

Insurance does not cover overtime lawsuit

Today's 7th U.S. Circuit Court of Appeals case involves employment practices liability policy coverage and the question of whether a class-action lawsuit seeking overtime pay under the Illinois Minimum Wage Act (820 ILCS 105/4a(1)) is covered by such policy or excluded from coverage by the policy exclusion for coverage of violations of "the Fair Labor Standards Act and other similar provisions of any federal, state or local statutory" rules.

Farmers Automobile Insurance Association v. St. Paul Mercury Insurance Co., 482 F.3d 976 (2007).

Farmers Automobile Insurance Association was sued in a class-action lawsuit brought by its claims adjusters seeking overtime pay pursuant to the Illinois Minimum Wage Act (820 ILCS 105/4a(1)). Farmers sought coverage for the lawsuit from St. Paul Mercury Insurance Co. under its employment practices liability policy.

St. Paul refused coverage relying upon the following exclusion stating there was no coverage for: "[A]ny 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 Reconciliation Act of 1983, the Occupational Safety and Health Act, 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 rules or regulations promulgated under any of the foregoing." Farmers sued St. Paul seeking a determination that coverage was owed. U.S. District Judge Michael M. Mihm of the Central District of Illinois granted summary judgment for St. Paul, finding the exclusion applied because the Illinois Minimum Wage Act was "similar to" the Fair Labor Standards Act, which is the federal minimum wage act.

On appeal, the 7th Circuit affirmed in an opinion authored by Judge Richard A. Posner. The court noted the purpose of the exclusion was to avoid a "moral hazard" (refusal of overtime pay by employers would be paid by insurance if coverage was provided). And, the court held the exclusion was not unclear or ambiguous to its intended audience: employers.

Posner began the discussion by noting the interpretation of the exclusion was a matter of contract interpretation:

"The Fair Labor Standards Act is of



Federal Courts

By Jay S. Judge

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course the federal minimum wage and overtime pay law, and so the question is whether Illinois's statutory overtime pay provision is 'similar.' The district judge answered yes and granted summary judgment for St. Paul. Farmers has appealed. The question of similarity is one of contract interpretation to be answered, the parties agree, under Illinois law."

The 7th Circuit addressed Farmers' contention that, under the rule of contra proferentum, St. Paul's exclusion was to be construed against St. Paul:

"That rule requires that contracts (especially insurance contracts), if ambiguous, be construed against the drafter — and hence, in a suit over an insurance policy, against the insurer. E.g., *Gillen v. State Farm Mutual Automobile Ins. Co.*, 215 Ill.2d 381, 830 N.E.2d 575, 581-84 (Ill. 2005). Partly because insurance contracts tend to be products of negotiation among insurance companies, *Outboard Marine Corp. v. Liberty Mutual Ins. Co.*, 154 Ill.2d 90, 607 N.E.2d 1204, 1218-19 (Ill. 1992), and partly because the companies, being averse to uncertainty (they are insurance companies, after all), are reluctant to alter policy language once its meaning has been settled by judicial decision, the language of insurance policies is often imprecise (like other products of multiparty compromise) and esoteric, and courts are reluctant to require the hapless insured to unravel its mysteries.

"The argument for contra proferentum is pretty feeble when the policyholder is a sophisticated commercial enterprise rather than an individual consumer, see generally *Beanstalk Group Inc. v. AM General Corp.*, 283 F.3d 856, 858-59 (7th Cir. 2002) — especially when it is another

insurance company."

The court recognized that Illinois applies the rule of contra proferentum to both unsophisticated insureds and sophisticated insureds:

"Nevertheless, some states don't limit contra proferentum to policies sold to commercially unsophisticated individuals. Illinois is one of them, reasoning that 'any insured, whether large and sophisticated or not, must enter into a contract with the insurer, which is written according to the insurer's pleasure by the insurer. Generally, since little or no negotiation occurs in this process, the insurer has total control of the terms and the drafting of the contract.' *Outboard Marine Corp. v. Liberty Mutual Ins. Co.*, supra, 607 N.E.2d at 1219. '[T]otal control' is an exaggeration; the insured cannot be forced to accept the contract drafted by the insurance company. But no matter; we must bow to the rule adopted by the Supreme Court of Illinois to guide the interpretation of contracts governed, as this one is, by Illinois law. The rule presumably is limited by its logic, and hence to cases in which there is no negotiation over the terms of the insurance contract."

Posner explained that words in an insurance policy must be interpreted in context — not standing alone:

"This is not to buy Farmers' contention that the word 'similar' is so hopelessly vague that it cannot be given any effect in an insurance-policy exclusion. Standing alone, the word 'similar' partakes of the vagueness of other verbal signifiers of matters of degree, such as 'substantial,' 'significant,' and 'probable.' But context can give it a precise meaning, as this case illustrates.

"The Fair Labor Standards Act requires employers engaged in interstate commerce to pay their hourly wage employees time and a half for any time they work in excess of 40 hours a week. The Illinois Minimum Wage Law imposes the identical requirement except that it is not limited to employers who operate in interstate commerce, though it is of course limited to Illinois workers."

The 7th Circuit discussion focused on the purpose of the exclusion — avoidance of a moral hazard:

"The purpose of the exclusion is equally applicable to both statutes. It is to avoid 'moral hazard,' which, in its most extreme form, is the temptation of an insured to precipitate the event insured against if the insurance goes

beyond merely replacing a loss. 'It's why an insurer will not insure your house against fire for more than it's worth,' *Moran Foods Inc. v. Mid-Atlantic Market Development Co.*, 476 F.3d 436, 439 (7th Cir. 2007), and why liability insurance policies are presumed not to insure against breaches of contract. *Krueger Int'l Inc. v. Royal Indemnity Co.*, supra, 481 F.3d at 995-97. Insurance against a violation of an overtime law, whether federal or state, would enable the employer to refuse to pay overtime and then invoke coverage so that the cost of the overtime would come to rest on to the insurance company. The employer would have violated the overtime law with impunity, unjustly enriching itself by the difference between the overtime wage for the hours in question and the straight wage. No insurance company would knowingly write a policy that would enable the insured to trigger coverage any time it wanted a windfall."

Finally, Posner considered and found unprevailing Farmers' contention that the average person would not understand the exclusion, explaining that it was directed to an audience of employers who would, in fact, well understand it:

"Farmers cites us to Illinois cases which say that words left undefined in an insurance policy should be interpreted with reference to the average person's understanding. But that is a blind guide in the present case because the average person has no understanding of the exclusion of claims based on the Fair Labor Standards Act and similar statutes. The language is not addressed to the average person, but to employers, and they know what the Fair Labor Standards Act is, know there are state counterparts, and could not think they'd bought insurance that would enable them to disregard the state overtime provisions. The interpretation of a document is relative to the understanding of the intended readership, not to the average Joe. It is no more relevant that he would not understand the exclusion of claims based on the Fair Labor Standards Act and similar statutes than that someone ignorant of the English language wouldn't understand it either."

Holding that there was no uncertainty that the Illinois Minimum Wage Act was "similar to" the Fair Labor Standards Act, and therefore the exclusion barred coverage, the 7th Circuit affirmed the judgment for St. Paul.