one policy effective from September 2000 to September 2001, and another policy effective from September 2001 to September 2002. The district court first addressed the insurer's argument that coverage was unavailable because the township made the decision to revoke the permits after the policies had expired. The court rejected this argument, reasoning that the complaints alleged numerous violations of the underlying plaintiffs' civil rights that occurred prior to the policies' expirations based on threats to revoke the license. The court also held that coverage was available only under the first policy period because that was when the city first gave notice of circumstances that might give rise to the claim.

The court also rejected the insurer's argument that the libel, slander and defamation allegations asserted against the city and its manager were not included in the policy definition of "employment wrongful acts" under the employment practices liability policy. The definition of "employment wrongful act(s)" included "actions involving...defamation...libel, slander...or other employment-related practices." The policy also stated that "Employment Wrongful Act(s) does not include any Public Official Wrongful Act(s)." The court held that the claim by the non-employee, underlying plaintiff could constitute an "employment wrongful act." The court also

rejected the insurer's argument that the policy covered only "employment-related conduct" with respect to employees of the Township, reasoning that "[t]his argument ignores the fact that, in the underlying State Action, it is alleged that [the city manager] committed the slander, libel and/or defamation while employed as the City's Manager."

The court next rejected the insurer's contention that there was no coverage for the plaintiffs' equal protection allegations because its policy excluded coverage for damage "arising out of the willful violation" of state or federal statutes. Although the court acknowledged that the underlying plaintiffs would have to prove that the city committed an "intentional retaliation" in order to prevail, the court held that it was not clear such proof would necessarily lead to the conclusion that the city's conduct was a "willful violation" of civil rights.

Finally, the court rejected the insurer's argument that most of the underlying plaintiffs' damages came under the exclusion for "damage to or destruction of any property including diminution of value or loss of use." The court found that Michigan case law supported the policyholder's position that the economic damages sought by the underlying plaintiffs were covered, as they were a result of constitutional harms, not the destruction of tangible property.

Errors and Omissions Liability

A second insurer had issued a claims-made, public entity general liability policy, which contained commercial general liability, public officials errors and omissions liability and umbrella coverage. The district court denied the second insurer's motion for summary judgment in its entirety. The court first held that the insurer was not entitled to summary judgment on the grounds that the "known-loss doctrine" negated the duty to indemnify because the city was aware of the underlying conduct at issue when it purchased the policy. The court reasoned that under Michigan law, the known-loss doctrine involves a "subjective component"—the insured's awareness of an immediate threat of injury—which "typically precludes summary judgment." Here, the city and the city manager had presented evidence refuting that "at the time the policy was purchased [they] either knew or were aware of the threat of litigation...that did not take place until after the policy was purchased."

The court also rejected the insurer's argument that the "knowledge of wrongful acts" exclusion in its policy precluded coverage for damages arising out of the federal action. That exclusion precluded coverage "if the insured had knowledge of circumstances which could reasonably be expected to give rise to a claim." The court agreed with the insureds that some of the facts alleged in the federal action were as a result of "wrongful acts" committed during the insurer's policy period and therefore were not known at the inception of the policy.

For more information, please contact us at 202.719.7130.