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Fair Labour Standards Act exclusions: ensuring clarity, explicitness and fulfilment

Contributed by **Mendes & Mount LLP**

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Authors

Robert M Flannery

Gerard C Morici

Fair Labour Standards Act

Fair Labour Standards Act claims by groups of employees are arising at an astronomical rate and quickly surpassing the filing rate of other employment-related class actions. In 2007 alone, the Wage and Hour Division of the US Department of Labour recovered more than $220 million in back wages for more than 341,000 employees. This escalating trend in Fair Labour Standards Act claims has resulted in heightened concern for employers, as these lawsuits are expensive to defend and costly to settle. A number of class action wage and hour claims have settled for more than $10 million. In turn, employers are increasingly looking towards their insurance carriers to provide coverage for the costs to defend and settle these lawsuits. Many employment practices liability (EPL) and directors and officers liability (D&O) policies contain Fair Labour Standards Act exclusions that eliminate coverage under the act and a variety of other federal statutes. However, the specific wording of the Fair Labour Standards Act exclusion in a particular policy is integral in determining whether the exclusion purports to exclude similar and/or related state laws.

The 1938 Fair Labour Standards Act, administered by the Wage and Hour Division of the Department of Labour, established a national, hourly minimum wage and promulgated eligibility rules for overtime pay. The act also covers issues pertaining to equal pay for equal work and child labour standards. In 1967 the act added prohibitions against age discrimination. The act does not regulate the specifics of wage payments, as state law generally outlines the more precise aspects of wage and hour obligations, such as:

- when and how wages must be paid;
- the deductions that may be taken from wages; and
- general requirements for meal and rest breaks.

As the state of California applies the most stringent labour laws, it is no wonder that many employees initiate lawsuits under the California Labour Code and related laws.

Coverage excluded for Fair Labour Standard Act claims

The insurance industry has been cognisant for quite some time that class action wage and hour suits are costly to defend and expensive to settle. Accordingly, insurers have included standard exclusions in EPL and D&O policies for claims based on, or arising out of, violations of wage and hour laws. One such exclusion – the Fair Labour Standards Act exclusion – eliminates coverage for claims under the act and a variety of other federal statutes. Since such exclusions often contain language purportedly aimed to exclude 'similar' or 'similar or related' state laws, insurers have taken the position that California wage and hour laws are similar and/or related to the act. In turn, insurers have argued that the exclusion applies to California claims alleging violations of wage and hour state laws.

Since there is no 'standard' Fair Labour Standards Act exclusion, some courts have ruled that the exclusion at issue in a given case does exclude similar and/or related state laws, while others have concluded that these laws are not excluded. The specific language of a given Fair Labour Standards Act exclusion, particularly whether the

wording could be deemed ambiguous and the choice of wording utilised therein, is integral in determining whether similar and/or related state laws would also be excluded. The first hurdle that an insurer must overcome in arguing that the Fair Labour Standards Act exclusion at issue excludes coverage for state laws similar and/or related to the act is whether the court may conclude that the exclusion is not ambiguous. Typically, courts conclude that language in a contract (eg, an insurance policy) is ambiguous if it is "susceptible to more than one reasonable interpretation". The second hurdle that an insurer must surmount is whether the parties' intention to exclude similar and/or related laws is clear.

The analysis of various Fair Labour Standards Act exclusions at issue in different cases, in conjunction with the court's ruling pertaining to each exclusion, is a valuable exercise that should assist underwriters to craft an exclusion that accomplishes exactly what the parties intend it to accomplish. Different courts have made varied interpretations depending on the particular Fair Labour Standards Act exclusion at issue.

Court decisions

Pro-insured

Insureds have relied on *SWH Corp v Select Ins Co*(1) to argue that Fair Labour Standards Act exclusions are ambiguous. Despite the fact that this case is an unpublished decision and technically should not be relied on as precedent, the court did conclude that the Fair Labour Standards Act exclusion at issue was ambiguous and that state laws 'similar' to the act were not excluded. In order to comprehend fully the rationale behind the court's decision, it is helpful to examine the entire exclusion.

The *SWH* Fair Labour Standards Act exclusion excluded coverage for loss in connection with any claim:

*"**for an actual or alleged violation of, responsibilities, obligations or duties imposed by** (1) any law governing workers' compensation, unemployment insurance, social security, disability benefits or similar law, **(2) the Fair Labor Standards Act** (except the Equal Pay Act), (3) the National Labor Relations Act, (4) the Worker Adjustment and Retraining Notification Act, (5) the Consolidated Omnibus Budget Reconciliation Act of 1985, (6) the Occupational Safety and Health Act, **(7) rules or regulations promulgated thereunder, amendments thereto or similar provisions of any federal, state or local statutory law or common law, (8) the Employee Retirement Income Security Act of 1974** or (9) any common law applicable to fiduciaries of any pension, profit sharing, health and welfare or other employee benefit plan or trust established or maintained for the purpose of providing Benefits to employees of the Insured Company; however, this exclusion shall not apply to any Employment Claim for any actual or alleged Regulatory Treatment".* (Emphasis added)

By plainly reading the above exclusion, it is apparently susceptible to more than one reasonable interpretation, as it is unclear whether "similar provision of any… state… law" relates to just the Occupational Safety and Health Act or all prior listed laws (including the Fair Labour Standards Act). According to the court in *SWH*, if the parties intended the state law modifier in sub-part (7) to modify *all* previous categories, that sub-part should have been placed at the very end of the paragraph and not seventh in a list of nine categories of law. The court's rationale is logical and intuitive. Significantly for insurers, however, the court's decision was explicit in stating that it would not have been difficult for the parties to exclude state wage and hour claims in the policy at issue, if that is what the parties intended. While the *SWH* decision is arguably policyholder friendly, it should also suggest to underwriters that it is possible to craft a Fair Labour Standards Act exclusion that does exclude laws similar and/or related to the act.

Pro-insurer

The US Court of Appeals for the Tenth Circuit, applying Kansas law, recently held in *Payless Shoesource, Inc v Travelers Cos, Inc*(2) that an EPL policy afforded no coverage for a class action based on a Fair Labour Standards Act exclusion that excluded coverage for laws 'similar' to the act. The language in the Fair Labour Standards Act exclusion in *Payless* differs from the Fair Labour Standards Act exclusion in the *SWH* case. The *Payless* Fair Labour Standards Act exclusion excludes coverage for loss in connection with any claims:

*"**for an actual or alleged violation of the Fair Labor Standards Act** (except the Equal Pay Act), the National Labor Relations Act, the Worker Adjustment and Retraining Notification Act, the Consolidated Omnibus Budget Reconciliation Act of 1985, the Occupational Safety and Health Act, the Employee Retirement [Income] Security Act of 1974, any workers' compensation, unemployment insurance, social security, or disability benefits law, **other similar provisions of any** federal, **state**, or local statutory or common **law or any amendments, rules or regulations promulgated under any of the foregoing**".* (Emphasis added)

In contrast to a plain reading of the *SWH* Fair Labour Standards Act exclusion, the

above exclusion is not ambiguous and the intention of the parties is quite clear. In the *Payless* Fair Labour Standards Act exclusion, as opposed to the *SWH* Fair Labour Standards Act exclusion, the "other similar provisions of any… state… law" language appears at the end of the exclusion, which strongly suggests that the modifier is meant to address all of the preceding laws in the exclusion. Further, the "under any of the foregoing" language strengthens the insurer's argument that the parties intended for state laws 'similar' to any of the listed laws to also be excluded. In *Payless* the court quite logically and unsurprisingly concludes that the Fair Labour Standards Act exclusion was unambiguous, and the parties intended that laws 'similar' to the act were not covered.

Before *Payless*, insurers frequently relied on an unpublished US district court decision in *Big 5 Corp v Gulf Underwriters Ins Co*(3) to deny coverage based on the Fair Labour Standards Act exclusion. The trial court concluded that coverage for a wage and hour claim on the basis that California wage and hour claims were 'similar' to excluded Fair Labour Standards Act claims and were thus also excluded. In *Big 5* the court offered minimal analysis of the policy at issue. A reading of the Fair Labour Standards Act exclusion in this case, however, assists in understanding the court's rationale.

The *Big 5* Fair Labour Standards Act exclusion excluded coverage for loss in connection with any claims:

*"**(1) for an actual or alleged violation of** (a) any law governing workers' compensation, unemployment insurance, social security, disability benefits or similar law, (b) the Employee Retirement Income Security Act of 1974, **(c) the Fair Labor Standards Act**, (d) the National Labor Relations Act, (e) the Worker Adjustment and Retraining Notification Act, (f) the Consolidated Omnibus Budget Reconciliation Act of 1985, (g) the Occupational Safety and Health Act or (h) rules or regulations promulgated thereunder, amendments thereto or **similar provisions of any** federal, **state** or local statutory **law** or common law; however, this exclusion shall not apply to any Employment Claim for any actual or alleged retaliatory treatment of the claimant by the Insured Company on account of the claimant's exercise of rights pursuant to any such law, rule or regulations".* (Emphasis added)

The above Fair Labour Standards Act exclusion is similar to the *SWH* exclusion in that the "similar… state law" modifier follows the Occupational Safety and Health Act. Significantly, however, in *Big 5* the state law modifier was listed last and after all of the laws listed in this exclusion, which suggested that it modifies all of the prior laws. While the *Big 5* Fair Labour Standards Act exclusion is arguably clear and unambiguous like the one found in *Payless*, a counter argument could be made. For example, an insured could contend that a 'similar law' modifier is included in sub-part (a), so why was this modifier omitted from the other sub-parts? This suggests that 'similar laws' are not intended to be excluded in these other sub-parts. Again, a plain reading clearly suggests that this exclusion is not ambiguous, but it would be beneficial for an insurer to be even clearer in demonstrating the parties' intention.

Practical implications

In order to craft a Fair Labour Standards Act exclusion that best exemplifies the true intention of the parties, it is useful to learn from different examples of Fair Labour Standards Act exclusions used in D&O and EPL policies. The *Payless* Fair Labour Standards Act exclusion is by far the clearest and least ambiguous exclusion discussed above. First, the state law modifier was located last and after the list of laws in the exclusion, which suggested that the language modifies all of the prior laws. Second, the "under any of the foregoing" language emphasised that the parties intended for the modifier to modify all of the listed laws.

An analysis of the arguments made by insureds in contending that a particular Fair Labour Standards Act exclusion does not exclude coverage for similar and/or related state laws should also assist an underwriter to draft the 'perfect' Fair Labour Standards Act exclusion. For instance, insureds have argued that the word 'similar' is ambiguous and that state labour codes are not 'similar' to the act, since they offer different levels of protection for employees. While this is a weak argument for insureds, it is worth including 'similar or related' with respect to state laws. Various courts have held that 'related' is not ambiguous and is a commonly used word with a broad meaning. It would be quite difficult for an insured to argue that the act and state labour codes are not at least 'related'.

Further, a distinction can be made between 'similar or related state laws' and 'similar or related provisions of state laws' in a Fair Labour Standards Act exclusion. For instance, an insured could argue that a specific provision of the California Labour Code is not 'similar or related to' any correlating provision of the act. It would be much more difficult for an insured, however, to argue that that the act as a whole is not 'similar or related to' the California Labour Code as a whole. It is, therefore, worthwhile for an underwriter to use the 'similar or related state laws' language instead.

Comment

Employers continue to be concerned with the rising rate of Fair Labour Standards Act claims asserted by large groups of employees with escalating defence costs and very high settlement values. These largely class action lawsuits often include allegations concerning violations of state labour codes and laws. Employers turn to their D&O and EPL carriers to provide coverage for these Fair Labour Standards Act and state law claims. If an insurer is careful to include a clearly written Fair Labour Standards Act exclusion (eg, the *Payless* Fair Labour Standards Act exclusion), with language that unambiguously demonstrates that the parties intended that state laws 'similar or related to' the act are also excluded, coverage would not be available for the insured. The steps outlined above should assist an underwriter to ensure that the Fair Labour Standards Act exclusion accomplishes its designed intention. The key is to be as clear as possible in demonstrating the intention of the parties in the Fair Labour Standards Act exclusion and in the insurance policy as a whole.

For further information on this topic please contact Robert M Flannery or Gerard C Morici at Mendes & Mount LLP by telephone (+1 212 261 8000), fax (+1 212 261 8750) or email (robert.flannery@mendes.com or gerard.morici@mendes.com).

Endnotes

(1) 2006 Cal App Unpub LEXIS 8694 (Cal Ct App 2006).

(2) No 08-3246 (10th Cir 2009).

(3) No CV 02-3320WJR (SHX), 2003 WL 22127029 (CD Cal 2003).