



This article is excerpted from The Risk Management Letter (ISSN 1070-0102), a publication of Warren, McVeigh & Griffin, Inc., independent risk management consultants.

The Risk Management Letter focuses on important news and information for professionals involved with risk and insurance issues.

Warren, McVeigh & Griffin, Inc.
1420 Bristol Street North
Suite 220
Newport Beach, CA 92660
Tel 949/752-1058
Fax 949/955-1929

www.griffincom.com

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"Hostile Work Environment Sexual Harassment" Covered Under Workers' Compensation Policy

The New Jersey Supreme Court recently affirmed a decision of the Appellate Division of the Superior Court of New Jersey that found an employer vicariously liable for "hostile work environment sexual harassment" covered under a workers' compensation and employers liability insurance policy. This article describes the court's reasoning and explains what impact, if any, this case will have on employers and insurers in states other than New Jersey.

Volume 19, Issue 6 (1998)

BY KEVIN G. FITZGERALD AND ETHAN D. LENZ

The plaintiff in the case, an employee of Personalized Audio Visual, Inc. (PAV), filed suit against her employer and PAV's president, Dennis Smith (Smith), alleging several causes of action, including a claim of "hostile work environment sexual harassment" brought under New Jersey's Law Against Discrimination ("LAD"). The case was based on the plaintiff's allegations that Smith hired her as an office manager in January 1991, and subsequently sexually harassed her until she resigned in February of that same year. In an amended complaint she alleged that PAV and Smith were liable under various negligence theories, including Smith's negligence in inflicting emotional distress and PAV's negligence in failing to train or supervise Smith.

PAV and Smith submitted claims to United States Fidelity & Guaranty Company ("USFG") seeking coverage under one of PAV's insurance policies, including their workers' compensation and employers liability insurance policy. Because USFG denied coverage, PAV and Smith instituted a third-party action seeking a declaratory judgment.

Before the declaratory judgment action was decided, the trial court tried the plaintiff's action against Smith and PAV. Following that trial, the jury returned an \$80,000 verdict in favor of the plaintiff. Among other findings, the jury determined that Smith and PAV were liable for hostile work environment sexual harassment. The trial court then awarded the plaintiff \$80,000 in compensatory damages and entered a judgment against PAV and Smith for almost \$182,000, which included the compensatory damage award, counsel fees under LAD, and prejudgment interest and disbursements. On appeal, the Appellate Division found that USFG was obligated to defend and indemnify PAV under the employers liability coverage section of PAV's workers' compensation policy. The court based its decision on the fact that a policy exclusion for harassment was not applicable to sexual harassment claims when liability was imposed vicariously, as opposed to directly. USFG appealed the Appellate Division's ruling to the Supreme Court.

The New Jersey Supreme Court's Decision

The Supreme Court began its decision by reviewing New Jersey's workers' compensation law. It found that all employers are required to carry workers' compensation insurance and that such insurance must afford coverage for claims adjudicated in both New Jersey's workers' compensation court and for work-related injuries asserted in a common civil law court.² Citing an earlier decision,³ the court stated:

The terms of a policy issued pursuant to [New Jersey's workers' compensation law] cannot conflict with the statutory mandate that there be coverage provided for all occupational injuries. Employers [sic] liability coverage...is traditionally written in conjunction with workers' compensation and is intended to serve as a 'gap filler' providing protection to the employer in those situations where the employee has a right to bring a tort action despite provisions of the workers' compensation statute.

The court then focused on the language of one of the policy's employers liability exclusions, which provided that the insurance did not cover:

7. Damages arising out of coercion, demotion, evaluation, reassignment, discipline, defamation, harassment, humiliation, discrimination against or termination of any employee, or any personnel practices, policies, acts or omissions.

While the court concluded that PAV was indeed liable for damages "arising out of" harassment and that the above exclusion seemed to preclude coverage, it also found that an employer would "reasonably expect" coverage for the types of injuries⁴ alleged by the plaintiff. Because New Jersey workers' compensation law required PAV to obtain coverage to pay any obligation arising out of bodily injury to an employee, and despite what the policy actually stated, the court reasoned that PAV contracted with USFG to provide coverage of bodily injuries falling inside or outside of the workers' compensation laws. The Supreme Court further limited the effect of the exclusion by stating that the exclusion:

...disclaims coverage for a class of discomforts that one typically would not associate with bodily injury—criticism, demotion, evaluation, and defamation, for example—and that one typically would not expect to be covered by a scheme designed to insure that employees' bodily injuries be compensated. The exclusion is valid as long as the liability arising from those discomforts is not related to bodily injury.

However, PAV's liability was primarily related to the personal injuries that the plaintiff suffered as a result of Smith's conduct, and the alleged personal injuries fell within the definition of "bodily injuries" adhered to by New Jersey courts. Therefore, the court concluded that the employment practices exclusion violated public policy underlying the workers' compensation scheme and was void.

Conclusion

The Supreme Court decision focused on the "reasonable expectations" of the insured and public policy considerations underlying New Jersey's workers' compensation law. Based on the decision, it does not appear possible to exclude "hostile work environment sexual harassment" claims under a workers' compensation policy in New Jersey, at least when such suits include allegations that the harassment led to "bodily injury" of the employee.⁵

Because of the added loss exposure created by this decision, insurers may begin to reconsider the adequacy of their rates for workers' compensation insurance sold in New Jersey. Although it is difficult to estimate exactly how other jurisdictions will receive the decision, in a previous case the Iowa Supreme Court rejected the argument that employers liability coverage extends to sexual discrimination claims.⁶ ☞

Kevin G. Fitzgerald is a partner and Ethan D. Lenz is an associate in the law firm of Foley & Lardner, 777 E. Wisconsin St., Milwaukee, WI 53202. They practice in the firm's Insurance Practice Group. Mr. Fitzgerald may be reached at 414/297-5841. Mr. Lenz may be reached at 414/297-5567.

NOTES

1 *Schmidt v. Smith*, 1998 WESTLAW 329267 (N.J. June 15, 1998)

2 Citing *N.J. Stat. Ann. 34:15-72*, *Schmidt*, 1998 WESTLAW 329267 at *1. Although Section 34:15-72 requires employers to "make sufficient provision for the complete payment of any obligation which he may incur to an injured employee," it does not expressly require that every employer do so through workers' compensation insurance.

3 *Id.* citing *Producers Dairy Delivery Co. v. Sentry Ins. Co.*, 718 P.2d 920, 927 (Cal. 1986).

4 The plaintiff alleged that she had suffered "emotional injuries accompanied by physical manifestations" as a result of the hostile work environment sexual harassment. See *supra* note 5.

5 New Jersey case law defines "bodily injury" to include "emotional injuries accompanied by physical manifestations." *Voorhees v. Preferred Mut. Ins. Co.*, 128 N.J. 165, 179 (1992). 1-2.

6 *Ottumwa Housing Auth. v. State Farm and Cas. Co.*, 495 N.W.2d 723 (Iowa 1993).