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NOTE

The Public Policy Exclusion and Insurance for Intentional Employment Discrimination

Sean W. Gallagher

INTRODUCTION

Within two years after passage of Title VII of the Civil Rights Act of 1964,¹ employers subject to the Act began obtaining insurance indemnifying them against civil liability for employment discrimination.² Insurance for employment discrimination liability remains available today³ under commercial general liability policies,⁴ excess umbrella policies designed to supplement commercial general liability

1. Civil Rights Act of 1964, Pub. L. No. 88-352, tit. VII, 78 Stat. 241, 253-266 (codified as amended principally at 42 U.S.C. §§ 2000e to 2000e-17 (1988 & Supp. III 1991)).

2. The first policies offering coverage for employment discrimination were available in 1966. *See* Solo Cup Co. v. Federal Ins. Co., 619 F.2d 1178, 1181-82 (7th Cir.) (describing coverage under an umbrella liability insurance policy issued in 1974), *cert. denied*, 449 U.S. 1033 (1980).

3. *See* Larry M. Golub, *Insurance Coverage Issues in Employment Discrimination and Civil Rights Action*, in ALI-ABA COURSE OF STUDY: EMPLOYMENT DISCRIMINATION AND CIVIL RIGHTS ACTIONS IN FEDERAL AND STATE COURTS 922 (1992) (discussing the availability of coverage for employment discrimination under existing policies); Thomas J. Hagarty, *Insurance Coverage and Civil Rights Litigation*, 27 FEDN. INS. COUNS. Q. 3 (1976) (discussing the availability of coverage for civil rights liability under existing policies); Alan M. Koral, *Liability Insurance Coverage of Discrimination and Other Employment-Related Claims*, 17 EMPLOYEE REL. L.J. 7, 7-8 (1991) (discussing the availability of coverage for discrimination and other employment-related claims under existing policies); John E. Peer & Ronald E. Mallen, *Insurance Coverage of Employment Discrimination and Wrongful Termination Actions*, 54 DEF. COUNS. J. 464, 465 (1987) (same).

4. *See* SL Indus. v. American Motorist Ins. Co., 591 A.2d 677, 680-81 (N.J. Super. Ct. App. Div. 1991) (finding coverage for pain and suffering arising from age discrimination under a general liability policy), *modified*, 607 A.2d 1266 (N.J. 1992); Louis A. Lehr, Jr., *CGL Insurance Coverage for Civil Rights and Employment Related Claims*, 38 FEDN. INS. & CORP. COUNS. Q. 397 (1988) (describing coverage for employment discrimination claims under comprehensive general liability (CGL) policies).

The Insurance Services Office, which provides the form under which many CGL policies are written, has responded to findings of coverage for employment discrimination under the CGL policy by proposing a new exclusionary endorsement. *See* COMMERCIAL GENERAL LIABILITY 124 (Donald S. Malecki & Arthur L. Flitner eds., 3d ed. 1990) [hereinafter ISO POLICY] (describing the exclusionary endorsement styled "CG 21 47" and entitled the "Employment-Related Practices Exclusion"). This endorsement excludes from the CGL policy any coverage for "bodily injury" or "personal injury" arising out of the following employer actions:

- (1) Refusal to employ;
- (2) Termination of employment;
- (3) Coercion, demotion, evaluation, reassignment, discipline, defamation, harassment, humiliation, discrimination or other employment-related practices, policies, acts or omissions;
- or
- (4) Consequential "bodily [or personal]" injury as a result of (1) through (3) above.

ISO POLICY, *supra*, at 125. The exclusion also precludes coverage for imputed liability because it "applies whether the insured may be held liable as an employer or in any other capacity." *Id.*

insurance,⁵ and specially designed "employment practices liability insurance" policies.⁶ One can interpret these policies to find coverage for liability incurred as a result of intentional as well as unintentional employment discrimination.⁷

Despite the adoption of this exclusion, insurers may continue to provide coverage to employers willing to pay an extra premium to "buy back" the excluded coverage.

5. See *Solo Cup*, 619 F.2d at 1181 (finding coverage for unintentional discrimination under an "umbrella excess liability policy" issued in 1974); *Union Camp Corp. v. Continental Cas. Co.*, 452 F. Supp. 565 (S.D. Ga. 1978) (finding that an umbrella excess coverage policy insured against liability for discriminatory employment practices). Introduced into the U.S. market by Lloyd's of London in the 1940s, the umbrella policy has been largely copied by U.S. insurers. Eugene R. Anderson et al., *Heads We Win, Tails You Lose: Insurance Companies Short-Change Policyholders on Advertising and Personal Injury*, in *THE ADVERTISING INJURY ENDORSEMENT IN INSURANCE DISPUTES: ITS SCOPE, APPLICATION, AND COVERAGE* 99, 106-07 (PLI Com. L. & Practice Course Handbook Series No. 620, 1992). Unlike the CGL policy, which only provides coverage under a broad reading of its coverage provisions, see Golub, *supra* note 3, at 2-6; Peer & Mallen, *supra* note 3, at 466, umbrella policies typically provide direct coverage for employer liability that arises out of "discrimination." Anderson et al., *supra*, at 107-08 (quoting the "broad form liability endorsement" drafted by U.S. insurers in response to the introduction of the Lloyd's umbrella policy into the U.S. market); see also *Union Camp*, 452 F. Supp. at 566 (describing coverage under a 1966-version umbrella excess insurance policy). In much the same way that the Insurance Services Office limited coverage under its CGL policy, some insurers have excluded discrimination coverage from their umbrella policies. See, e.g., *Transport Ins. Co. v. Lee Way Motor Freight*, 487 F. Supp. 1325, 1327 (N.D. Tex. 1980) (describing the exclusion of discrimination coverage from an umbrella policy in 1972). Nevertheless, umbrella policies continue to offer coverage for employment discrimination. See *School Dist. for Royal Oak v. Continental Cas. Co.*, 912 F.2d 844, 846 (6th Cir. 1990) (describing and quoting the umbrella policy offered by the Continental Casualty Company); *Town of S. Whitley v. Cincinnati Ins. Co.*, 724 F. Supp. 599, 601-02 (N.D. Ind. 1989) (quoting the Cincinnati Insurance Company's umbrella policy in full), *aff'd*, 921 F.2d 104 (7th Cir. 1990); *University of Ill. v. Continental Cas. Co.*, 599 N.E.2d 1338, 1343-45 (Ill. App. Ct.) (describing the Continental policy), *appeal denied*, 606 N.E.2d 1235 (Ill. 1992); *Clark-Peterson Co. v. Independent Ins. Assocs.*, 492 N.W.2d 675, 676 n.3 (Iowa 1992) (describing the policy offered by the Cincinnati Insurance Company).

6. The insurance industry only recently introduced "employment practices liability insurance," which is designed to cover corporate and individual liability for employment discrimination, sexual harassment, and wrongful termination. See Golub, *supra* note 3, at 939-59 (providing specimen forms of new policies offered expressly to cover employment discrimination); Meg Fletcher, *Firms Fear Rise in Discrimination Suits: New Policies Cover Employment Claims*, BUS. INS., Mar. 23, 1992, at 2; Tammy Joyner, *Discriminating Insurers Explore a New Niche*, DETROIT NEWS, Dec. 13, 1992, at D1.

The policy provided by the Lexington Insurance Company, which is characteristic of this type of insurance, covers "employment related Wrongful Termination, Discrimination and Sexual Harassment liability." LEXINGTON INSURANCE CO., EMPLOYMENT PRACTICES LIABILITY INSURANCE POLICY 1 (Mar. 1992) (on file with author) [hereinafter LEXINGTON POLICY]. The policy defines discrimination to include "termination of an employment relationship or a demotion or a failure or refusal to hire or promote any individual because of race, color, religion, age, sex, disability, pregnancy or national origin." *Id.* at 6. Lexington's policy also covers the wrongful acts of employees and other agents of the insured corporation, "but only for the conduct of [the employer's] business within the scope of their employment." *Id.* at 4.

7. See, e.g., *Royal Oak*, 912 F.2d at 849 (interpreting an umbrella insurance policy to find coverage for intentional employment discrimination). The employment practices policy offered by Lexington might also be interpreted to provide some coverage for intentional employment discrimination. The policy excludes coverage for the intentional acts of any insured, including individual employees, stating that "[t]his insurance does not apply for the benefit of any individual insured who intentionally caused the harm alleged to have arisen out of an insured event." LEXINGTON POLICY, *supra* note 6, at 5. The policy does cover, however, the liability of individual employees acting within the scope of their employment. *Id.* These provisions leave room for a court to find coverage for some forms of employer liability for intentional employment discrim-

Despite the strong public policy favoring the enforcement of contracts as they are written,⁸ courts have often refused to enforce some forms of employment discrimination insurance on the grounds that such insurance itself violates "public policy."⁹ Courts have universally agreed that insurance for *unintentional* discrimination does not violate public policy,¹⁰ and they have therefore enforced insurance policies to cover employer liability for disparate impact discrimination.¹¹ But courts often refuse to enforce, on public policy grounds, insurance policies that cover *intentional* employment discrimination,¹²

ination. For instance, the exclusion suggests that the insurance could be applied "for the benefit" of the corporation when the corporation is vicariously liable for the intentional acts of its supervisors acting within the scope of their employment because in those circumstances it is unlikely that the corporation "intentionally caused the harm" to the employee who was discriminated against. See also Golub, *supra* note 3, at 953 (quoting a "Discrimination Errors and Omissions Liability Insurance" policy offered by Lloyd's that covers "wrongful acts of discrimination" and excludes "intentional acts" but does not impute the intentional acts of one insured to another).

8. See, e.g., *Royal Oak*, 912 F.2d at 849 ("Public policy normally favors enforcement of insurance contracts according to their terms." (citing *Ranger Ins. Co. v. Bal Harbour Club, Inc.*, 549 So. 2d 1005, 1010 n.1 (Fla. 1989) (Ehrlich, C.J., dissenting))); *Northwestern Natl. Cas. Co. v. McNulty*, 307 F.2d 432, 444 (5th Cir. 1962) (Gwin, J., concurring) (noting the public policy favoring the enforcement of contracts); *Union Camp*, 452 F. Supp. at 568 ("Exercise of the freedom of contract is not lightly to be interfered with. It is only in clear cases that contracts will be held void as against public policy.").

9. See *infra* sections II.A, II.B.

10. See *Solo Cup Co. v. Federal Ins. Co.*, 619 F.2d 1178, 1187 (7th Cir.) (upholding coverage for disparate impact discrimination), *cert. denied*, 449 U.S. 1033 (1980); *Transport Ins. Co. v. Lee Way Motor Freight*, 487 F. Supp. 1325, 1328 (N.D. Tex. 1980) (finding insurance for pattern and practice discrimination to be valid, on the erroneous assumption that "[i]ntent to discriminate is irrelevant in a pattern and practice case"); *Union Camp*, 452 F. Supp. at 567-68 (upholding coverage for disparate impact discrimination but not disparate treatment discrimination); *School Dist. No. 1 v. Mission Ins. Co.*, 650 P.2d 929 (Or. Ct. App. 1982) (approving coverage for disparate impact but not disparate treatment discrimination in the context of an employer's refusal to approve a variable annuity pension plan); see also Steven L. Willborn, *Insurance, Public Policy, and Employment Discrimination*, 66 MINN. L. REV. 1003, 1005-06 (1982) (suggesting that evolving insurance law doctrine prohibits insurance for disparate treatment but allows it for disparate impact cases); Effie F. Anastassiou, Comment, *Insurance Against Civil Liability for Employment Discrimination*, 80 COLUM. L. REV. 192, 195-96 (1980) (stating that unintentional conduct is usually insurable but that intentional conduct is not insurable).

11. Disparate impact discrimination "involve[s] employment practices that are facially neutral in their treatment of different groups but that in fact fall more harshly on one group than another and cannot be justified by business necessity." *International Bhd. of Teamsters v. United States*, 431 U.S. 324, 336 n.15 (1977). Paradigmatic examples of disparate impact discrimination include the use of "invalid" standardized tests. See, e.g., *Albemarle Paper Co. v. Moody*, 422 U.S. 405 (1975) (use of Wonderlic Personnel Test and high school diploma requirement); *Griggs v. Duke Power Co.*, 401 U.S. 424 (1971) (same). Other examples of disparate impact discrimination include the use of height and weight requirements that disproportionately exclude women or minorities, or experience requirements that exclude minorities from fields that traditionally have been closed to them. See, e.g., *Dothard v. Rawlinson*, 433 U.S. 321 (1977) (height and weight requirements excluding women from prison guard jobs); *Chrisner v. Complete Auto Transit, Inc.*, 645 F.2d 1251 (6th Cir. 1981) (experience requirement disproportionately excluding female truck drivers). Congress codified disparate impact analysis in the Civil Rights Act of 1991, which amended Title VII. See Pub. L. No. 102-166, § 703(k), 105 Stat. 1099 (1991) (codified at 42 U.S.C. § 2000e-2(k) (Supp. III 1991)).

12. See, e.g., *Solo Cup*, 619 F.2d at 1187; *Union Camp*, 452 F. Supp. at 567-68. But see, e.g., *Royal Oak*, 912 F.2d at 848-50 (applying Michigan law to allow coverage for intentional religious discrimination in employment); *Ranger Ins. Co. v. Bal Harbour Club, Inc.*, 509 So. 2d 945 (Fla.

such as disparate treatment discrimination,¹³ retaliatory discharge,¹⁴ and sexual harassment.¹⁵

Although courts in other contexts invoke public policy to void the provisions of otherwise valid contracts,¹⁶ the practice of voiding contracts that violate public policy has taken on unique application in the

Dist. Ct. App. 1987) (en banc) (allowing coverage for discrimination in private housing), *rev'd*, 549 So. 2d 1005 (Fla. 1989); *University of Ill. v. Continental Cas. Co.*, 599 N.E.2d 1338, 1351 (Ill. App. Ct.) (approving coverage for retaliatory discharge and noting that "we find there is no Illinois public policy prohibiting insuring for damages caused by one's intentional acts except to the extent that the insured wrongdoer may not be the person who recovers the policy proceeds"), *appeal denied*, 606 N.E.2d 1235 (Ill. 1992); *Independent Sch. Dist. No. 697 v. St. Paul Fire & Marine Ins.*, 495 N.W.2d 863, 868 (Minn. Ct. App.) (holding that public policy does not preclude coverage for intentional age discrimination), *review granted*, No. 92-1625, 1993 Minn. LEXIS 225 (Minn. Mar. 30, 1993).

13. *Solo Cup*, 619 F.2d at 1186 (suggesting that disparate treatment discrimination is intentional discrimination within the public policy exclusion); *Legg Mason Wood Walker v. INA*, 23 Fair Empl. Prac. Cas. (BNA) 778, 782 n.12 (D.D.C. 1980) ("An insurance policy covering intentional discrimination by the insured would likely violate public policy and thus be held unenforceable." (citing *Union Camp*, 452 F. Supp. at 567-68)). *But see Andover Newton Theological Sch., Inc. v. Continental Cas. Co.*, 930 F.2d 89, 93 (1st Cir. 1991) ("Massachusetts public policy does not bar insurance coverage for an employment action solely because it is found to violate the ADEA in an individual disparate treatment case."); *Town of S. Whitley v. Cincinnati Ins. Co.*, 724 F. Supp. 599, 604 (N.D. Ind. 1989) (holding that "reckless disregard" under ADEA is insurable), *aff'd*, 921 F.2d 104 (7th Cir. 1990); *Andover Newton Theological Sch., Inc. v. Continental Cas. Co.*, 566 N.E.2d 1117, 1118-19 (Mass. 1991) (finding, on a certified question from the First Circuit, that Massachusetts public policy does not prohibit coverage for "reckless disregard" under the ADEA).

14. *See, e.g., Chicago Bd. of Options Exch., Inc. v. Harbor Ins. Co.*, 738 F. Supp. 1184, 1187 (N.D. Ill. 1990) (stating that liability for retaliatory discharge may be uninsurable but that a corporation's vicarious liability for a retaliatory discharge would be insurable); *Rubenstein Lumber Co. v. Aetna Life & Cas. Co.*, 462 N.E.2d 660, 662 (Ill. App. Ct. 1984) (stating in dicta that retaliatory discharge is uninsurable). *But see Continental Cas. Co. v. Canadian Universal Ins. Co.*, 924 F.2d 370, 374 (1st Cir. 1991) (enforcing coverage for retaliatory discharge and sexual harassment); *U.S. Fire Ins. Co. v. Beltmann N. Am. Co.*, 695 F. Supp. 941, 948-49 (N.D. Ill. 1988) (permitting employer to insure liability for retaliatory discharge), *rev'd on other grounds*, 883 F.2d 564 (7th Cir. 1989); *Dixon Distrib. Co. v. Hanover Ins. Co.*, 612 N.E.2d 846, 855 (Ill. App. Ct.) (finding coverage for retaliatory discharge under an umbrella policy and finding that this coverage did not violate public policy), *appeal granted*, 622 N.E.2d 1203 (Ill. 1993); *Ellis v. Transcontinental Ins. Co.*, 619 So. 2d 1130, 1135 (La. Ct. App.) (finding coverage for retaliatory discharge under CGL and umbrella policies even though retaliatory discharge is an intentional tort), *cert. denied*, 625 So. 2d 1043 (La. 1993).

15. *See, e.g., Continental Ins. Co. v. McDaniel*, 772 P.2d 6, 9 (Ariz. Ct. App. 1988) (denying coverage under policy exclusion that was the functional equivalent of a public policy limitation); *Coit Drapery Cleaners, Inc. v. Sequoia Ins. Co.*, 18 Cal. Rptr. 2d 692, 697 (Ct. App. 1993) (denying coverage for sexual harassment under California's statutory exclusion); *B&E Convalescent Ctr. v. State Compensation Ins. Fund*, 9 Cal. Rptr. 2d 894, 906-07 (Ct. App. 1992) (denying coverage based on statutory exclusion of coverage for willful wrongdoing). *But see Canadian Universal*, 924 F.2d at 374 (enforcing coverage for retaliatory discharge and sexual harassment); *Seminole Point Hosp. Corp. v. Aetna Cas. & Sur. Co.*, 675 F. Supp. 44, 47 (D.N.H. 1987) (permitting insurance to cover a hospital's liability for sexual harassment committed by its president); *Clark-Peterson Co. v. Independent Ins. Assocs.*, 492 N.W.2d 675, 676 (Iowa 1992) (denying coverage for intentional discrimination under a straight interpretation of the policy but enforcing coverage under the "reasonable expectations" doctrine).

16. It is well settled that "[p]arties may incorporate in their agreements any provisions that are not illegal or violative of public policy." 17A AM. JUR. 2D *Contracts* § 238 (1991). For a discussion of the application of public policy to police the provisions of private contracts, see generally 17A *id.*

area of insurance law. Courts vigorously invoke public policy to police the provisions of insurance contracts, and they have refused to enforce or have voided provisions in insurance contracts for a wide variety of reasons.¹⁷ In some cases, the insured raises public policy to contest the enforcement of unconscionable policy provisions.¹⁸ In these cases, the insured asks the court not to enforce the contract provision because enforcement of the provision would work an inequitable hardship on the insured.¹⁹ This Note addresses the similar, but not entirely analogous, circumstance in which an insurance company raises public policy as a reason not to enforce the insurance contract, and a court must decide whether to impose a "public policy exclusion"²⁰ to preclude an insured employer from enforcing its insurance contract to cover liability for intentional employment discrimination.

Courts consider whether to adopt such a public policy exclusion in the following context: An employer buys general liability insurance that protects against a wide range of risks, including employment discrimination liability. Subsequently, an employee sues the employer for intentional discrimination. When the employer requests defense and indemnification coverage from its insurance company, the insurance company either refuses to defend the suit or defends the suit under a reservation of rights,²¹ claiming that intentional discrimination is not a

17. For example, courts have refused to enforce insurance contracts that violate express statutory or regulatory requirements, or that allow the insurance company to take advantage of the insured. See, e.g., *Travelers Indem. Co. v. Williams*, 167 S.E.2d 174, 176 (Ga. Ct. App. 1969) (voiding provisions of an automobile policy that conflicted with the state uninsured motorist statute). Courts have also questioned the notice and timing restrictions insurers include in health insurance policies because these restrictions force insureds to engage in perverse behavior in order to obtain coverage. *Strickland v. Gulf Life Ins. Co.*, 242 S.E.2d 148, 149-50 (Ga. 1978).

18. See, e.g., *Strickland*, 242 S.E.2d at 149-50 (questioning notice requirements forcing an insured to engage in perverse behavior in order to obtain coverage); *C&J Fertilizer, Inc. v. Allied Mut. Ins. Co.*, 227 N.W.2d 169, 171, 179-81 (Iowa 1975) (holding that the provisions of an insurance policy covering theft were void to the extent that they required the insured to prove "visible marks" of theft before recovering under the policy).

19. Like other contracts, insurance policies can be "held invalid under the doctrine of unconscionability." 69 N.Y. JUR. 2D *Insurance* § 685 (1988). For a discussion of the application of the unconscionability doctrine to insurance, see Donald M. Zupanec, Annotation, *Doctrine of Unconscionability as Applied to Insurance Contracts*, 86 A.L.R.3d 862 (1978).

20. Courts do not expressly draft a "public policy exclusion" into contracts of insurance. Rather, they invoke public policy to refuse to enforce insurance coverage for certain forms of liability, primarily liability for intentionally incurred losses. See *infra* sections I.A., I.B. In accordance with the convention used in the literature, this Note refers to the practice of voiding coverage that is contrary to public policy as either a "court-imposed intentional act exclusion" or more broadly as the "public policy exclusion." See Gary T. Schwartz, *The Ethics and the Economics of Tort Liability Insurance*, 75 CORNELL L. REV. 313, 341 n.125 (1990) (noting that the prohibition against insuring intentional wrongdoing "is a blend of a public-policy prohibition and an 'implied exception' read into the insurance policy" (citing ROBERT E. KEETON, *INSURANCE LAW: BASIC TEXT* 292-93 (1971))); W.E. Shipley, Annotation, *Liability Insurance as Covering Accident, Damage, or Injury Due to Wanton or Wilful Misconduct or Gross Negligence*, 20 A.L.R.3d 320, 331 (1969) (referring to the "public policy preclusion").

21. The insurer could also defend the suit without reserving its right to contest coverage, which would give rise to claims by the insured employer that the insurer had waived its right to contest coverage or that coverage arose as a matter of estoppel. See ROBERT H. JERRY II, UN-

covered risk under the policy. At this point, the court must determine the extent of coverage under the policy²² — a question of contract interpretation.²³ In resolving this dispute, the court will look to the coverage provisions of the policy, particularly the definitions of “occurrence” or “wrongful acts,” and to any exclusions in the policy, particularly any “intentional act,” “employer liability,” or “discrimination” exclusion.²⁴ Interpreting the policy in light of these

DERSTANDING INSURANCE LAW §§ 114[a]-[c] (1987) (describing the options that are available to an insurance company that wants to contest coverage under the policy without creating a conflict of interest in the insurance company's representation of the insured, and without incurring liability for failing to defend the underlying case). This Note does not consider whether insurance for intentional employment discrimination could arise by waiver or estoppel, and it does not consider whether coverage by estoppel would comport with public policy. For an example of a court's consideration of this issue, see *St. Paul Ins. Cos. v. Talladega Nursing Home, Inc.*, 606 F.2d 631, 634 n.2 (5th Cir. 1979).

22. This Note addresses the validity and legality of insurance for intentional employment discrimination. It does not separately address the validity of insurance for the cost of defending employment discrimination cases. However, courts are generally willing to enforce insurance to cover defense costs even in cases in which the underlying liability might be uninsurable as a matter of public policy. See, e.g., *Andover Newton Theological Sch., Inc. v. Continental Cas. Co.*, 930 F.2d 89, 95 (1st Cir. 1991) (“Although an argument can be made that a public policy is to some extent subverted by insurance against defense costs, the basic fact is that this is not insurance against liability.”); *B&E Convalescent Ctr. v. State Compensation Ins. Fund*, 9 Cal. Rptr. 2d 894, 903 (Ct. App. 1992) (“[E]ven though public policy . . . precludes an insurer from indemnifying an insured in an underlying action the duty to defend still exists so long as the ‘insured reasonably expect[s] the policy to cover the types of acts involved in the underlying suit.’” (quoting *Republic Indem. Co. v. Superior Ct.*, 273 Cal. Rptr. 331, 335 (Ct. App. 1990))). The substantial cost of defending employment discrimination lawsuits makes the enforceability of insurance for defense costs important to employers. See *Fletcher*, *supra* note 6, at 39 (citing defense costs and the uncertainty surrounding the standard of liability for employment discrimination as two reasons that employers might be inspired to buy insurance for employment discrimination).

23. The interpretation issues change depending upon the wording of the insurance contract, but the public policy question remains the same. See *infra* Part II (considering public policy challenges to coverage under a wide variety of different insurance policies). Some courts and judges do not view the public policy exclusion as an exclusion at all, but rather view public policy considerations as a guide to the interpretation of the insurance contract. These courts do not find coverage and then declare it void. Rather, they use public policy as a guide to the interpretation of the parties' intent in making the contract. See, e.g., *Ranger Ins. Co. v. Bal Harbour Club, Inc.*, 509 So. 2d 940, 945 (Fla. Dist. Ct. App. 1987) (Ferguson, J., dissenting) (refusing to interpret a policy to find coverage for intentional religious discrimination on the grounds that such an interpretation would require the court to enforce coverage that violates public policy), *revd.*, 549 So. 2d 1005 (Fla. 1989); *United Servs. Auto. Assn. v. Elitzky*, 517 A.2d 982, 989 (Pa. Super. Ct. 1986) (“[W]e feel that an ‘intended’ harm clause should be coterminous with the public policy exclusion.”), *appeal denied*, 528 A.2d 957 (Pa. 1987). The effect of these two methods of interpretation is the same: no coverage that is contrary to public policy.

24. *Great Global Assurance Co. v. Shoemaker*, 599 So. 2d 1036, 1040 (Fla. Dist. Ct. App. 1992) (Farmer, J., dissenting) (describing exclusion for “claims made by anyone related to their employment” and suggesting that this exclusion was meant to exclude coverage for Title VII liability and liability under state antidiscrimination laws); *Lehr*, *supra* note 4, at 397 (describing in general the construction of comprehensive general liability policies and courts' interpretations of “occurrence”); *Peer & Mallen*, *supra* note 3 (discussing the availability of coverage for employment discrimination under existing policies). Some policies expressly exclude coverage for “discrimination.” See *ISO POLICY*, *supra* note 4, at 124; see also *Reliable Springs Co. v. St. Paul Fire & Marine Ins. Co.*, 869 F.2d 993, 995 (6th Cir. 1989) (finding no coverage for violation of the Age Discrimination in Employment Act under a general liability policy that excluded coverage for “any offense related to discrimination or unfair employment practices”); *Ottumwa Hous.*

provisions, the court may find that the insurance policy was intended to provide coverage for intentional employment discrimination.²⁵ The insurance company, however, will often argue that public policy considerations should prevent enforcement of this coverage.²⁶ Insurance companies argue that courts should not enforce insurance to cover an employer's liability for intentional employment discrimination because such insurance promotes wrongdoing,²⁷ and because it allows employers to benefit from their own wrongful acts of discrimination.²⁸ In this situation, the court must decide whether to impose a public policy exclusion — at the behest of the insurance companies responsible for drafting policies — that precludes an employer from enforcing coverage that is provided by the policy.

This Note argues that courts choosing to apply²⁹ the public policy exclusion to insurance for intentional employment discrimination liability should nevertheless permit employers to enforce insurance covering negligent supervision liability and liability imputed to an employer as a result of the intentional discrimination committed by its employees. Part I establishes a framework for understanding the cases in which courts have invoked public policy to refuse enforcement of insurance contracts, arguing that the rationale behind the public policy exclusion is utilitarian and that courts refuse to enforce insurance

Auth. v. State Farm Fire & Cas. Co., 495 N.W.2d 723, 729 (Iowa 1993) (refusing to enforce coverage for discrimination under a worker's compensation and employer liability policy because the policy expressly excluded coverage for "discrimination"). Courts also refuse to enforce coverage for employment discrimination under Title VII because an award of back pay is not "damages," see, e.g., Maryland Cup Corp. v. Employers Mut. Liab. Ins. Co., 568 A.2d 1129, 1133 (Md. Ct. Spec. App. 1990), for sexual harassment because it "aris[es] out of . . . employment" and thus falls under a contractual exclusion, Omark Indus., Inc. v. Safeco Ins. Co., 590 F. Supp. 114, 120 (D. Or. 1984), and for proceedings before the Equal Employment Opportunity Commission because they are not adversarial proceedings or actions for damages. Campbell Soup Co. v. Liberty Mut. Ins. Co., 571 A.2d 969, 970 (N.J. Super. Ct. App. Div.), cert. denied, 584 A.2d 230 (N.J. 1990).

25. See, e.g., School Dist. for Royal Oak v. Continental Cas. Co., 912 F.2d 844, 848-49 (6th Cir. 1990) (finding coverage for intentional employment discrimination); University of Ill. v. Continental Cas. Co., 599 N.E.2d 1338, 1351 (Ill. App. Ct.) (same), appeal denied, 606 N.E.2d 1235 (Ill. 1992); Independent Sch. Dist. No. 697 v. St. Paul Fire & Marine Ins. Co., 495 N.W.2d 863, 867-68 (Minn. Ct. App.) (same), review granted, No. 92-1625, 1993 Minn. LEXIS 225 (Mar. 30, 1993).

26. The Supreme Court of Minnesota, in another context, has succinctly defined the two-tiered inquiry courts undertake in deciding whether to require an insurance company to indemnify the insured when coverage would arguably violate public policy. Interpreting a professional liability policy to determine whether it provided coverage for breach of fiduciary duty, the court stated that "[t]here are, as we see it, two main issues: (1) Does the insurance policy, by its terms, cover forfeited attorney's fees? (2) If so, is such a policy provision unenforceable as a matter of public policy?" Perl v. St. Paul Fire & Marine Ins. Co., 345 N.W.2d 209, 211 (Minn. 1984).

27. See *infra* sections I.B., II.A.

28. See, e.g., *Royal Oak*, 912 F.2d at 847-48; *Solo Cup v. Federal Ins. Co.*, 619 F.2d 1178 1187-88 (7th Cir.), cert. denied, 449 U.S. 1033 (1980); *Independent Sch. Dist. No. 697*, 495 N.W.2d at 867.

29. Some courts choose not to apply the public policy exclusion to void coverage for intentional employment discrimination. See *infra* section II.B.

for liability arising out of intentional wrongdoing on the grounds that such insurance detracts from the deterrent effect of civil liability. Applying this framework, Part I also explores the rationale behind the exceptions to the public policy exclusion that some courts have created to permit employers to insure against imputed liability arising out of intentional torts committed by employees and against negligent supervision liability.³⁰ Part II summarizes the position taken by the courts that have applied the public policy exclusion to refuse enforcement of coverage for intentional employment discrimination. Part II then contrasts this position with the position taken by courts that have refused to adopt a public policy exclusion and by courts that have applied the negligent supervision exception to enforce insurance for sexual harassment liability. Part III relies on the analytic framework of Part I and the case discussion of Part II to suggest a three-part test for applying the negligent supervision and imputed liability exceptions to insurance for intentional employment discrimination. Part IV considers and rejects the contention that courts should not enforce coverage for intentional employment discrimination liability on the grounds the enforcement of such coverage would be inconsistent with the expressive function of Title VII liability. This Note concludes that courts applying the public policy exclusion to insurance for intentional employment discrimination should, in some circumstances, permit employers to enforce insurance policies that cover imputed liability and negligent supervision liability incurred as a result of intentional discrimination committed by employees.

I. THE PUBLIC POLICY EXCLUSION IN INSURANCE LAW

This Part considers the rationale behind the public policy exclusion in insurance law and the principle behind the exceptions courts have drawn to permit enforcement of insurance covering an employer's imputed and negligent supervision liability. Section I.A describes the historical foundation of the public policy doctrine in first-party insurance³¹ and explains that courts apply the public policy ex-

30. In some circumstances, employers face derivative liability as a result of their negligence in failing to prevent an employee from committing intentional torts, not because courts impute liability for the employee's intentional tort to the employer under an agency theory. See *infra* note 109 and accompanying text.

31. The difference between first-party and third-party insurance has been explained as follows:

An insurance policy may contain both first party property and third party liability coverages. . . .

Where insured is seeking coverage against loss or damage sustained by insured, for damage to his own property, the claim is first party in nature. If, however, insured is seeking coverage against liability of insured to another, the claim is third party in nature.

46 C.J.S. *Insurance* § 861 (1993) (footnotes omitted); see also KENNETH S. ABRAHAM, ENVIRONMENTAL LIABILITY INSURANCE LAW: AN ANALYSIS OF TOXIC TORT AND HAZARDOUS WASTE INSURANCE COVERAGE ISSUES 23 (1991) (noting that a property insurance policy is "a 'first-party' policy because it covers the insured against physical loss of or injury to his or her

clusion to void coverage in that context in part to protect innocent third parties to the insurance contract. Section I.B explains how courts have imported this rationale into the liability insurance context to void those forms of insurance that "promote wrongdoing" and demonstrates how the public policy exclusion in liability insurance has produced inconsistent and conflicting rules among the states. Section I.C describes the exceptions courts have drawn to permit coverage for some forms of intentional misconduct, with a particular focus on the imputed liability and negligent supervision exceptions, and argues that these exceptions comport with the rationale behind the public policy exclusion.

A. *The Origins of the Public Policy Doctrine*

The practice of voiding insurance coverage on public policy grounds developed in the context of first-party life, health, and property insurance.³² In this context, courts have held that public policy prohibits an insured from recovering insurance proceeds for intentionally self-inflicted injuries or for losses over which the insured has complete control.³³ For instance, courts invoke public policy to prohibit the beneficiary of a life insurance policy from recovering the policy proceeds if he has murdered the named insured.³⁴ Similarly, courts

own property"); JERRY, *supra* note 21, § 130[a], at 43 ("In first-party insurance, the contract between the insurer and the insured is designed to indemnify the insured for a loss suffered directly by the insured. . . . Liability insurance, on the other hand, is sometimes described as third-party insurance because the interests protected by the contract are ultimately those of third parties injured by the insured's conduct.").

32. See *U.S. Fire Ins. Co. v. Beltmann N. Am. Co.*, 695 F. Supp. 941, 948 (N.D. Ill. 1988) (noting that Illinois courts developed the public policy exclusion for first-party insurance and refusing to import that exclusion to void coverage under a liability insurance policy because "the public policy considerations that preclude insurance coverage for self-inflicted injury lose a great deal of their force in the context of insurance for tortious liability to innocent third parties"), *revd. on other grounds*, 883 F.2d 564 (7th Cir. 1989); *St. Paul Ins. Cos. v. Talladega Nursing Home, Inc.*, 606 F.2d 631, 633 (5th Cir. 1979) (describing how the Alabama public policy exclusion was "extended" from the first-party to the third-party context); *University of Ill. v. Continental Cas. Co.*, 599 N.E.2d 1338, 1350-51 (Ill. App. Ct.) (reaching a conclusion similar to that reached in *Beltmann* and stating: "Based on our analysis of the cases . . . we find there is no Illinois public policy prohibiting insuring for damages caused by one's intentional acts except to the extent that the insured wrongdoer may not be the person who recovers the policy proceeds."), *appeal denied*, 606 N.E.2d 1235 (Ill. 1992).

33. See, e.g., *Hussar v. Girard Life Ins. Co. of Am.*, 252 So. 2d 374, 374 (Fla. Dist. Ct. App. 1971) (holding that public policy prohibits recovery from health insurer for self-inflicted injuries); see also 1 WARREN FREEDMAN, RICHARDS ON THE LAW OF INSURANCE § 1:13, at 48 (6th ed. 1990) ("Insurance, by its very definition, covers injury, damage or loss which is fortuitous and not within the control of the . . . insured."); JERRY, *supra* note 21, § 63A, at 302 ("Insureds should not receive coverage for destroying their own property.").

34. See *New Eng. Mut. Life Ins. Co. v. Null*, 605 F.2d 421, 424 (8th Cir. 1979) (citing "the accepted rule that a life insurance policy is void *ab initio* when it is shown that the beneficiary thereof procured the policy with a present intention to murder the insured"); *Commercial Travelers Mut. Accident Assn. v. Witte*, 406 S.W.2d 145, 149 (Ky. 1966) (holding that a beneficiary cannot recover life insurance proceeds if he murders the insured); 1B JOHN A. APPLEMAN & JEAN APPLEMAN, *INSURANCE LAW AND PRACTICE* § 481 (1981) ("It has uniformly been held that a beneficiary under a contract of personal insurance who murders the insured cannot recover

generally refuse to require insurance companies to pay the proceeds of a property insurance policy to an insured who intentionally destroys his own property³⁵ through, for instance, arson.³⁶

Courts rely on both equitable and utilitarian rationales in applying public policy to void coverage in these circumstances. First, courts prohibit the insured from recovering the policy proceeds to cover intentionally incurred losses on the basis of the "fundamental principle" that "no one shall be permitted to profit from his own wrongdoing."³⁷ Insurance is designed to indemnify an insured against the *risk* of loss,³⁸ and, in the cases that have recognized a public policy against enforcing life or property insurance, the insured has at least implicitly concealed the fact that he has obtained coverage for the *certainty* that losses will occur. If an insured knows that damages have already occurred, or if the insured intentionally suffers losses to his property that he has insured against, the insured commits a fraud against the insurance company by seeking recovery under the policy.³⁹ The insured has obtained insurance to cover losses he knows will occur without revealing to the insurance company that the insured-against losses are sure to obtain. The insured can thus "profit" — by receiving the pol-

the policy benefits."). See generally F.S. Tinio, Annotation, *Killing of Insured by Beneficiary as Affecting Life Insurance or Its Proceeds*, 27 A.L.R.3d 794 (1969). Even though public policy forbids the beneficiary from recovering, it does not discharge the insurance company from its responsibility to pay the policy proceeds into the insured's estate. See 1B APPLEMAN, *supra*, § 482.

35. 12 APPLEMAN & APPLEMAN, *supra* note 34, § 7031 ("[A]rson by the insured will prevent him from recovering."); JERRY, *supra* note 21, § 63A, at 302.

36. See, e.g., *Checkley v. Illinois Cent. R.R.*, 100 N.E. 942, 944 (Ill. 1913) ("A fire insurance policy issued to [anyone], which purported to insure his property against his own willful and intentional burning of the same, would manifestly be condemned by all courts as contrary to a sound public policy . . ."), quoted in *Beltmann*, 695 F. Supp. at 948. One commentator has called this the "barn burning defense," stating that "the insured who intentionally burns his own barn is not entitled to collect the insurance on it!" 1 FREEDMAN, *supra* note 33, § 1:13, at 48-49.

37. See *Messersmith v. American Fidelity Co.*, 133 N.E. 432, 433 (N.Y. 1921) (noting that insurance coverage for some forms of wrongdoing should be barred by "the fundamental principle that no one shall be permitted to take advantage of his own wrong"); *Peoples Sec. Life Ins. Co. v. Arrington*, 412 S.E.2d 705, 707 (Va. 1992) (noting that the statutory bar against a murderer's recovering life insurance proceeds reflects the public policy that "no person shall be allowed to profit from his wrongful acts"); 1 FREEDMAN, *supra* note 33, § 1:13, at 48 ("The thrust is clear that an insured . . . should not gain upon the occurrence of the insured event, which event is brought about deliberately by the insured . . .").

38. See JERRY, *supra* note 21, § 63, at 300 ("It is a fundamental requirement in insurance law that the insurer will not pay for a loss unless the loss is 'fortuitous' . . .").

39. Similar concerns with the potential for fraud underlie the "insurable interest" requirement in insurance. An insured cannot obtain insurance unless he has an "insurable interest" in the property insured, and the value of recovery against an insurance policy cannot exceed the insured's interest in the property. The reason for this latter rule is obvious: if an insured could obtain insurance coverage in excess of the value of the property insured, the insured would have an extraordinary incentive to destroy the property and collect the insurance proceeds. See generally *id.* §§ 40-46 (describing the insurable interest requirement in life, property, and liability insurance). Moreover, "[t]he public policy supporting [the exclusion of coverage for intentional wrongdoing] is identical to that which supports the insurable interest requirement." *Id.* § 63A, at 302.

icy proceeds — as a result of his wrongdoing, the fraud against his insurance company.

Second, courts void insurance coverage in these circumstances to deter wrongdoing and to prevent harm to third parties and the public at large.⁴⁰ This second rationale focuses on the incentives insurance creates for the insured to engage in wrongdoing, not simply on the prospect of an inequitable recovery of policy proceeds by the insured. For example, the prospect of a large payoff in the form of insurance proceeds might inspire the beneficiary of a life insurance policy to murder the insured party. The public policy exclusion protects the life of the insured party by removing this incentive for wrongdoing. One can provide a similar explanation for the ban on recovering for arson. If arsonists could enforce their property insurance, they would have an incentive to destroy their property whenever the proceeds from their insurance policy exceeded their subjective valuation of the property.⁴¹ Again, the public policy exclusion removes this incentive.

These incentives reflect moral hazard, which is the tendency of insurance to change the behavior of insured parties.⁴² In the particular context of the public policy exclusion, the moral hazard is the tendency of insurance to induce the insured party to incur losses that are covered under the policy. This tendency can manifest itself either as increased negligence on the part of the insured — failing to take appropriate steps to avoid losses — or as intentional wrongdoing in reliance on the availability of insurance — consciously incurring losses in order to collect the insurance proceeds.⁴³ For example, the theory of moral hazard predicts that a driver with automobile insurance will take fewer steps to avoid getting into an accident or that the driver

40. See *L'Orange v. Medical Protective Co.*, 394 F.2d 57, 60 (6th Cir. 1968) (noting that "the violation of public policy is measured by the tendency of the contract to injure the public good").

41. See 1 FREEDMAN, *supra* note 33, § 1:13; JERRY, *supra* note 21, § 63A, at 302.

42. In *Western Cas. & Sur. Co. v. Western World Ins. Co.*, 769 F.2d 381 (7th Cir. 1985), Judge Easterbrook described the moral hazard problem by stating that "[o]nce a person has insurance, he will take more risks than before because he bears less of the cost of his conduct." 769 F.2d at 385. Other descriptions of the problem abound. See, e.g., JERRY, *supra* note 21, § 10[c][2], at 13 ("[T]he existence of insurance could have the perverse effect of increasing the probability of loss. . . . This phenomenon is called *moral hazard*."); Scott E. Harrington, *Prices and Profits in the Liability Insurance Market*, in *LIABILITY: PERSPECTIVES AND POLICY* 42, 47 (Robert E. Litan & Clifford Winston eds., 1988) ("Moral hazard is the tendency for the presence and characteristics of insurance coverage to produce inefficient changes in buyers' loss prevention activities, including carelessness and fraud"); Schwartz, *supra* note 20, at 338 n.117 (" 'Moral hazard' is sometimes distinguished from 'morale hazard,' the former referring to deliberate acts like arson, the latter to the mere relaxation of the defendant's discipline of carefulness." (citing C. ARTHUR WILLIAMS, JR. & RICHARD M. HEINS, *RISK MANAGEMENT AND INSURANCE* 217 (4th ed. 1981))).

43. See George L. Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 YALE L.J. 1521, 1547 (1987) ("Moral hazard refers to the effect of the existence of insurance itself on the level of insurance claims made by the insured. . . . *Ex ante* moral hazard is the *reduction in precautions* taken by the insured to prevent the loss, because of the existence of insurance." (second emphasis added)).

might intentionally wreck his automobile because he knows that insurance will pay for his losses.⁴⁴ Although courts recognize moral hazard and often prohibit those forms of insurance that promote wrongdoing, they do not invalidate all insurance it infects.⁴⁵ Rather, courts have found that insurance for negligence does not promote wrongdoing,⁴⁶ while they assume that insurance for intentional wrongdoing is tarnished with an impermissible moral hazard. On the basis of this distinction, courts have generally voided coverage for intentionally incurred losses on public policy grounds, while they have enforced insurance that covers losses resulting from the insured party's own negligence.⁴⁷

44. See JERRY, *supra* note 21, § 63A, at 302.

45. Moreover, courts do not void all forms of insurance that allow an insured to be unjustly enriched by the availability of insurance. Take, for example, the case of a taxi driver insured against liability for injuries she causes while driving her cab. If she intentionally speeds, she can take on more fares and earn more money than if she obeys the traffic laws. Further, if she injures someone while speeding, her liability would be insurable. Though she relied on insurance to act negligently — driving in excess of the speed limit is generally negligent — and although she has been unjustly enriched at the expense of the victims of her negligence, the taxi driver can be indemnified against the liability she incurs.

46. Corbin noted this assumption in his treatise on contracts:

Liability insurance policies, taken out by employers, owners of automobiles, and others, are contracts for indemnity against consequences of tortious negligence on the part of servants and employees. Such contracts are not made illegal by the fact that they provide for indemnity against consequences of the negligent conduct of the employer or owner himself. It is not believed that harmful negligence is made more probable by such indemnification
6A ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 1471, at 587-88 (1962), *quoted in* Harrell v. Travelers Indem. Co., 567 P.2d 1013, 1016 (Or. 1977); *see also* Hartford Life Ins. Co. v. Title Guar. Co., 520 F.2d 1170, 1175 (D.C. Cir. 1975) ("It is settled law that a person may insure himself against the results of his own negligent violations of law."). Some courts recognize that insurance for negligence might promote wrongdoing but nevertheless refuse to adopt a public policy exclusion to void such coverage. *See, e.g.,* Kansas City Stock Yards Co. v. A. Reich & Sons, 250 S.W.2d 692, 698 (Mo. 1952) (observing that insurance for negligence provides a temptation to negligence on the part of the insured but declining to adopt a public policy exclusion for negligent wrongs).

47. *See, e.g.,* A. Reich & Sons, 250 S.W.2d at 698 (holding that public policy does not forbid property insurer from indemnifying insured against losses to value of property in a case in which the loss is attributable to the insured's negligence). Insurance for negligence was at one time the subject of a public policy debate similar to the one that now rages over the availability of insurance for intentional wrongdoing. *See* Lazenby v. Universal Underwriters Ins. Co., 383 S.W.2d 1, 7 (Tenn. 1964) (White, J., concurring) ("In the early years of the casualty insurance business it was argued by some that by allowing one to insure against his own negligent acts that carelessness would be encouraged, resulting in increased injuries and deaths on the highways."); W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 82, at 585-86 (5th ed. 1984) ("For a time . . . there was considerable uncertainty as to whether any contract by which one was to be protected against the consequences of one's own negligence . . . was not contrary to public policy. . . . [W]hen it became apparent that no dire consequences in fact resulted, those objections passed out of the picture . . ."); Mary C. McNeely, *Illegality as a Factor in Liability Insurance*, 41 COLUM. L. REV. 26, 33 (1941) ("When the validity of liability insurance was attacked as contrary to public policy, the most seriously urged contention was that indemnifying the assured against his own negligence would result in a relaxation of vigilance toward the rights of others.").

B. *The Public Policy Exclusion in Liability Insurance*

Courts impose a similar public policy exclusion to preclude the enforcement of *liability* insurance for intentional wrongdoing. Borrowing the public policy doctrine developed in the first-party context,⁴⁸ courts have indicated that liability insurance for intentional wrongdoing "would be barred by the fundamental principle that no one shall be permitted to take advantage of his own wrong."⁴⁹ In contrast to the first-party context, however, courts generally void liability insurance coverage for intentional wrongdoing only because that form of insurance "promotes wrongdoing"⁵⁰ and "encourage[s] conduct which is socially undesirable because it is injurious to others,"⁵¹ and not because it leads to the inequitable enrichment of insured tortfeasors. Nor do they limit the exclusion only to those forms of liability that are particularly egregious.⁵² The rationale behind the public policy exclusion in the liability insurance context is largely utilitarian,⁵³ and courts

48. See *St. Paul Ins. Cos. v. Talladega Nursing Home, Inc.*, 606 F.2d 631, 633 (5th Cir. 1979) (applying the Alabama public policy exclusion that was developed in first-party insurance to liability insurance); *U.S. Fire Ins. Co. v. Belmann N. Am. Co.*, 695 F. Supp. 941, 948 (N.D. Ill. 1988) (arguing that "the public policy considerations that preclude insurance coverage for self-inflicted injury lose a great deal of their force in the context of insurance for tortious liability to innocent third parties"), *revd. on other grounds*, 883 F.2d 564 (7th Cir. 1989); *University of Ill. v. Continental Cas. Co.*, 599 N.E.2d 1338, 1350-51 (Ill. App. Ct.) ("Based on our analysis of the cases . . . we find there is no Illinois public policy prohibiting insuring for damages caused by one's intentional acts except to the extent that the insured wrongdoer may not be the person who recovers the policy proceeds."), *appeal denied*, 606 N.E.2d 1235 (Ill. 1992).

49. *Hartford Accident & Indem. Co. v. Village of Hempstead*, 397 N.E.2d 737, 742 (N.Y. 1979) (quoting *Messersmith v. American Fidelity Co.*, 133 N.E. 432, 433 (N.Y. 1921)) (internal quotation marks omitted).

50. The public policy exclusion therefore derives from the observation that "insurance, by removing from the defendant the threat of actual liability, obviously calls into question tort law's ability to achieve deterrence." Schwartz, *supra* note 20, at 313.

51. James A. Fisher, *The Exclusion from Insurance Coverage of Losses Caused by the Intentional Acts of the Insured: A Policy in Search of a Justification*, 30 SANTA CLARA L. REV. 94, 94 (1990); see also Donald F. Farbstein & Francis J. Stillman, *Insurance for the Commission of Intentional Torts*, 20 HASTINGS L.J. 1219 (1969); Judith A. Warshawsky, Comment, *The Expansion of Insurance Coverage To Include the Intentional Tortfeasor*, 23 LOY. L. REV. 122 (1977).

52. For instance, courts applying the public policy exclusion to liability insurance do not distinguish between intentional assault and intentional sexual assault in determining whether assault should be insurable. See *infra* notes 70-71 and accompanying text.

53. Some courts have recognized another rationale behind the imposition of a public policy ban against insurance for intentional or willful wrongdoing. Largely relying on then Judge Cardozo's opinion in *Messersmith v. American Fidelity Co.*, 133 N.E. 432, 433 (N.Y. 1921), these courts recognize "unjust enrichment" and "avoidance of punishment" as the evils to which the public policy exclusion should be addressed. Consequently, one court has noted:

[P]unishment rather than deterrence is the real basis upon which coverage should be excluded. A person should suffer the financial consequences flowing from his intentional conduct and should not be reimbursed for his loss, even though he bargains for it in the form of a contract of insurance. A similar idea is expressed in the cases which exclude coverage on the ground that "a person should not profit from his own wrong." *Isenhardt v. General Cas. Co. of Am.*, 377 P.2d 26, 28 (Or. 1962). This logic animates the rationale by which many courts refuse to enforce insurance to indemnify punitive damages. See *infra* notes 97-100 and accompanying text. This rationale for the public policy exclusion, however, itself has a utilitarian component, as the purpose of punishing wrongdoers is largely to deter their

void those forms of liability insurance that impermissibly detract from the deterrent effect of civil liability.⁵⁴

In the process of importing the public policy doctrine from first-party to liability insurance, the courts have ignored differences between the two forms of insurance.⁵⁵ In the first-party context, courts apply the public policy exclusion to prevent recovery when the insured destroys his own property, or property that he controls, and the insured-against loss is the lost value of the property.⁵⁶ In contrast, in the liability insurance context, courts prohibit recovery when the insured engages in intentional wrongdoing that causes harm to a third party, the loss insured being the liability that results from the insured's wrongful conduct.⁵⁷ In each case, the insured "controls" the loss in the sense that he can, at least nominally, determine whether it will occur. A party insured against liability for intentional wrongdoing, however, cannot "benefit from his own wrongdoing" through the mechanism of insurance in the same way as a party insured against losses to his property can; the injured third party ultimately receives

wrongdoing. See, e.g., JOSHUA DRESSLER, UNDERSTANDING CRIMINAL LAW § 2.03 (1987). Therefore, to say that insurance detracts from the intended punishment is also to say that insurance detracts from the deterrent effect of liability.

54. In determining which forms of liability insurance impermissibly detract from the deterrent effect of civil liability, most courts that have applied the public policy exclusion to liability insurance have recognized a distinction between *intentional behavior* that results in harm to another person and the *intentional infliction of harm*. The logic behind this distinction is that an "intentional act may result in an unintended injury." *Spruill Motors, Inc. v. Universal Underwriters Ins. Co.*, 512 P.2d 403, 408 (Kan. 1973); see also 1 FREEDMAN, *supra* note 33, § 1:13; 43 AM. JUR. 2D *Insurance* § 708 (1982). Thus, courts only invoke public policy to void coverage for intentional wrongdoing when the insurance company can show that the insured also *intentionally injured* another person. See generally 1 FREEDMAN, *supra* note 33, § 1:13 (describing the issues that arise when courts consider coverage for intentional wrongdoing and noting that the "'intentional act' exclusion generally calls for a specific intent to cause injury"). Courts therefore permit an insured to enforce coverage for liability that results from the unexpected harmful consequences of a wrongful, intentional act. As explained by one court, "[o]ne who intentionally injures another may not be indemnified for any civil liability thus incurred. However, one whose intentional act causes an unintended injury may be so indemnified." *Public Serv. Mut. Ins. Co. v. Goldfarb*, 425 N.E.2d 810, 814 (N.Y. 1981). Consequently, the public policy exclusion in insurance law is a court-imposed "intentional injury" exclusion, rather than a court-imposed exclusion of coverage for any liability that stems from an "intentional act." See *Continental Ins. Co. v. McDaniel*, 772 P.2d 6, 9 (Ariz. Ct. App. 1988) (making an explicit comparison between the scope of the public policy exclusion and the scope of a contractual intentional acts exclusion); 1 FREEDMAN, *supra* note 33, § 1:13 (noting the distinction between intentional acts that result in injury and intentionally caused injuries and suggesting that most courts recognize this distinction).

55. Courts that *do* recognize a distinction between the public policy exclusion in first-party and third-party insurance, however, abandon the public policy exclusion in the liability insurance context. See *U.S. Fire Ins. Co. v. Beltmann N. Am. Co.*, 695 F. Supp. 941, 948 (N.D. Ill. 1988), *rev'd on other grounds*, 883 F.2d 564 (7th Cir. 1989); *University of Ill. v. Continental Cas. Co.*, 599 N.E.2d 1338, 1350-51 (Ill. App. Ct.), *appeal denied*, 606 N.E.2d 1235 (Ill. 1992).

56. See *supra* note 31 (describing the difference between first- and third-party insurance).

57. See *supra* note 31; see also Willborn, *supra* note 10, at 1015 ("The employer has not acted with the 'design of producing loss under his insurance contract;' the insurance proceeds will go to the victims of discrimination, not to the employer.").

the proceeds of a liability insurance policy,⁵⁸ while the insured retains the proceeds of a property insurance contract.

Although it derives from the public policy doctrine developed in first-party insurance, the public policy exclusion in liability insurance reflects a different set of priorities. The courts employ the same rhetoric as in the first-party context — they claim, for instance, to impose the public policy exclusion to prevent an insured from benefiting from his own wrongdoing. Additionally, they apply the exclusion to the same class of wrongdoing, invoking public policy to void coverage for intentional but not negligent wrongdoing.⁵⁹ The concern in liability insurance, however, is not the avoidance of fraud or unjust enrichment; rather, it is maintaining the deterrent effect of civil liability.⁶⁰ Courts applying the public policy exclusion to liability insurance therefore stress that liability insurance covering intentional wrongdoing tends to increase the incidence of wrongdoing.⁶¹ Thus, the public policy exclusion in liability insurance reflects a utilitarian calculus; liability insurance violates public policy to the extent that it “promotes wrongdoing” by insuring intentional misconduct, not to the extent that it confers an undeserved profit on the insured tortfeasor.

The courts have arrived at widely varying interpretations of this doctrine in applying the public policy exclusion to intentional torts.⁶²

58. See *Vigilant Ins. Co. v. Kambly*, 319 N.W.2d 382, 385 (Mich. Ct. App. 1982) (noting that the proceeds of a medical malpractice policy do not permit a doctor to “benefit” from having sexually assaulted a patient because the proceeds are ultimately paid to the innocent victim).

59. See *infra* notes 62-84 and accompanying text (describing the various approaches to defining intent); see also *Great Am. Indem. Co. v. Saltzman*, 213 F.2d 743, 748 (8th Cir.) (“[N]o public policy is involved in permitting one to insure against the results of [negligent] acts.”), *cert. denied*, 348 U.S. 862 (1954); *Isaacson Iron Works v. Ocean Accident & Guar. Corp.*, 70 P.2d 1026, 1029 (Wash. 1937) (“Nowadays many policies are written which by their terms protect the insured against his own negligence. The ordinary automobile indemnity coverage and insurance against fire are of this class. Such policies are not against public policy.”) The Eighth Circuit in *Saltzman* noted that the maxim “one cannot profit from one’s own wrong” does not apply to liability insurance. The court stated:

It is argued that to permit plaintiff to recover . . . would in effect permit him to profit by his own wrong, but plaintiff is not profiting by his own wrong but is simply being indemnified against the result of his own wrongful acts and that . . . is the very purpose of liability insurance. To commit an act of negligence is a wrongful act . . . but it is perfectly legitimate that one protect himself against the result of his own negligence by a contract of insurance. 213 F.2d at 748.

60. See *Farbstein & Stillman*, *supra* note 51, at 1245-46; *Willborn*, *supra* note 10, at 1009 (“Insurance [for intentional discrimination] would undermine the deterrent effect of damages. Hence, to preserve the deterrent effect, [public policy] prohibits insurance for such liability.”).

61. See, e.g., *Ranger Ins. Co. v. Bal Harbour Club, Inc.*, 549 So. 2d 1005, 1007 n.4 (Fla. 1989).

62. The court-imposed public policy exclusion therefore resembles its contractual counterpart, the language of which has sparked numerous interpretations. A typical contractual exclusion might prevent coverage for “bodily injury or property damage caused intentionally by or at the direction of the insured.” 70 *NEW YORK JUR. 2D Insurance* § 1416, at 247 (1988). Courts commonly interpret this exclusion, and others like it, to require proof that the insured “intended the act and to cause some kind of bodily injury.” *Id.* However, some courts interpret the clause less strictly, excluding coverage for injuries that are the natural and probable consequence of an intentional act, while others require even more specific proof that the insured intended both the

Some courts have arrived at a strict standard for applying the public policy exclusion to liability insurance,⁶³ categorically refusing to enforce coverage for any intentional tort. The courts in other states have yet to settle on a single standard. The Illinois courts, for instance, have taken conflicting approaches to the public policy exclusion. One Illinois state court has concluded that intentional torts are categorically uninsurable as a matter of public policy,⁶⁴ but at least two Illinois courts have refused to follow this proclamation,⁶⁵ and one federal court in Illinois has arrived at a less stringent definition of the public policy exclusion.⁶⁶ Some state legislatures have codified the public

act and a specific injury in order for coverage to be excluded. See generally 43 AM. JUR. 2D *Insurance* § 710 (1982) (discussing the various ways in which courts interpret the contractual exclusion for intentional acts); James L. Rigelhaupt, Jr., Annotation, *Construction and Application of Provision of Liability Insurance Policy Expressly Excluding Injuries Intended or Expected by Insured*, 31 A.L.R.4TH 957 (1984) (discussing cases in which the court construed or applied an intentional injury clause).

63. For instance, Alabama adheres to a categorical prohibition against insurance that indemnifies a person against the consequences of his own intentional acts, without respect to the insured's intent to cause harm. *St. Paul Ins. Cos. v. Talladega Nursing Home, Inc.*, 606 F.2d 631, 633 (5th Cir. 1979) (citing *Pruet v. Dugger-Holmes & Assocs.*, 162 So. 2d 613 (Ala. 1964), and *Fidelity-Phenix Fire Ins. Co. v. Murphy*, 146 So. 387 (Ala. 1933)). The Alabama courts have declared that "all contracts insuring against loss from intentional wrongs are void in Alabama as against public policy," *Talladega*, 606 F.2d at 633, and they have defined "intentional wrong" to include "both intentionally causing injury and 'intentionally doing some act which reasonable and ordinary prudence' would indicate likely to result in injury." 606 F.2d at 634 (quoting *Hartford Fire Ins. Co. v. Blakeney*, 340 So. 2d 754, 756 (Ala. 1976), *overruled on other grounds* by *Alabama Farm Bureau Mut. Cas. Ins. Co. v. Dyer*, 454 So. 2d 921 (Ala. 1984)). Other states have adopted a similarly unforgiving definition of intent, particularly in guiding the interpretation of the contractual exclusion for "intentional acts." See ROBERT E. KEETON & ALAN I. WIDISS, *INSURANCE LAW* § 5.4(d)(2), at 520 (1988) (describing the five possible interpretations of the contractual exclusion); Fisher, *supra* note 51, at 128; Rigelhaupt, *supra* note 62, at 983-99.

64. In *Rubenstein Lumber Co. v. Aetna Life & Cas. Co.*, 462 N.E.2d 660 (Ill. App. Ct. 1984), the Illinois appellate court considered whether, as a matter of contract interpretation, a liability insurance policy covered a retaliatory discharge claim leveled against an employer. Under its interpretation of the policy, the court denied coverage because it held that the judgment in a retaliatory discharge case does not constitute "benefits" within the coverage of the employer's worker's compensation insurance. 462 N.E.2d at 661. The court noted in dicta, however, that, "even if the policy was written to expressly require the [insurance company] to defend and indemnify the [employer] in the retaliatory discharge action, we believe that such a provision would be void as against public policy." 462 N.E.2d at 662. In reaching this conclusion, the court appeared to rely exclusively on the fact that Illinois courts have classified retaliatory discharge as an intentional tort. 462 N.E.2d at 662.

65. See *Dixon Distrib. Co. v. Hanover Ins. Co.*, 612 N.E.2d 846, 857 (Ill. App. Ct.) ("The courts, however, should be very cautious in establishing public policy by court fiat."), *appeal granted*, 622 N.E.2d 1203 (Ill. 1993); *University of Ill. v. Continental Cas. Co.*, 599 N.E.2d 1338, 1350-51 (Ill. App. Ct.) ("Based on our analysis of the cases . . . we find there is no Illinois public policy prohibiting insuring for damages caused by one's intentional acts except to the extent that the insured wrongdoer may not be the person who recovers the policy proceeds."), *appeal denied*, 606 N.E.2d 1235 (Ill. 1992).

66. *U.S. Fire Ins. Co. v. Beltmann N. Am. Co.*, 695 F. Supp. 941 (N.D. Ill. 1988), *revd. on other grounds*, 883 F.2d 564 (7th Cir. 1989). In *Beltmann*, the District Court for the Northern District of Illinois refused to apply Illinois public policy to void coverage for retaliatory discharge. The court reasoned that Illinois state courts had applied the public policy exclusion exclusively to first-party insurance, and the court refused to import that exclusion into a liability insurance policy because the "public policy considerations that preclude insurance coverage for self-inflicted injury lose a great deal of their force in the context of insurance for tortious liability

policy exclusion;⁶⁷ courts in these states interpret the statutory public policy exclusion in much the same way as other courts have interpreted the judicially created public policy exclusion — as if it were a contractual exclusion for “intentional acts” or “intentional injuries.”⁶⁸ Finally, some courts have simply abandoned the public policy exclusion and enforced insurance to cover compensatory and even punitive damages that result from intentional wrongdoing.⁶⁹

This confusing array of standards has led courts to arrive at inconsistent and conflicting results. Some courts have invoked public policy to void insurance for relatively innocuous risks, while others have enforced insurance for remarkably egregious misconduct. For instance, some courts have enforced professional liability insurance to cover a physician's liability for sexually assaulting his patients during the course of their treatment.⁷⁰ In contrast, other courts have invoked

to innocent third parties.” 695 F. Supp. at 948. The court instead adopted a public policy exclusion modeled on the standard that Illinois applies to void coverage for punitive damages and thereby found that liability insurance “is allowed to cover at least *compensatory* damages flowing from intentional or willfully inflicted harms.” 695 F. Supp. at 949. Consequently, the court found that Illinois public policy only forbids coverage for punitive damages resulting from willful wrongdoing and not compensatory damages flowing from an intentional wrong. 695 F. Supp. at 949.

67. Section 533 of the California Insurance Code provides that “[a]n insurer is not liable for a loss caused by the willful act of the insured . . . but he is not exonerated by the negligence of the insured . . .” CAL. INS. CODE § 533 (West 1993). California courts read this limitation into every contract for insurance that is written in California. See *J.C. Penney Cas. Ins. Co. v. M.K.*, 804 P.2d 689, 694 (Cal.) (noting that § 533 is “an implied exclusionary clause which by statute is to be read into all insurance policies” (quoting *United States Fidelity & Guar. Co. v. American Employer's Ins. Co.*, 205 Cal. Rptr. 460 (Ct. App. 1984))), *cert. denied*, 112 S. Ct. 280 (1991). Other states that have provided for a statutory public policy exclusion include Massachusetts, see MASS. GEN. L. ch. 175, § 47 (1992) (precluding companies from insuring “any person against liability for causing injury, other than bodily injury, by his deliberate or intentional crime or wrongdoing”), and North Dakota, see N.D. CENT. CODE § 26.1-32-04 (1989). Some states have codified an exclusion for punitive damages. See, e.g., OHIO REV. CODE ANN. § 3937.182 (Baldwin 1993).

68. Despite the apparently stringent language of the statute, California courts do not require a showing of “willfulness” before invoking § 533 to void coverage. Just as the Illinois courts have yet to settle on a single standard for the judicially created public policy exclusion, the California courts have yet to agree on the proper interpretation of the statutory prohibition embodied in § 533. Some courts have invoked the exclusion only when there is proof of a “‘preconceived design to inflict injury,’” *Clemmer v. Hartford Ins. Co.*, 587 P.2d 1098, 1110 (Cal. 1978) (quoting *Walters v. American Ins. Co.*, 8 Cal. Rptr. 665, 670 (Dist. Ct. App. 1960)), while others have been willing to infer an intent to injure from the circumstances of the wrongful act. *J.C. Penney*, 804 P.2d at 698 (holding that § 533 “does not require a showing by the insurer of its insured's ‘preconceived design to inflict harm’ when the insured seeks coverage for an intentional and wrongful act if the harm is inherent in the act itself”). For an analysis of the standard in California, see Gary L. Fontana & Anthony J. Barron, *Insurance Coverage for Intentional Acts*, in COMPREHENSIVE GENERAL LIABILITY POLICIES 1993: INSURANCE CLAIMS AND COVERAGE LITIGATION, (Practising Law Institute, May-June 1993).

69. See, e.g., *Harris v. County of Racine*, 512 F. Supp. 1273, 1280 (E.D. Wis. 1981) (enforcing insurance to cover punitive damages imposed for violations of 42 U.S.C. § 1983); *Colson v. Lloyd's of London*, 435 S.W.2d 42, 47 (Mo. Ct. App. 1968) (enforcing coverage for false arrest); see also *infra* section II.B.

70. See, e.g., *St. Paul Fire & Marine Ins. Co. v. Asbury*, 720 P.2d 540 (Ariz. Ct. App. 1986) (holding that a professional liability insurance policy covers liability for sexual assault); *St. Paul*

public policy to refuse to allow indemnification for simple assault.⁷¹ Moreover, some courts have enforced insurance to provide coverage for punitive damages imposed as a result of intentional civil rights violations,⁷² and the majority of courts have enforced insurance to cover punitive damages in one form or another,⁷³ in spite of the fact that courts impose punitive damages largely to punish and deter egregious wrongdoing.⁷⁴ Various courts have also enforced insurance to cover many other forms of intentional wrongdoing,⁷⁵ including false arrest,⁷⁶

Fire & Marine Ins. Co. v. Shernow, 610 A.2d 1281 (Conn. 1992) (same); *St. Paul Fire & Marine Ins. Co. v. Mitchell*, 296 S.E.2d 126 (Ga. Ct. App. 1982) (same); *Vigilant Ins. Co. v. Kambly*, 319 N.W.2d 382 (Mich. Ct. App. 1982) (same); *St. Paul Fire & Marine Ins. Co. v. Love*, 459 N.W.2d 698 (Minn. 1990) (same); *L.L. v. Medical Protective Co.*, 362 N.W.2d 174 (Wis. Ct. App. 1984) (same). But see *St. Paul Ins. Co. v. Cromeans*, 771 F. Supp. 349, 352 (N.D. Ala. 1991) (finding professional liability for sexual abuse uninsurable under Alabama law); *Public Serv. Mut. Ins. Co. v. Goldfarb*, 425 N.E.2d 810 (N.Y. 1981) (holding as a matter of public policy that a dentist's liability insurance policy could not cover his liability for sexually abusing a patient).

71. See, e.g., *Fire Ins. Exch. v. Altieri*, 1 Cal. Rptr. 2d 360, 365 (Ct. App. 1991) (finding that California's statutory exclusion of coverage for "willful" wrongdoing precludes indemnification in a case in which the insured intended to punch another person even though he did not intend the resulting harm), *review denied*, 1992 Cal. LEXIS 383 (Jan. 22, 1992).

72. See, e.g., *Harris*, 512 F. Supp. at 1284 (permitting coverage for punitive damages assessed under 42 U.S.C. § 1983); see also Eric Chen, *Insurance of Section 1983 Punitive Damages: Wrong Law, Wrong Result*, 51 INS. COUNS. J. 533, 533-36 (1984) (describing the emerging caselaw on the validity of insurance for § 1983 damages).

73. JERRY, *supra* note 21, § 65[f], at 352 n.74 (citing *Jurisdiction Survey on the Insurability of Punitive Damages*, in *INSURANCE, EXCESS AND REINSURANCE DISPUTES* 1986, at 115-33 (Barry R. Ostranger & Thomas R. Newman eds., 1986) (punitives are insurable in two-thirds of the states that have considered the issue)); Michael A. Rosenhouse, Annotation, *Liability Insurance Coverage as Extending to Liability for Punitive or Exemplary Damages*, 16 A.L.R.4TH 11 (1982) (listing the various approaches taken by different states).

74. See, e.g., *Northwestern Natl. Cas. Co. v. McNulty*, 307 F.2d 432, 442 (5th Cir. 1962) ("[B]y 'punitive damages' we mean damages awarded with a view to punish . . . and to deter . . .").

75. As noted above, see *supra* text accompanying notes 21-28, the question whether insurance contracts can be enforced to cover intentional torts involves two issues — whether the contract provides coverage and whether coverage comports with public policy. With respect to the first issue, insurance contracts often provide coverage for intentional torts. See 12 APPLEMAN & APPLEMAN, *supra* note 34, § 7031, at 150 ("Insurance companies, in comprehensive liability policies, . . . generally cover liability arising from libel and slander, invasion of privacy, false arrest, and false imprisonment, as well as malicious prosecution. . . . Every one of the acts recited requires a deliberate, and generally thoughtful and purposeful, act."). Insurance companies providing coverage for such intentional torts may also include intentional act exclusions in their policies. Some courts have resolved the clear conflicts between the provision and the exclusion of intentional tort coverage in favor of the insured by finding that the policies provide coverage for intentional torts. See, e.g., *Davidson v. Cincinnati Ins. Co.*, 572 N.E.2d 502, 507-08 (Ind. Ct. App. 1991) (finding that a policy providing coverage for malicious prosecution was rendered "illusory" by the inclusion of an intentional act exclusion and consequently requiring the insurance company to satisfy the reasonable expectations of the insured by defending a malicious prosecution action); *Levinson v. Aetna Cas. & Sur. Co.*, 346 N.Y.S.2d 428, 430 (App. Div. 1973) (finding that a similarly ambiguous policy provided coverage for malicious prosecution).

76. See, e.g., *Colton v. Swain*, 527 F.2d 296, 303-05 (7th Cir. 1975) (assuming an insurance policy would provide coverage for false arrest and malicious prosecution in a case in which the evidence also supported an action under 42 U.S.C. § 1983); see also *City of Cedar Rapids v. Northwestern Natl. Ins. Co.*, 304 N.W.2d 228, 230 (Iowa 1981) (enforcing insurance policy that

malicious prosecution,⁷⁷ defamation,⁷⁸ and retaliatory discharge.⁷⁹

Because of the conflicting formulations of the public policy exclusion and because of its inconsistent application from state to state, it is difficult to formulate one approach the various states should adopt in applying the exclusion to insurance for intentional employment discrimination. Nevertheless, courts applying the public policy exclusion at least nominally adhere to the same underlying rationale. Alabama courts void insurance coverage for liability that flows from intentional acts because "no one shall be permitted to profit by his own fraud, or to take advantage of his own wrong, or to found any claim upon his own iniquity."⁸⁰ In Illinois, the rationale behind the public policy exclusion is that enforcing coverage for intentional wrongdoing would allow the insured to benefit from his own wrongdoing.⁸¹ California's section 533 "is a 'codification of the jurisprudential maxim that no man shall profit from his own wrong.'"⁸² Each of the courts employing this rhetoric voids liability insurance that in one way or another "promotes wrongdoing."⁸³ Therefore, the basic rationale underlying the public policy exclusion, regardless of its formulation by the court, is "to prevent encouragement of willful torts."⁸⁴

C. *The Imputed Liability and Negligent Supervision Exceptions*

Most states have drawn exceptions to the public policy exclusion and have enforced insurance for some forms of intentional wrongdoing.⁸⁵ Courts recognize these exceptions in two circumstances. First, they permit insurance to cover intentional wrongdoing in cases

provided coverage for punitive damages arising out of a false arrest), *overruled on other grounds* by *Parks v. City of Marshalltown*, 440 N.W.2d 377, 379 (Iowa 1989).

77. See *Davidson*, 572 N.E.2d at 507-08; *Levinson*, 346 N.Y.S.2d at 430. But see *Ledford v. Gutoski*, 855 P.2d 196, 199 (Or. Ct. App. 1993) (excluding malicious prosecution from coverage because it necessarily involves an "intent to do harm"), *review granted*, 318 Or. 325 (1994).

78. See *Ranger Ins. Co. v. Bal Harbour Club, Inc.*, 549 So. 2d 1003, 1012 n.3 (Fla. 1989) (Ehrlich, C.J., dissenting).

79. See, e.g., *Continental Cas. Co. v. Canadian Universal Ins. Co.*, 924 F.2d 370, 374 (1st Cir. 1991) (enforcing coverage for retaliatory discharge and sexual harassment).

80. *Fidelity-Phenix Fire Ins. Co. v. Murphy*, 146 So. 387, 390 (Ala. 1933) (quoting *Riggs v. Palmer*, 22 N.E. 188, 190 (N.Y. 1889)).

81. *Rubenstein Lumber Co. v. Aetna Life & Cas. Co.*, 462 N.E.2d 660, 662 (Ill. App. Ct. 1984) (dictum).

82. *American States Ins. Co. v. Borbor*, 826 F.2d 888, 894 (9th Cir. 1987) (quoting *Don Burton, Inc. v. Aetna Life & Cas. Co.*, 575 F.2d 702, 705 (9th Cir. 1978)).

83. 6A CORBIN, *supra* note 46, § 1471, *quoted in* *Harrell v. Travelers Indem. Co.*, 567 P.2d 1013, 1016 (Or. 1977).

84. *American States*, 826 F.2d at 894.

85. Even Alabama has recognized an exception to its rule against insuring intentional torts. The Alabama courts have recognized an exception for imputed liability, noting that "it is not against public policy to indemnify an insured against the consequences of a violation of law by others without his direction or participation." *Armstrong v. Security Ins. Group*, 288 So. 2d 134, 136 (Ala. 1973).

in which the availability of insurance cannot be expected to promote wrongdoing,⁸⁶ that is, in cases in which insurance is not likely to create a substantial moral hazard for the insured to commit intentional wrongdoing. Second, courts enforce coverage for intentional wrongdoing in cases in which the public policy favoring the compensation of victims outweighs the public policy against the promotion of wrongdoing.⁸⁷

These two principles in fact explain many of the inconsistencies in the application of the public policy exclusion. Take for example the cases in which courts have enforced insurance for a physician's liability for sexual assault of his patients.⁸⁸ First, insurance for a physician's sexual assault liability may not promote wrongdoing by physicians. Physicians cannot insure against the threat of criminal sanction, nor can they insure against loss of reputation or the revocation of their physician's license.⁸⁹ Given these auxiliary, uninsurable deterrents, it is unlikely that a physician would decide to sexually as-

86. See, e.g., *Preferred Mut. Ins. Co. v. Thompson*, 491 N.E.2d 688, 691 (Ohio 1986) (permitting insurance for an assault committed in self-defense and noting that, under the circumstances, intentional act insurance could not be expected to promote wrongdoing).

87. Automobile insurance illustrates these principles. Applying the public policy exclusion consistently with its underlying rationale, courts might enforce automobile liability insurance to cover some intentional torts. Some courts might note that drivers are not likely to wreck their cars intentionally, even though they are insured, because other factors besides tort liability provide a deterrent. For instance, drivers are deterred from getting in accidents by the threat of criminal sanction, and by the fear of personal injury in the wreck. See Fleming James, Jr., *Accident Liability Reconsidered: The Impact of Liability Insurance*, 57 YALE L.J. 549, 558 (1948) (listing the "deterrents" to wrongdoing besides civil liability and noting that accidents sometimes "involve the threat of criminal liability"); see also *Northwestern Natl. Cas. Co. v. McNulty*, 307 F.2d 432, 444 (5th Cir. 1962) (Gewin, J., concurring) ("If the criminal penalties provided [for reckless driving] fail to deter the wrongdoer, I seriously doubt that closing the market to insurance coverage will do so."); *Travelers Indem. Co. v. Hood*, 140 S.E.2d 68, 70 (Ga. Ct. App. 1964) ("We hold that it is not against public policy for a contract for automobile insurance to cover liability of the insured arising out of willful and wanton misconduct in unlawfully racing automobiles on a public highway."); *S.S. v. State Farm Fire & Cas. Co.*, 808 S.W.2d 668, 671 (Tex. Ct. App. 1991) (noting that "public policy discourages vehicle operators from negligently injuring others with their vehicles," but also noting that "it cannot be said that enforcement of the indemnity provisions of an automobile insurance policy encourages collisions"), *affd.*, 858 S.W.2d 374 (Tex. 1993).

Some courts find an exception to the public policy exclusion that permits the enforcement of automobile insurance to cover intentional torts because they feel that compensating the victims of automobile accidents is more important than preventing insured drivers from being indemnified against their liability. See *Hudson v. State Farm Mut. Ins. Co.*, 569 A.2d 1168, 1170-71 (Del. 1990) (refusing to void coverage for intentional wrongdoing under an automobile policy, despite the public policy exclusion because of the competing public policy behind the state motor vehicle financial responsibility law); *S.S.*, 808 S.W.2d at 671 (concluding that a homeowner's insurance policy provides coverage for negligent transmission of a sexually transmitted disease by relying on the analogous context of automobile insurance in which public policy favors the compensation of tort victims); *Vigilant Ins. Co. v. Kambly*, 319 N.W.2d 382, 385 (Mich. Ct. App. 1982) (allowing insurance to cover a physician's sexual assault of his patient based in part on the public policy that favors the compensation of tort victims).

88. See sources cited *supra* note 70.

89. See Glen O. Robinson, *Rethinking the Allocation of Medical Malpractice Risks Between Patients and Providers*, LAW & CONTEMP. PROBS., Spring 1986, at 173, 176-77 ("[L]egal liability imposes some costs that are uninsurable, such as harm to reputation, disruption of the physi-

sault his patients simply because he has insurance to cover his civil liability.⁹⁰ Therefore, the sexual assault cases reflect a logic of "surrogate deterrence"; when other significant deterrents to intentional wrongdoing exist, courts do not need to invoke the public policy exclusion to void coverage because the availability of insurance probably would not cause the insured to commit wrongful acts.⁹¹ Second, the public policy favoring compensation of tort victims supports the enforcement of coverage for a physician's sexual assault. In the words of one court, sexual assault by a physician should be insurable in some cases because "it is not the insured who will benefit, but the innocent victim who will be provided compensation for her injuries."⁹²

This section explores the exceptions some courts have drawn, based largely on the first of these rationales — that not all insurance for intentional acts promotes wrongdoing — to permit employers to obtain insurance for imputed liability and negligent supervision liability arising out of the intentional wrongdoing of their employees. Courts do not base these exceptions on competing public policies favoring the enforcement of insurance, but rather on the utilitarian rationale underlying the public policy exclusion. The purpose of the public policy exclusion is to remove the incentive to wrongdoing created by insurance covering intentional wrongdoing. That purpose does not apply to insurance for imputed liability and negligent supervision liability because those forms of insurance do not promote intentional wrongdoing.

1. *The Imputed Liability Exception*

Some courts have created an exception to the public policy exclusion that permits employers to obtain insurance against liability that is imputed⁹³ to them as a result of the intentional torts committed by

cian's practice, and emotional stress caused by litigation. These are real costs which a physician presumably will seek to avoid even if they are not accompanied by direct economic penalties.").

90. See *Kambly*, 319 N.W.2d at 385 ("[I]t is unlikely that the insured was induced to engage in the unlawful conduct by reliance upon the insurability of any claims arising therefrom or that allowing coverage here would induce future similar unlawful conduct by practitioners.").

91. Courts have also permitted recovery for intentional wrongdoing when the circumstances suggest that the availability of insurance did not actually "promote" the wrongdoing. For instance, courts have permitted coverage in assault cases when the insured did not have time before committing the assault to reflect upon the availability of insurance to cover his losses. *JERRY*, *supra* note 21, § 63B ("Allowing coverage of intentional acts committed in self-defense is not clearly violative of public policy."); see also *Preferred Mut. Ins. Co. v. Thompson*, 491 N.E.2d 688, 691 (Ohio 1986) (permitting insurance for an assault committed in self-defense and noting that, under the circumstances, intentional act insurance will not promote wrongdoing).

92. *Kambly*, 319 N.W.2d at 385; see also *St. Paul Fire & Marine Ins. Co. v. Asbury*, 720 P.2d 540, 542 (Ariz. Ct. App. 1986) (permitting insurance for a physician's sexual assault and quoting *Kambly*).

93. In applying this "imputed liability" exception to the public policy exclusion, courts have looked to the insured's actual conduct rather than the particular "theory" under which liability is imputed to the insured. See *Arenson v. National Auto. & Cas. Ins. Co.*, 286 P.2d 816, 818 (Cal. 1955) (enforcing coverage under a homeowner's policy for liability parents incurred as a

their employees.⁹⁴ Imputed liability in this context is any liability an employer incurs because of the employer's agency relationship with its employees. The employer faces liability not for its own conduct, but for the conduct of agents for which the employer can be held responsible. Courts recognize an "imputed liability" exception to the public policy exclusion for two reasons, each of which relates to whether the insurance promotes intentional wrongdoing. First, courts generally hold that public policy forbids an insured from obtaining insurance against his *own* intentional wrongdoing, not someone else's intentional wrongdoing.⁹⁵ Here, the intentional wrong is committed by an agent, not the insured employer. Second, and more significantly, courts recognize that insurance for liability imputed to an employer under

result of the intentional wrongdoing of their son); *Dayton Hudson Corp. v. American Mut. Liab. Ins. Co.*, 621 P.2d 1155, 1160 (Okla. 1980) (holding vicarious liability to be insurable "unless the employer's volition was either directly or indirectly an element in the commission of the harm"); *McLeod v. Tecorp Intl., Ltd.*, 844 P.2d 925, 927 n.3 (Or. Ct. App. 1992) (noting that the fact that an employee was acting within the scope of his employment is of little concern in determining whether an employer's imputed liability should be insurable because it "is the insured's actual conduct, not the imputed conduct of another" that matters), *modified*, 850 P.2d 1161 (Or. Ct. App.), *rev'd.*, 865 P.2d 1283 (Or. 1993).

94. See, e.g., *Dart Indus., Inc. v. Liberty Mut. Ins. Co.*, 484 F.2d 1295, 1297 (9th Cir. 1973) (considering California's statutory bar against insuring willful wrongdoing and determining that California caselaw "clearly indicates the policy of the statutory exclusion as being limited to a situation where the insured is personally at fault"); *Scott v. Instant Parking, Inc.*, 245 N.E.2d 124, 126 (Ill. App. Ct. 1969) ("This case . . . involves only the right of a corporation to insure against liability caused by its agents and servants. There is no reasonable basis to declare the latter type insurance is against public policy."); *Leon Lowe & Sons, Inc. v. Great Am. Surplus Lines Ins. Co.*, 572 So. 2d 206, 210 (La. Ct. App. 1990) ("Public policy forbids a person from insuring against his own intentional acts, but does not forbid him from insuring against the intentional acts of another for which he may be vicariously liable."); *Perl v. St. Paul Fire & Marine Ins. Co.*, 345 N.W.2d 209, 216 (Minn. 1984) (refusing to enforce a professional liability policy to permit an individual attorney to be indemnified for the attorney's fees he forfeited for breaching his fiduciary duty to his client but permitting recovery by the attorney's law firm); *Floralbell Amusement Corp. v. Standard Sur. & Cas. Co.*, 9 N.Y.S.2d 959, 963 (N.Y. City Ct. 1937) (noting that it is "far fetched" to assume that coverage of one employer's liability incurred as the result of an unauthorized assault committed by one of its employees would be an inducement to the insured employer to encourage its employees to commit assaults because it can with equal force be said that liability insurance encourages negligence). In at least one state, the imputed liability exception is statutory with respect to punitive damages. See KAN. STAT. ANN. § 40-2,115 (1986).

95. See *American States Ins. Co. v. Borbor*, 826 F.2d 888, 894 (9th Cir. 1987) ("Section 533 is a 'codification of the jurisprudential maxim that no man shall profit from his *own wrong*.'" (quoting *Don Burton, Inc. v. Aetna Life & Cas. Co.*, 575 F.2d 702, 705 (9th Cir. 1978)) (emphasis added)); *Chicago Bd. of Options Exch., Inc. v. Harbor Ins. Co.*, 738 F. Supp. 1184, 1187 (N.D. Ill. 1990) ("[The Exchange] did not insure itself . . . against its own intentional torts. Rather . . . [it] insured itself against the intentional torts of its officers and directors."); *Dayton Hudson Corp. v. American Mut. Liab. Ins. Co.*, 621 P.2d 1155, 1160 (Okla. 1980). Interestingly, the courts have recognized a similar exception to the rule forbidding first-party insurance from covering the deliberate destruction of property. "In recent years, a number of courts have moved away from the rule barring recovery [for intentionally incurred losses to property] to a rule that permits recovery by an *innocent coinsured* of a loss intentionally caused by . . . another coinsured." JERRY, *supra* note 21, § 63A, at 303 (emphasis added). This innocent coinsured exception arises in the case of joint ownership of property, particularly marital property. *Id.* The rationale for the exception, at least in part, is that "it is one individual who is responsible for the wrongdoing, not all the coinsureds." *Id.* at 304.

agency principles does not necessarily provide coverage for an employer's intentional wrongdoing.⁹⁶

Although courts have recognized this exception to the public policy exclusion in cases involving insurance for intentional wrongdoing,⁹⁷ they have developed the rationale behind the imputed liability exception more fully in the context of insurance for punitive damages.⁹⁸ Punitive damages are designed to deter as well as to punish wrongdoing, and insurance arguably detracts from this deterrent effect.⁹⁹ Many courts therefore refuse to enforce insurance that covers punitive damages on public policy grounds.¹⁰⁰ Of the courts that forbid insurance for punitive damages, however, many have enforced coverage for imputed liability for punitive damages.¹⁰¹

96. See KEETON & WIDISS, *supra* note 63, § 5.4(d)(5), at 528 ("In most circumstances, courts hold both (1) that the express provisions commonly used in liability insurance policies do not preclude coverage for damages awarded for an intentional tort when the insured is held to be responsible on a theory of vicarious liability, and (2) that it would not be appropriate to imply a limitation that would restrict the coverage.").

97. See, e.g., *McBride v. Lyles*, 303 So. 2d 795, 799 (La. Ct. App. 1974); see also *Arenson*, 286 P.2d at 818. Commentators also have expressly recognized the exception, both as a guide to interpreting contractual exclusions and as a limitation on the public policy exclusion. See KEETON & WIDISS, *supra* note 63, § 5.4(d)(5) (describing the imputed liability exception to the contractual exclusion and suggesting the exception is tied to public policy).

98. See *Dayton Hudson*, 621 P.2d at 1160 ("In almost all jurisdictions which disallow insurance coverage for punitive damages, an exception is recognized for those torts in which liability is vicariously imposed on the employer for a wrong of his servant."). See generally *Rosenhouse*, *supra* note 73 (describing the approach taken by the various courts that have considered the insurability of punitive damages and describing the imputed liability exception).

99. See JERRY, *supra* note 21, § 65[f], at 351 ("The major battleground in the debate over the insurability of punitive damages concerns the question of deterrence. Opponents of insurability argue that allowing punitive damages to be insured frustrates the very purpose of the award and therefore contravenes public policy.") (emphasis omitted).

100. Many states disallow coverage for punitive damages in some circumstances. See *Rosenhouse*, *supra* note 73. The rationale behind this public policy exclusion of coverage tracks the rationale behind the court-imposed intentional act exclusion. See *Public Serv. Mut. Ins. Co. v. Goldfarb*, 425 N.E.2d 810, 814 (N.Y. 1981) (noting that punitive damages are "a punishment for intentional wrongdoing . . . [and] to allow insurance coverage for such damages 'is totally to defeat the purpose of punitive damages' " (quoting *Hartford Accident & Indem. Co. v. Village of Hempstead*, 397 N.E.2d 737, 744 (N.Y. 1979))); *American Home Assurance Co. v. Safway Steel Prods. Co.*, 743 S.W.2d 693, 700 n.6 (Tex. Ct. App. 1987) ("The entire public policy argument behind not enforcing policies which insure against punitive damages changes from state to state."), *writ denied* (Tex. 1988). However, the principle behind the imposition of "punishment" is largely the deterrence of wrongdoing, see *supra* note 53, so the refusal to allow insurance against punishment reflects, at least in part, the same concerns with antideterrent insurance that underlie the public policy exclusion. Moreover, even those courts that insist that the purpose of punitive damages is to punish, recognize an exception for imputed liability. In permitting insurance to cover vicarious liability for punitive damages, these courts stress that the "avoidance of punishment" reasoning behind the public policy exclusion does not apply: "[I]f the employer did not participate in the wrong the policy of preventing the wrongdoer from escaping the penalties for his wrong is inapplicable." *Northwestern Natl. Cas. Co. v. McNulty*, 307 F.2d 432, 440 (5th Cir. 1962).

101. Several courts have noted that in "almost all jurisdictions which disallow insurance coverage for punitive damages, an exception is recognized for those torts in which liability is vicariously imposed on the employer for a wrong of his servant." *Dayton Hudson*, 621 P.2d at 1160; see also *McNulty*, 307 F.2d at 439-40 (finding punitive damages uninsurable but suggesting an exception for imputed liability); *Perl v. St. Paul Fire & Marine Ins. Co.*, 345 N.W.2d 209, 216

The rationale behind the exception permitting insurance for imputed liability for punitive damages is relatively straightforward. Courts impute liability for punitive damages to an employer on the theory that punitive damages will inspire the employer to take better care in supervising its employees.¹⁰² Insurance for imputed liability, however, removes only part of the incentive employers have for policing the conduct of their employees.¹⁰³ Moreover, insurance for an employer's imputed liability does not inspire individual employees to act wrongfully because it does not indemnify them for purely *personal* liability. Therefore, even though this form of imputed liability is based on the employer's relationship to its employees and not on proof of an employer's wrongdoing, an employer's imputed liability resembles liability for negligence.¹⁰⁴ Ultimately, an employer is held liable in these circumstances because the employer has failed to take appropriate steps to prevent its employees from engaging in wrongful conduct. Consequently, as long as the employer's failure to prevent its employees' wrongdoing does not itself reflect the employer's intentional wrongdoing, courts should enforce insurance for vicariously imposed punitive damages.¹⁰⁵

(Minn. 1984) (citing cases allowing insurance coverage for punitive damages for imputed liability). Courts recognize this exception largely because they do not perceive a connection between the availability of insurance for vicariously imposed punitive damages and the promotion of wrongdoing. See *Sinclair Oil Corp. v. Columbia Gas. Co.*, 682 P.2d 975, 981 (Wyo. 1984) (refusing to void coverage for vicariously imposed punitive damages and noting "we know of no studies, statistics or proofs which indicate that contracts of insurance to protect against liability for punitive damages have a tendency to make willful or wanton misconduct more probable").

102. See, e.g., *Harrell v. Travelers Indem. Co.*, 567 P.2d 1013, 1020 (Or. 1977) ("[T]he basis for the imposition of vicarious liability for punitive damages upon a corporation or other employer is also one of deterrence — i.e. the deterrent effect upon an employer of an award of punitive damages by encouraging him to exercise closer control over his employees.").

103. *Floralbell Amusement Corp. v. Standard Sur. & Cas. Co.*, 9 N.Y.S.2d 959, 963 (N.Y. City Ct. 1937) (noting that it is "far fetched" to assume that coverage of an employer's liability incurred as a result of an unauthorized assault committed by one of its employees would be an inducement to the insured employer to encourage its employees to commit assaults, because one can argue with equal force that liability insurance encourages negligence). Individual employees are deterred largely by the sanction imposed against them by their employer, not by the prospect of liability. If the employer is jointly liable, it is likely to bear the cost of defending the suit, and the individual employee is likely to be "judgment proof" — that is, unlikely to have assets sufficient to cover her share of the liability. STEVEN SHAVELL, *ECONOMIC ANALYSIS OF ACCIDENT LAW* 207 (1987) ("[I]n making judgments about the importance of risk aversion [it is important to] consider the size of losses in relation to the parties' assets."). Therefore, the only significant deterrent the individual employees face is the prospect of an internal sanction imposed by their employer. This sanction is of course uninsurable, except to the extent that employees can obtain unemployment benefits.

104. See *Floralbell*, 9 N.Y.S.2d at 962-63 (noting that insurance for imputed liability is the equivalent of insurance for negligence); see also JERRY, *supra* note 21:

Where punitive damages are vicariously imposed, the public policies against coverage of punitive damages are much less compelling. . . . The employer [may have] no meaningful ability to prevent the conduct of an employee bent on acting in . . . a destructive way. At best, the employer [might be] simply negligent — not reckless or grossly negligent — in failing to supervise the employee.

Id. § 65[f], at 353.

105. See *McNulty*, 307 F.2d at 439-40 ("[I]f the employer did not participate in the wrong

This imputed liability exception applies equally to the public policy against insuring liability for intentional torts.¹⁰⁶ As with imputed liability for punitive damages, the primary actor responsible for an employer's imputed liability for intentional torts is the agent or employee who committed the tort. Insurance for imputed liability may create some incentive for employers to permit their agents to commit intentional wrongs, but it does not directly promote intentional wrongdoing — it does not indemnify intentional wrongdoing.¹⁰⁷ The imputed liability exception thus comports with the rationale underlying the public policy exclusion; it is insurance for an employer's failure to prevent wrongdoing, not insurance for an employer's intentional wrongdoing. Therefore, although it is not based on a finding that the employer has been negligent, an employer's imputed liability for the intentional torts committed by its employees is analogous to employer liability for negligence, which *is* insurable under the public policy exclusion.¹⁰⁸

2. *The Negligent Supervision Exception*

Courts also recognize a related exception that allows employers to insure against the liability they incur for negligent supervision of their employees.¹⁰⁹ Like imputed liability, negligent supervision liability arises out of an employer's failure to ensure that its employees will not commit intentional torts. In the case of negligent supervision liability, however, the employer's liability is predicated directly on its own

the policy of preventing the wrongdoer from escaping the penalties for his wrong is inapplicable.").

106. The California Supreme Court explained the rationale behind the imputed liability exception in *Arenson v. National Auto. & Cas. Ins. Co.*, 286 P.2d 816 (Cal. 1955). In *Arenson*, the plaintiff sought coverage under his liability policy after his son started a fire that damaged school property. The plaintiff had been held liable for the son's wrongdoing under a California statute that imposed liability on parents for the willful torts of their children. The insurance company contested coverage, a defense that implicated § 533's prohibition against insuring "willful" misconduct. However, the California Supreme Court found that § 533 did not prevent coverage, stating that "Section 533 . . . has no application to a situation where the plaintiff [insured] is *not personally at fault*." 286 P.2d at 818 (emphasis added).

107. See *infra* note 109.

108. An employer liable on the grounds of respondeat superior is an "innocently condemned" civil obligor," and the imputed liability does not reflect the employer's own wrongdoing. *Dayton Hudson Corp v. American Mut. Liab. Ins. Co.*, 621 P.2d 1155, 1160 n.19 (Okla. 1980). On the other hand:

When recovery against the employer for an act of his servant is rested on [the employer's] prior knowledge of the servant's propensity to commit the very harm for which damages are sought, the basis of liability is not *respondeat superior* but rather the employer's *own negligence* in not discharging the unfit servant.

621 P.2d at 1161. However, in either case the loss results from negligent omission to prevent rather than an intent to commit the harm, and it should be insurable under the public policy exclusion.

109. See, e.g., *Chicago Bd. of Options Exch., Inc. v. Harbor Ins. Co.*, 738 F. Supp. 1184, 1187-88 (N.D. Ill. 1990) (retaliatory discharge is uninsurable, but the corporation's vicarious liability would be insurable); *Seminole Point Hosp. Corp. v. Aetna Cas. & Sur. Co.*, 675 F. Supp. 44, 47 (D.N.H. 1987) (holding that an employer may insure against harm resulting from "negligent supervision," including harm caused by the intentional acts of its employees).

wrongdoing — its failure to take adequate steps to prevent the employee's tortious conduct — and not on the agency relationship between the employer and its employees.

The principle underlying the imputed liability exception applies equally in cases of negligent supervision liability. As with imputed liability, insurance for negligent supervision liability cannot be expected to promote wrongdoing in the sense forbidden under the public policy exclusion. Insurance for negligent supervision liability does not indemnify the employer or its employees against liability for their own intentional wrongs. Regardless of whether an individual *employee* intentionally causes the harm giving rise to the employer's liability, the *employer* has been merely negligent in failing to prevent the employee's conduct. Therefore, although insurance for negligent supervision liability may create an incentive for employers to act negligently in supervising their employees, it does not violate the public policy exclusion because it does not insure or promote intentional wrongs.

3. *Limitations*

In keeping with the rationale behind the public policy exclusion, courts have limited the imputed liability and negligent supervision exceptions to cases "where the [insured employer] *is not personally at fault*"¹¹⁰ and have intimated that insurance for imputed liability only comports with public policy to the extent that "the employer [does] not participate in the wrong."¹¹¹ The reason for this limitation is clear: courts are willing to enforce insurance for imputed liability and negligent supervision liability only to the extent that such liability reflects an employer's *negligence* rather than the employer's own *intentional* wrongdoing. Like the courts' formulations of the public policy exclusion, however, these efforts to limit the imputed liability and negligent supervision exceptions have not been consistent, and the courts have arrived at varying definitions of the employer involvement necessary to destroy the exceptions.

Thus, courts have upheld coverage in cases in which an employer has been "innocently condemned" through the mechanism of imputed liability for the wrongful conduct of its employees.¹¹² The rationale of these courts is that "indemnity [in this situation] is not contrary to public policy because the insured . . . is guilty of no wrong-doing, but simply has the misfortune to be legally responsible for the wrong-

110. *Arenson*, 286 P.2d at 818.

111. *Northwestern Natl. Cas. Co. v. McNulty*, 307 F.2d 432, 440 (5th Cir. 1962); see also *Beaver v. Country Mut. Ins. Co.*, 420 N.E.2d 1058, 1061 (Ill. App. Ct. 1981) (allowing insurance for imputed liability, but only if "the employer did not participate in the wrong" (quoting *McNulty*, 307 F.2d at 440)); JERRY, *supra* note 21, § 65[f], at 353-54 (suggesting that courts limit the imputed liability exception to cases of employer liability in which there is nothing greater than mere negligence in the wrongdoing on the part of the employer).

112. *Dayton Hudson*, 621 P.2d at 1160.

doing of another."¹¹³ By contrast, these courts would likely refuse to enforce coverage when the employer intended its employees to cause harm or when the employer directed the intentional misconduct of its employees.¹¹⁴ Rather than reflecting insurable negligence, employer liability in these cases would reflect uninsurable *intentional* misconduct by the employer.

Courts have not adequately considered the gray area between these extremes. Some courts have stated that they would not enforce coverage when an employer knows of an employee's propensity to commit wrongdoing and fails to take any action to prevent it.¹¹⁵ Other courts have intimated they would void coverage if an employer was grossly negligent in permitting its employees to commit intentional wrongs.¹¹⁶ Still other courts, however, have stated that they would permit an employer to recover under the exceptions as long as the employer did not authorize or direct the wrongdoing. Presumably, these courts would enforce coverage even if the employer had been grossly negligent in failing to supervise his employees.¹¹⁷

In sum, the courts have not distilled any clear or principled distinction between employer involvement that precludes coverage and employer involvement that is merely insurable negligence. Consequently, although the courts have recognized the imputed liability and negligent supervision exceptions, they have not provided clear guidance as to how courts should apply these exceptions in close cases. Clearly, however, the exceptions comport with the rationale behind the public policy exclusion. The only unresolved question is what level of employer involvement should preclude enforcement of coverage.

113. *Dart Indus. v. Liberty Mut. Ins. Co.*, 484 F.2d 1295, 1298 (9th Cir. 1973) (quoting *Hendrix v. Employers Mut. Liab. Ins. Co.*, 98 F. Supp. 84, 87 (E.D.S.C. 1951), *revd. on other grounds*, 199 F.2d 53 (4th Cir. 1952)).

114. *See Coit Drapery Cleaners, Inc. v. Sequoia Ins. Co.*, 18 Cal. Rptr. 2d 692, 702 (Ct. App. 1993) ("Here, the trial court found [the insured was] well aware of, and ratified and condoned, the sexual harassment of female employees as a way of satisfying [the president's] urges for sexual domination of females. [The insured corporation] should not receive insurance coverage for the liability it, thus, intentionally created.").

115. *See, e.g., Ohio Cas. Ins. Co. v. Welfare Fin. Co.*, 75 F.2d 58, 60 (8th Cir. 1934), *cert. denied*, 295 U.S. 734 (1935), *cited in Dayton Hudson*, 621 P.2d at 1161. According to *Dayton Hudson*, the court in *Ohio Casualty* "reasoned that if a master had reason to know in advance that his servant was likely to commit the injurious act for which liability was imposed, the situation may be legally analogous to that where the insured himself commits a willful or intentional injury." *Dayton Hudson*, 621 P.2d at 1161.

116. *Dayton Hudson*, 621 P.2d at 1161 ("We think the ultimate answer depends in each case on whether prior knowledge makes the master's negligence 'ordinary' or 'gross.'").

117. *See, e.g., Armstrong v. Security Ins. Group*, 288 So. 2d 134, 136 (Ala. 1973) (considering whether one coinsured owner of a sandwich shop could be insured against liability incurred after the other owner shot a patron); *McLeod v. Tecorp Intl., Ltd.*, 844 P.2d 925, 927 (Or. Ct. App. 1992) ("[Employer's] liability . . . could be based on vicarious liability. The relevant inquiry on those claims is whether [the employer] expected, foresaw or intended the alleged conduct."), *modified*, 850 P.2d 1161 (Or. Ct. App.), *revd.*, 865 P.2d 1283 (Or. 1993).

D. *Summary*

Courts have adopted a “public policy exclusion” that precludes the enforcement of liability insurance for intentional wrongdoing, although courts adhere to this exclusion with varying degrees of intransigence. The rationale behind the public policy exclusion is clear. Courts assume that insurance for intentional torts promotes wrongdoing and that it tends to encourage conduct that may cause harm to innocent third parties. Therefore, they hold that public policy requires them to prevent this result by refusing to enforce coverage. In applying this public policy exclusion, some courts have adopted a blanket rule, and other courts have been more flexible. Most courts, however, have enforced insurance coverage for an employer’s imputed liability or negligent supervision liability incurred as a result of the intentional torts committed by its employees and other agents. These exceptions are consistent with the rationale behind the public policy exclusion because they effectively permit insurance for liability arising out of an employer’s negligence.

II. THREE APPROACHES TO THE PUBLIC POLICY EXCLUSION IN INSURANCE FOR INTENTIONAL EMPLOYMENT DISCRIMINATION

Relatively few courts have addressed the question of whether to enforce insurance covering employer liability for intentional employment discrimination. The purpose of this Part is to catalogue and assess the three general approaches that these courts have taken and to lay a foundation in case precedent for the argument that courts should enforce coverage for some forms of intentional discrimination liability under the negligent supervision and imputed liability exceptions. Section II.A summarizes the approach taken by courts that have applied the public policy exclusion to void coverage for intentional employment discrimination and compares that approach with the approach taken by courts that have refused to adopt the public policy exclusion. Section II.A also analyzes the arguments that support each of these approaches and suggests that the debate over the public policy exclusion can be reduced to an unresolved empirical question concerning the effect of insurance on the behavior of insured employers. Without offering to resolve this debate, section II.B describes the most recent approach courts have adopted in applying the public policy exclusion to insurance for employment discrimination. Section II.B. also describes how some courts have begun to consider the enforceability of insurance coverage for sexual harassment liability under a negligent supervision exception to the public policy exclusion.

A. *The Debate over the Adoption of the Public Policy Exclusion*

1. *The Rigid Public Policy Exclusion*

Many courts refusing to enforce insurance for intentional employment discrimination liability have adhered to a blanket rule against insuring intentional wrongdoing. The first court to adopt this approach, and one of the first courts to have considered the validity of insurance for employment discrimination,¹¹⁸ was the Seventh Circuit in *Solo Cup Co. v. Federal Insurance Co.*¹¹⁹ In this case, the Seventh Circuit considered the scope and enforceability of an insurance policy that provided defense and indemnification coverage for "discrimination," but that excluded coverage for intentional wrongdoing.¹²⁰ Although *Solo Cup* did not involve intentional discrimination,¹²¹ the court considered the general issue of the insurability of liability for employment discrimination. The court decided that insurance for disparate impact discrimination did not violate public policy, but that insurance for disparate treatment or intentional employment discrimination would be unenforceable as a matter of public policy.¹²² To

118. The first case to consider the validity of insurance for intentional employment discrimination was *Union Camp Corp. v. Continental Cas.*, 452 F. Supp. 565 (S.D. Ga. 1978). In that case, the Southern District of Georgia considered an insurance company's obligation to provide coverage for the back pay settlement of a Title VII class action. The "umbrella excess policy" that the employer in *Union Camp* carried expressly covered personal injuries arising out of "discrimination." 452 F. Supp. at 566. The insurance company argued, however, that the court should not enforce those coverage provisions because to do so would "encourage violation of the Civil Rights Acts of 1866 and 1964" and therefore would injure the public. 452 F. Supp. at 567. Therefore, the question in *Union Camp* closely resembled the question posed in *Solo Cup Co. v. Federal Ins. Co.*, 619 F.2d 1178 (7th Cir.), *cert. denied*, 449 U.S. 1033 (1980): the claimed discrimination was presumably "unintentional," as it involved claims of disparate impact discrimination, and the policy directly indemnified acts of unintentional discrimination. *Union Camp*, 452 F. Supp. at 566. Like the court in *Solo Cup*, the court in *Union Camp* concluded that the purpose of awarding back pay damages under Title VII was at least in part the deterrence of employment discrimination, but the court enforced the coverage because it held that coverage for those awards would not be injurious to the public good. 452 F. Supp. at 567-68. The *Union Camp* court never directly addressed the validity of insurance for intentional conduct, as the policy contained an exclusion for "discrimination . . . committed by, at the direction of, or with the consent of the insured." 452 F. Supp. at 566. In fact, the court appeared to rely on this exclusion to some extent in determining the validity of the policy before it, stating, "[h]ere the policy would not cover intentional or consensual acts of discrimination by the insured. The fact that coverage would be excluded in these circumstances would in itself be a deterrent to incentive to violate the Civil Rights Act." 452 F. Supp. at 568.

119. 619 F.2d 1178 (7th Cir.), *cert. denied*, 449 U.S. 1033 (1980).

120. 619 F.2d at 1181-82. The policy excluded coverage for intentional wrongdoing by defining covered "occurrences" under the policy to include only "an accident . . . which unexpectedly and unintentionally results in personal injury . . ." 619 F.2d at 1181.

121. The underlying action was for disparate impact discrimination, which the court interpreted to be unintentional discrimination. 619 F.2d at 1186-87.

122. The court intimated that coverage for "disparate treatment" discrimination would be excluded from coverage under the policy's definition of coverage. 619 F.2d at 1186 ("The extent [of coverage under the policy] is . . . inconsistent with liability predicated on the disparate treatment theory since such a liability would necessarily involve a determination that Solo acted with a discriminatory motive or purpose."). However, the court also suggested that coverage for such liability would be void as a matter of public policy. 619 F.2d at 1187.

reach that conclusion, the court adopted a rigid, court-imposed intentional act exclusion,¹²³ citing Seventh Circuit authority for the proposition that a "contract of insurance to indemnify a person for damages resulting from his own intentional misconduct is void as against public policy."¹²⁴ Because the court did not consider disparate impact discrimination to be intentional discrimination, the court held that insurance for disparate impact discrimination did not violate this exclusion.¹²⁵

The Florida Supreme Court's more recent consideration of insurance for intentional religious discrimination in *Ranger Insurance Co. v. Bal Harbour Club, Inc.*¹²⁶ exemplifies the rigidity of this approach. Like the court in *Solo Cup*, the *Ranger* court held that unintentional discrimination is "clearly a legitimate business risk and as such is insurable."¹²⁷ The court undertook a two-part analysis, however, to hold that insurance for intentional discrimination is void as against public policy.¹²⁸ The court first concluded that intentional discrimination is "a type [of conduct] that will be encouraged by insurance."¹²⁹ The court then considered the purposes behind the imposition of liability for intentional discrimination and determined that liability for intentional discrimination is designed primarily to deter wrongdoing rather than to compensate its victims.¹³⁰ The court therefore concluded that it would violate public policy to enforce insurance coverage for intentional discrimination because such coverage is infected with an impermissible moral hazard.¹³¹

123. The court stated that it did "not think that allowing an employer to insure itself against losses incurred by reason of disparate impact liabilities will tend in any way to injure the public good, which we equate here with that equality of employment opportunity mandated by Title VII." 619 F.2d at 1188.

124. 619 F.2d at 1187 (quoting *Industrial Sugars, Inc. v. Standard Accident Ins. Co.*, 338 F.2d 673, 675 (7th Cir. 1964)).

125. 619 F.2d at 1187.

126. 549 So. 2d 1005 (Fla. 1989). Although this case did not involve employment discrimination, the court's reasoning could just as easily apply to void insurance for intentional employment discrimination because the court did not limit its reasoning to a particular type of discrimination in making its decision. In fact, the Florida Supreme Court drew extensive analogies to Title VII and relied heavily on a student Note addressing the public policy implications of insuring intentional employment discrimination. 549 So. 2d at 1009 (quoting and citing Anastassiou, *supra* note 10). In fact, the court specifically noted that the Florida antidiscrimination statute "appears to be patterned after Title VII of the Federal Civil Rights Act of 1964." 549 So.2d at 1009. Courts commonly interpret state statutes in accordance with the purposes behind Title VII. See *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 106 & n.26 (1983) (citing cases).

127. *Ranger*, 549 So. 2d at 1006; see also *Solo Cup*, 619 F.2d at 1186-88.

128. *Ranger* borrowed the structure of this analysis from a student Note published in the *Columbia Law Review*, which in turn borrowed the structure from *Northwestern National Casualty Co. v. McNulty*, 307 F.2d 432 (5th Cir. 1962). See *Ranger*, 549 So. 2d at 1007 (citing *Anastassiou*, *supra* note 10, at 195-96). *McNulty* is one of the leading cases finding insurance for punitive damages to be invalid.

129. 549 So. 2d at 1007.

130. 549 So. 2d at 1008.

131. The court reasoned that "[t]he rationale underlying this rule [against insurability] is

The *Ranger* “test,” like the test to which the court in *Solo Cup* referred, is, in effect, a blanket rule against insuring intentional wrongdoing. As illustrated above, all insured conduct is of the “type that will be encouraged by insurance,”¹³² at least in the sense that the theory of moral hazard predicts that the availability of insurance will inspire negligent as well as intentional wrongdoing by insured employers. Consequently, the *Ranger* court’s determination that insurance for intentional but not unintentional discrimination encourages wrongdoing is nothing more than adherence to a blanket presumption that insurance for intentional acts promotes wrongdoing. In fact, the *Ranger* court explained the purpose of its “test” as follows: “An examination of the first factor leads to the determination of whether the existence of insurance will directly stimulate commission of a wrongful act, and an examination of the second factor leads to the determination of whether deterrence or compensation should be given priority.”¹³³ However, the court’s “examination of the first factor” — whether the insured conduct is “a type that will be encouraged by insurance” — was utterly conclusory. The court merely stated that “[i]t is axiomatic in the insurance industry that one should not be able to insure against one’s own intentional misconduct.”¹³⁴ The court did not inquire into any special factors that might mitigate the moral hazard of insurance for intentional discrimination,¹³⁵ nor did the court in any way question the assumption that insurance for intentional wrongs always promotes wrongdoing.

In sum, the courts that have voided coverage for intentional discrimination have done so on the basis of a categorical public policy exclusion that precludes coverage for intentional wrongdoing.¹³⁶ In applying this exclusion, they have ignored the special nature of employment discrimination liability and instead have relied on the characterization of liability as either “intentional” or “unintentional” wrongdoing. It is unclear from the opinions whether these courts have applied the exclusion under an “intent to injure” or “intent to act” standard,¹³⁷ but it does appear that they have assumed without question that insurance for “intentional” discrimination promotes wrong-

that the availability of insurance will directly stimulate the intentional wrongdoer to violate the law.” 549 So. 2d at 1007. Although Florida courts have departed from this assumption about the antideterrent effect of insurance for other forms of liability, 549 So. 2d at 1007 (citing cases), the *Ranger* court was unwilling to carve an exception for intentional discrimination.

132. See *supra* notes 42-43 and accompanying text.

133. 549 So. 2d at 1007.

134. 549 So. 2d at 1007.

135. See *infra* notes 169-71 and accompanying text.

136. But see *Coit Drapery Cleaners, Inc. v. Sequoia Ins. Co.*, 18 Cal. Rptr. 2d 692, 699-702 (Ct. App. 1993) (considering a more flexible application of the public policy exclusion that would permit coverage for “negligent supervision” in some circumstances but rejecting that approach based on the particular facts of the case).

137. See *supra* note 54 (describing the distinction courts sometimes draw between intentional

doing.¹³⁸ Moreover, the courts taking this approach have not considered the potential application of the imputed liability or the negligent supervision exceptions.

2. *Abandoning the Public Policy Exclusion*

At the other end of the spectrum, an increasing number of courts have abandoned the public policy exclusion altogether and have enforced insurance for intentional employment discrimination.¹³⁹ The Sixth Circuit's consideration of insurance for intentional employment discrimination in *School District for Royal Oak v. Continental Casualty Co.*¹⁴⁰ best exemplifies this approach. The insured school board in *Royal Oak* settled an intentional employment discrimination suit brought by an aggrieved teacher and then sought indemnification for that settlement under its general liability insurance policy.¹⁴¹ The policy covered "all loss" that the school district or its employees become legally obligated to pay," provided that "the subject of the loss does not include 'matters which shall be deemed uninsurable under [state] law.'"¹⁴² The policy did not contain an intentional act exclusion.¹⁴³

The court in *Royal Oak* found that the policy covered the school district's liability for its intentional religious discrimination.¹⁴⁴ The insurance company invoked both the contractual exclusion for "matters that are uninsurable under [state] law" and the public policy exclusion to argue that Michigan public policy precluded enforcement of the coverage.¹⁴⁵ Citing cases in which Michigan courts enforced insurance to cover a psychiatrist's liability for "felonious sexual activity," the district court had held that "Michigan does not as a general rule bar recovery under public liability policies [simply] because some illegal act was involved in the damage."¹⁴⁶ The district court had further noted that it was "unaware of any Michigan law that deems

acts and intentional injuries in deciding whether to enforce insurance under the public policy exclusion).

138. Neither the *Ranger* court nor the *Solo Cup* court distinguished between intent to injure and intent to act.

139. These courts include: the Sixth Circuit in *School Dist. for Royal Oak v. Continental Cas. Co.*, 912 F.2d 844 (6th Cir. 1990) (applying Michigan law); the Florida appellate court in *Ranger Ins. Co. v. Bal Harbour Club, Inc.*, 509 So. 2d 945 (Fla. Dist. Ct. App. 1987) (en banc), *rev'd*, 549 So. 2d 1005 (Fla. 1989); and the Minnesota Court of Appeals in *Independent Sch. Dist. No. 697 v. St. Paul Fire & Marine Ins. Co.*, 495 N.W.2d 863 (Minn. Ct. App.), *review granted*, No. 92-1625, 1993 Minn. LEXIS 225 (Mar. 30, 1993).

140. 912 F.2d 844 (6th Cir. 1990).

141. 912 F.2d at 845-46.

142. 912 F.2d at 846.

143. *See* 912 F.2d at 846.

144. 912 F.2d at 849-50.

145. 912 F.2d at 847-48.

146. 912 F.2d at 849 (quoting *Bowman v. Preferred Risk Mut. Ins. Co.*, 83 N.W.2d 434, 436 (Mich. 1957)).

intentional discrimination "uninsurable." ' ' '147

The Sixth Circuit affirmed the coverage for intentional discrimination on several grounds. The court first questioned the assumption that insurance for intentional discrimination promotes wrongdoing: "Perhaps the existence of liability insurance might occasionally 'stimulate' [discrimination], but common sense suggests that the prospect of escalating insurance costs and the trauma of litigation, to say nothing of the risk of uninsurable punitive damages, would normally neutralize any stimulative tendency the insurance might have."¹⁴⁸ The Sixth Circuit also noted that "[p]ublic policy normally favors enforcement of insurance contracts according to their terms."¹⁴⁹ The court further reasoned that the insurance company responsible for drafting the policy, not the court, was in the best position to avoid undesirable coverage.¹⁵⁰ In this regard, the district court in *Royal Oak* had stated that "insurers can always exclude or limit coverage" for discrimination.¹⁵¹ The Sixth Circuit also emphasized that, "[h]ad the company wished to exclude coverage for intentional religious discrimination in employment, it could and should have said so."¹⁵²

Other courts that have abandoned the public policy exclusion have echoed these sentiments. Some have questioned whether the inference that insurance stimulates wrongdoing can overcome the "competing public policies . . . [that] favor freedom of contract and the enforcement of insurance contracts according to their terms."¹⁵³ Others have adverted to the deterrent effect of mechanisms in the market for insurance.¹⁵⁴ These courts have noted that insurance companies are capable of policing their own contracts and that insurance companies have

147. 912 F.2d at 849 (quoting the transcript of the proceedings in the district court).

148. 912 F.2d at 848; see also *Ranger Ins. Co. v. Bal Harbour Club, Inc.*, 509 So. 2d 945, 948 (Fla. Dist. Ct. App. 1987) ("[W]rongdoers can be adequately punished under present law by the imposition of punitive damages, where appropriate, since it is against the public policy of this state to insure against such damages."), *revd.*, 549 So. 2d 1005 (Fla. 1989); 509 So. 2d at 947 ("The proposition that insurance taken out by an employer to protect against liability under Title VII will encourage violations of the Act is . . . speculative and erroneous." (quoting *Union Camp Corp. v. Continental Cas. Co.*, 452 F. Supp. 565, 567 (S.D. Ga. 1978))); *Independent Sch. Dist. No. 697 v. St. Paul Fire & Marine Ins. Co.*, 495 N.W.2d 863, 867 (Minn. Ct. App.) (quoting *Royal Oak*, 912 F.2d at 848), *review granted*, No. 92-1625, 1993 Minn. LEXIS 225 (Mar. 30, 1993).

149. *Royal Oak*, 912 F.2d at 849 (citing *Ranger*, 549 So. 2d at 1010 n.1 (Ehrlich, C.J., dissenting)).

150. 912 F.2d at 849.

151. 912 F.2d at 849 (quoting the transcript of the proceedings in the district court).

152. 912 F.2d at 849.

153. *Independent Sch. Dist. No. 697 v. St. Paul Fire & Marine Ins. Co.*, 495 N.W.2d 863, 868 (Minn. Ct. App.) (citing *Ranger*, 549 So. 2d at 1010 n.1 (Ehrlich, C.J., dissenting)), *review granted*, No. 92-1625, 1993 Minn. LEXIS 225 (Mar. 30, 1993); see also *Royal Oak*, 912 F.2d at 849.

154. *Ranger*, 509 So. 2d at 948 ("[T]he marketplace itself will discourage wrongful acts of discrimination."); *Independent Sch. Dist.*, 495 N.W.2d at 867 (quoting *Royal Oak*, 912 F.2d at 848).

ample motivation to prevent insureds from recovering for intentionally incurred losses or fraudulent claims.¹⁵⁵

The courts that have refused to adopt the public policy exclusion have therefore done so on the basis of three arguments. First, they have noted the lack of empirical proof for the assumption that insurance promotes intentional wrongdoing.¹⁵⁶ Second, they have noted the competing public policy that favors the enforcement of contracts as they are written and the need to compensate the victims of intentional wrongdoing.¹⁵⁷ Third, they have emphasized that insurance companies can themselves exclude coverage for intentional wrongdoing and have frowned on attempts to avoid contractual obligations by appealing to vague public policy concerns.¹⁵⁸

3. *Assessing the Arguments*

In essence, the courts that apply the public policy exclusion to void coverage for intentional employment discrimination and those that have abandoned it disagree over an unresolved empirical question concerning the tendency of insurance to promote wrongdoing.¹⁵⁹ Adherents to the public policy exclusion assume that insurance for intentional discrimination provides an incentive to wrongdoing on the part of insured employers and that such insurance therefore promotes discrimination.¹⁶⁰ The courts that have refused to adopt the public policy exclusion refuse to rely on this assumption in order to interfere with the right of private parties to contract.¹⁶¹ Starting with a strong

155. See, e.g., *Royal Oak*, 912 F.2d at 849 ("Had the company wished to exclude coverage for intentional religious discrimination in employment, it could and should have said so."); *Union Camp Corp. v. Continental Cas. Co.*, 452 F. Supp. 565, 568 (S.D. Ga. 1978) ("Continental and other insurers which have issued policies containing such clauses have not up to now conceived that they were violating public policy by writing insurance policies insuring against losses resulting from discriminatory employment practices."); *Ranger*, 509 So. 2d at 947 (citing *Union Camp*, 452 F. Supp. at 567-68); *University of Ill. v. Continental Cas. Co.*, 599 N.E.2d 1338, 1350-51 (Ill. App. Ct.) ("[T]he insurer is an informed contracting party with no inferiority in bargaining position and should not be allowed to escape from the contract it freely entered into. . . . This court will not rewrite the . . . policy to create an exclusion."), *appeal denied*, 606 N.E.2d 1235 (Ill. 1992); *Independent Sch. Dist.*, 495 N.W.2d at 868 ("The carrier is, of course, free to expressly provide an exclusion for such conduct in the future.").

156. See *supra* note 148 and accompanying text.

157. See *supra* note 153 and accompanying text.

158. See *supra* text accompanying notes 152-56.

159. Compare *Union Camp*, 452 F. Supp. at 567 (assumption that insurance promotes wrongdoing is "speculative and erroneous") and *Dixon Distrib. Co. v. Hanover Ins. Co.*, 612 N.E.2d 846, 857 (Ill. App. Ct.) ("We decline to assume that insured employers would be more inclined to fire employees for asserting protected rights without facts to support [that assumption]."), *appeal granted*, 622 N.E.2d 1203 (Ill. 1993) and *Sinclair Oil Corp. v. Columbia Cas. Co.*, 682 P.2d 975, 981 (Wyo. 1984) ("We know of no studies, statistics or proofs which indicate that contracts of insurance to protect against liability for punitive damages have a tendency to make willful or wanton conduct more probable. . . .") with *Ranger Ins. Co. v. Bal Harbour Club, Inc.*, 549 So. 2d 1005, 1007 (Fla. 1989) (uninsurability of intentional wrongdoing is "axiomatic").

160. See *supra* section II.A.1.

161. See *School Dist. for Royal Oak v. Continental Cas. Co.*, 912 F.2d 844, 849 (6th Cir.

presumption favoring the enforcement of contracts as they are written, the courts abandoning the public policy exclusion have looked for, and failed to find, any substantial connection between the availability of insurance and the increased incidence of wrongdoing.¹⁶² Not finding any justification for court intervention, they leave the avoidance of moral hazard to the private market in insurance, trusting that insurance companies will only provide coverage for intentional employment discrimination if the companies themselves can control for moral hazard.

Strong arguments support the positions of the courts on both sides of this disagreement. Courts invoking the public policy exclusion rely on an assumption that has significant intuitive appeal. First, the theory of moral hazard supports the assumption that insurance for intentional wrongdoing stimulates the commission of intentional torts.¹⁶³ Second, current insurance practices seem to confirm its accuracy. Insurance companies generally do not provide coverage for intentional wrongdoing,¹⁶⁴ presumably because they recognize that insurance for intentional wrongdoing promotes wrongdoing. By contrast, insurance companies do insure negligence, presumably because they can control the moral hazard associated with insurance for negligence.¹⁶⁵

However, equally strong arguments support the position taken by

1990). The determination of "public policy" is an inherently legislative function that involves balancing complex interests and issues outside the context of a particular factual setting. Some courts have expressed discomfort at invading the province of the legislature to "create" the public policy exclusion. *See, e.g., Dixon*, 612 N.E.2d at 857 (refusing to "assume that insured employers would be more inclined to fire employees [in retaliation] for asserting protected rights" and noting that courts "should be very cautious about establishing public policy by court fiat . . . [because] courts are ill equipped to determine what the public policy should be"). In the words of the U.S. Supreme Court:

[T]he right of private contract is no small part of the liberty of the citizen, and . . . the usual and most important function of courts of justice is rather to maintain and enforce contracts, than to enable parties thereto to escape from their obligation on the pretext of public policy

.....
Baltimore & O. Sw. Ry. v. Voigt, 176 U.S. 498, 505 (1900).

162. According to one court, "[a] contract to indemnify the insured for damages he is forced to pay as a result of an intentionally inflicted injury upon another should not be regarded as contrary to public policy unless the fact of insurance coverage can be related *in some substantial way* to the commission of wrongful acts of that character." *Isenhart v. General Cas. Co. of Am.*, 377 P.2d 26, 28 (Or. 1962) (emphasis added). The courts abandoning the public policy exclusion have not found this connection. *See Royal Oak*, 912 F.2d at 848.

163. *See supra* notes 42-44 and accompanying text.

164. Most liability insurance policies expressly exclude coverage for intentional wrongdoing. *See JERRY, supra* note 21, § 63 (noting that almost all insurance policies exclude recovery for deliberate destruction or intentional wrongdoing because of the implicit requirement that insurance cover only fortuitous losses). Indeed, "[v]irtually all liability insurance policies contain exclusions (or definitions of covered losses) precluding coverage of liability for intentionally-caused harm." *ABRAHAM, supra* note 31, at 21.

165. *See Harrell v. Travelers Indem. Co.*, 567 P.2d 1013, 1017 (Or. 1977) ("It has long been recognized that there is no empirical evidence that contracts of insurance to protect against liability for negligent conduct are invalid . . . because of any 'evil tendency' to make negligent conduct 'more probable' or because there is any 'substantial relationship' between the fact of insurance and such negligent conduct.").

courts refusing to adopt the public policy exclusion. Some insurance companies do provide insurance for intentional wrongdoing,¹⁶⁶ and the trend in the insurance industry and in the courts is toward a greater acceptance of insurance for intentional wrongs.¹⁶⁷ Moreover, the public policy exclusion may even be unnecessary.¹⁶⁸ Insurance

166. *Royal Oak*, 912 F.2d at 846 (quoting terms of excess policy coverage for "false arrest, libel, slander, defamation of character, invasion of privacy, wrongful eviction, assault or battery"); see *supra* notes 70-79 and accompanying text.

167. Historically, the courts have not always recognized a distinction between negligent and intentional wrongdoing as the touchstone for applying the public policy exclusion, and at one time the courts even entertained the idea of a public policy exclusion to prohibit insurance for negligence. See *Lazenby v. Universal Underwriters Ins. Co.*, 383 S.W.2d 1, 7 (Tenn. 1964) (White, J., concurring) ("In the early years of the casualty insurance business it was argued by some that by allowing one to insure against his own negligent acts that carelessness would be encouraged, resulting in increased injuries and deaths on the highways."); *KEETON ET AL.*, *supra* note 47, § 82, at 585; *McNeely*, *supra* note 47, at 33. In much the same way that critics now decry liability insurance for intentional wrongdoing, critics once argued that courts should not enforce insurance for liability arising out of negligence because it would promote wrongdoing and allow wrongdoers to benefit from their own wrongdoing. See *Lazenby*, 383 S.W.2d at 5. Indeed, critics of insurance have made similar claims about every new form of insurance that has been introduced. *ALEXANDER C. CAMPBELL, INSURANCE AND CRIME* 378 (1902) (claiming that various forms of insurance have caused the "building of unseaworthy ships, the mismanagement of a friendly society, the burning of a town, and the starving of a baby"). For instance, when child life insurance was first introduced, there was a tremendous public outcry for its abolition, as critics claimed that the availability of insurance would devalue the lives of children and encourage parents to murder their own children. See generally *VIVIANA A. ZELIZER, PRICING THE PRICELESS CHILD: THE CHANGING VALUE OF CHILDREN* (1985) (describing the controversy created by the development of child life insurance). Like the public policy exclusion against insuring liability for intentional wrongdoing, each of these challenges was based, at least in part, on assumptions about the perverse incentives that insurance would create for insureds to "benefit from their own wrongdoing." See *McNeely*, *supra* note 47, at 34-59 (describing challenges to various forms of liability insurance).

Insurance for intentional wrongdoing, however, is the only form of insurance that has not weathered challenges to its validity. The courts have not prohibited the enforcement of child life insurance and have universally accepted the validity of insurance for negligence. See 12 *APPLEMAN & APPLEMAN*, *supra* note 34, § 7031, at 145 ("It is now unquestioned that insurance against liability arising from acts of negligence is valid."). In fact, a similar trend may be discerned toward the acceptance of liability insurance covering intentional wrongdoing. Notwithstanding the protestations of the *Ranger* court, intentional act insurance has become widely available and widely accepted in the insurance industry. See *supra* notes 70-79 and accompanying text.

168. Employers have an incentive to avoid discrimination regardless of whether they have insurance to cover their discrimination liability. See *James*, *supra* note 87, at 558 (listing the incentives, other than civil liability, that an insured employer faces — including the threat of "disrupt[ion] of the normal process of . . . business life," "bad public relations, or bad labor relations," and the fear of "criminal liability"). Insured employers that fail to sanction individuals who discriminate would face the prospect of substantial uninsured liability. They would have to pay any deductible or coinsurance required by their insurance, and they would face the "unlimited" liability that exceeds the policy limits. See *Kent D. Syverud, The Duty to Settle*, 76 VA. L. REV. 1113, 1133 (1990) (describing the infinite potential for liability faced by individual insureds and suggesting that tort liability is not fully insurable). The employer might also face liability for uninsured punitive damages. See *Ranger Ins. Co. v. Bal Harbour Club, Inc.*, 509 So. 2d 945, 948 (Fla. Dist. Ct. App. 1987) (en banc), *revd.*, 549 So. 2d 1005 (Fla. 1989) ("[W]rongdoers can be adequately punished under present law by the imposition of punitive damages, where appropriate, since it is against the public policy of this state to insure against such damages."). An insured employer that allowed its agents to discriminate would also incur greater losses than insured employers that took measures to avoid liability, and because of these losses the employer will have to pay a higher premium for insurance. See *Willborn*, *supra* note

companies that provide coverage for intentional wrongdoing have every incentive to police the moral hazard effects of that insurance,¹⁶⁹ and they can take measures to ensure that policyholders do not rely on the availability of insurance to incur insured-against losses.¹⁷⁰ Indeed,

10, at 1022 (discussing how competitive concerns motivate compliance with antidiscrimination laws).

Also, the availability of insurance to cover the employer's liability may not affect individual employees responsible for an employer's discrimination liability in their decision to discriminate. These individuals are already effectively "insured" against the consequences of intentional discrimination. See RICHARD PERES, *DEALING WITH EMPLOYMENT DISCRIMINATION* 135 (1978) ("The supervisor who inappropriately fires a worker is not liable for the back pay which may be incurred against the company. The employer pays the attorney's fees, court costs, and damages. The employer takes the time to comply with an investigation, meet with government officials, go to public hearings, etc."). Take for instance the supervisors responsible for the discrimination in *Hamilton v. Rodgers*, 791 F.2d 439 (5th Cir. 1986). Even though the court in *Hamilton* held that individual supervisors could be held liable for their own intentional discrimination, the court also held that their employer was jointly and severally liable for that discrimination. 791 F.2d at 444-45. Therefore, even though they made the decision to discriminate and thereby caused the company's liability to accrue, the individual supervisors in *Hamilton* did not face any real prospect of personal liability; the plaintiffs could recover fully from the corporation. See PERES, *supra*, at 132-33; *infra* text accompanying notes 240-41. Individuals, whether they are members of the board or low-level supervisors, are not deterred from discriminating by the threat of liability but rather by the threat of "internal" sanction imposed by the company. Cf. James, *supra* note 87, at 558 (listing the deterrents employees face to getting in an accident while at work, including "the fear of discipline for a job badly done"). Consequently, as with imputed liability, insurance may only promote employers to incur liability for intentional discrimination to the extent that it will promote employers to take fewer measures to sanction the individuals responsible for the discrimination.

169. See Willborn, *supra* note 10, at 1029-30 ("[T]he interests of insurance companies correlate with the interests supporting the public policy restriction. Most insurance contracts will consequently contain warranties designed to further the same deterrence goals as the [public policy exclusion].") (emphasis added).

170. Most companies offering coverage for intentional discrimination would take some measures to combat moral hazard. At the very least, such companies would have to structure their policies and the premiums they charge in a way that would deter insured employers from engaging in intentional discrimination. Willborn, *supra* note 10, at 1024-25 (describing the measures insurance companies take to combat moral hazard); Telephone Interview with Dana Marino, Underwriter, Lexington Insurance Company (Sept. 23, 1992). The marketing of "Employment Practices Liability Insurance" (EPLI) illustrates the two approaches insurance companies might take. EPLI policies largely exclude coverage for intentional discrimination, see *supra* notes 6-7, but some companies offering EPLI take additional measures to combat moral hazard. "Conservative" insurance companies require potential insureds to meet objective criteria of insurability before writing a policy, and they try to reduce their insured's exposure to employment discrimination liability even after they have underwritten the policy. Telephone Interview with Dana Marino, *supra*. For instance, some insurance companies require the insured employer to have in place or to institute an official policy concerning sexual harassment before they will underwrite insurance, and most broker an "employment practices audit" that is designed to reduce an employer's exposure to employment discrimination liability. *Id.*; see also Fletcher, *supra* note 6, at 39. Many companies also refuse to write policies for high-risk employers, such as employers that have a history of discrimination or other employment-related liability, and they might also refuse to write policies for employers that do not adopt a grievance procedure or other official policy to discourage discrimination. Telephone Interview with Dana Marino, *supra*. Other insurance companies offering EPLI policies are less conservative and write policies for any employer, regardless of whether the employer has taken measures to reduce its exposure to discrimination liability. *Id.* These companies maintain the profitability of their policies by setting premiums to reflect the individual risk insured; for high-risk employers, this premium may be prohibitively expensive whereas, for low-risk employers, it may mirror the premium charged on "conservative" policies. *Id.* Therefore, employers insured under these aggressive policies would

the insurance market might not support insurance for intentional

have an incentive to avoid discrimination liability to the extent that it would lower their premium to do so and to the extent that they are otherwise forced to retain some risk of liability in the form of a deductible, coinsurance, or a limit upon coverage.

Regardless of whether they are conservative or aggressive in their underwriting practices, insurance companies offering intentional discrimination insurance would force insured employers to retain some risk of liability as a deterrent to discrimination. See Schwartz, *supra* note 20, at 316-17; see also JERRY, *supra* note 21, § 10[c][2], at 13. For instance, they would place limits upon the amount of coverage they provide. See Golub, *supra* note 3, at 944 (noting that employment practices policies have limits on coverage ranging from \$25,000 to \$1,000,000). They would also require the insured to pay a deductible or coinsurance against any recovery sought under the policy. See *id.* (describing a policy with a range of deductibles from \$1,500 to \$10,000); *id.* at 948 (minimum deductible of \$2,500); Fletcher, *supra* note 6, at 39 (noting that Lexington requires a minimum \$25,000 premium on its policy, which covers up to \$5 million in liability, and requires a minimum deductible of \$5,000).

Insurance companies can also be expected to deter insured employers from intentionally discriminating by charging a responsive premium that reflects the employer's history of discrimination liability. Although no insurance policy offers a perfectly responsive premium, see Schwartz, *supra* note 20, at 321, insurance companies can "experience rate" their policies or raise premiums to penalize insured employers that incur losses against the policy. Under experience rating, "[t]he premium that [the insurer] charges to employers is based on . . . the cost of providing benefits to the employees of that company in previous years. *The more benefits paid out under the plan, the higher the premium will be for the employer.*" Aetna Life Ins. Co. v. Borges, 869 F.2d 142, 143 (2d Cir.) (emphasis added), cert. denied, 493 U.S. 811 (1989). Insurance companies might also "retrospectively rate" their policies. See Schwartz, *supra* note 20, at 317. "Under retrospective rating, the insured pays a premium at the beginning of the policy year. At the end of the year, the insured's actual liability record is totaled up, and the insured is then either given a rebate or assessed a surcharge to take that actual record into account." *Id.* These measures force the insured to pay for some of its own losses, and this retained risk of liability deters insured employers from intentionally discriminating. See *id.* at 316-17.

Insurance companies may also take further steps to reduce losses. For instance, they might investigate whether potential insureds have a history of discrimination and refuse to underwrite a policy for a "high-risk" employer that is likely to discriminate. Farbstein & Stillman, *supra* note 51, at 1253 (noting that just because insurance for intentional acts "is legal does not mean that it will be sold to everyone"); Willborn, *supra* note 10, at 1024 ("The rational insurer will attempt to avoid providing coverage to employees that view insurance as a license to discriminate."). They might also refuse coverage to any employer that did not meet certain minimum requirements of insurability. See Farbstein & Stillman, *supra* note 51, at 1253. For instance, an insurance company might require employers to show that they have made some attempt to reduce their exposure to discrimination liability, or require an employer to adopt a grievance procedure and educate its employees about the importance of avoiding discrimination liability before selling insurance to the employer. SHAVELL, *supra* note 103, at 195 ("[I]nsurers may make premiums depend on insured's risk-reducing actions . . ."). Insurance companies might also offer an employment practices audit in conjunction with their policies, or otherwise undertake to educate employers about avoiding discrimination liability. See JOHN B. LEWIS, EMPLOYMENT PRACTICES LOSS PREVENTION GUIDELINES 51 (1992) (a manual prepared by the law firm Arter & Hadden for promulgation by the Chubb Group of Insurance Companies); SHAVELL, *supra* note 103, at 199 ("[I]nsurers often supply advice about risk reduction . . ."); Schwartz, *supra* note 20, at 356 (noting that insurance companies may offer advice on loss-reduction techniques because they are repeat players); Willborn, *supra* note 10, at 1021-22 ("Insurance may be deterrence-enhancing because insurance companies have an incentive to engage in loss prevention activities. . . . [T]hese activities translate into anti-discrimination counseling and advice which should promote compliance with, rather than violations of, the law.") (citation omitted); Fletcher, *supra* note 6, at 39.

In this regard, courts have not only approved insurance for disparate impact discrimination, but they have also predicted that the availability of insurance might reduce the incidence of unintentional discrimination. For instance, in 1980, the Seventh Circuit stated:

We do not think that allowing an employer to insure itself against losses incurred by reason of disparate impact liabilities will tend in any way to injure the public good, which

wrongdoing unless the companies providing that coverage were able to control against moral hazard.¹⁷¹

we equate here with that equality of opportunity mandated by Title VII. To the contrary, the fact of insurance may be helpful toward achieving the desirable goal of voluntary compliance with the Act. . . . [I]t is not undesirable, nor inconceivable, that discrimination insurers might aid in preventing the injury of discrimination as well.

Solo Cup Co. v. Federal Ins. Co., 619 F.2d 1178, 1188 (7th Cir.) (emphasis added), *cert. denied*, 449 U.S. 1033 (1980). The courts have not explained why they have not made similar predictions about the risk-reducing efforts of insurance companies offering insurance for intentional discrimination.

171. Mechanisms in insurance would ensure that the availability of insurance for intentional employment discrimination would lead to only a marginal increase in the incidence of discrimination. SHAVELL, *supra* note 103, at 213 ("[T]he availability of insurance does not necessarily dilute injurer's incentive to reduce risk; and where it does do that, the dilution of incentives [moral hazard] will be moderate, for policies that would substantially increase risks would be so expensive that they would not be attractive for purchase."). Aggressive insurance companies that did not control for moral hazard would have to predict higher losses under their policies than companies that combat moral hazard because the premium charged on an insurance policy, whether it is set as an average across a pool of insureds, Priest, *supra* note 43, at 1541, or on an individualized basis, *id.* at 1544, must reflect the level of risk posed by the insured employers. The higher the moral hazard associated with each insured, the higher the premium the insurance company will have to charge to cover expected losses against the policy. *Id.* at 1541. Consequently, aggressive insurance companies would have to raise the price of their policies relative to those offered by more conservative insurance companies. As the price of insurance rises, those employers facing the lowest risk of loss, and consequently not relying on insurance to commit wrongdoing, would buy a cheaper form of insurance. *Id.* at 1541, 1576 (describing the "unravelling" of the insurance pool that occurs as low-risk insureds drop out). They would buy insurance that controls against moral hazard, or they would simply go uninsured. *Id.* at 1549. At the same time, employers bent on intentional discrimination would be precluded from buying policies from insurance companies that monitor against high risks, and these employers would therefore continue to buy policies without a screen for moral hazard. Willborn, *supra* note 10, at 1022 ("[I]nsurance companies would deny coverage or charge higher than normal premiums to employers with questionable employment practices . . ." (citation omitted)). Through this process of "adverse selection," which is the tendency for "high risks to buy more coverage than low risks at a given rate," Priest, *supra* note 43, at 1540-41, high-risk insureds would gravitate toward policies that do not account for moral hazard, and low-risk insureds would gravitate toward policies that do account for moral hazard. As this occurs, the pool of potential insureds would "unravel" for policies that do not account for moral hazard, and the price of these policies would continue to rise. Jon D. Hanson & Kyle D. Logue, *The First-Party Insurance Externality: An Economic Justification for Enterprise Liability*, 76 CORNELL L. REV. 129, 140 (1990) (describing the "unravelling" effect); Priest, *supra* note 43, at 1542, 1576. At some point, employers choosing whether to buy insurance to cover their potential liability would decide that the price of insurance is too high and that it is cheaper and more efficient to avoid liability than it is to buy insurance. Because of these effects, the market in insurance for intentional discrimination would evolve toward an equilibrium. *Id.* Policies that do not effectively account for adverse selection and moral hazard would be priced out of the market, while policies that do account for moral hazard and adverse selection would thrive.

The market in insurance might tend toward an equilibrium in which some insurance promotes intentional discrimination. Economists might justify this increase in discrimination in terms of efficiency. They might suggest, for instance, that insurance is efficient because tort recoveries fully compensate the victims of discrimination and that any increase in the level of discrimination can be justified on the grounds of victim "indifference" and the efficient allocation of resources to loss avoidance. SHAVELL, *supra* note 103, at 212; Steven Shavell, *On Liability and Insurance*, 13 BELL J. ECON. 120, 128 (1982) ("[T]he welfare of victims is unaffected by the occurrence of the accidents because victims are fully compensated for losses. Thus there is no apparent opportunity for beneficial intervention in the insurance market."). This assumption has come under attack. See Hanson & Logue, *supra*, at 132 n.10 (citing the economic literature justifying insurance on the grounds that it is "Pareto superior" and noting that "the justification depends on the unrealistic assumption that consumers are fully compensated for their injuries");

Courts refusing to adopt the public policy exclusion can resort to other arguments as well. First, the public policy exclusion is both inconsistent and self-defeating. It involves an unprincipled distinction between insurance for disparate impact and disparate treatment discrimination,¹⁷² and it encourages an imprecision in the drafting of insurance policies that may itself promote discrimination by insured

Schwartz, *supra* note 20, at 351 (noting the same justification and demonstrating its shortcomings). Efficiency, moreover, is incommensurate with the goals behind employment discrimination liability. See Cass R. Sunstein, *Incommensurability and Valuation in Law*, 92 MICH. L. REV. 779, 850 (1994). Efficiency is not among the announced goals of the antidiscrimination laws, which are designed to be a "spur" and a "catalyst" to employers to "eliminate discrimination in employment." H.R. REP. NO. 914, 88th Cong., 2d Sess., pt. 1, at 26 (1963), *reprinted in* 1964 U.S.C.C.A.N. 2355, 2401 ("The purpose of this title is to eliminate . . . discrimination in employment based on race, color, religion, or national origin.") (emphasis added). The courts that have refused to adopt the public policy exclusion for insurance covering intentional employment discrimination have not done so on the basis of this efficiency argument. Rather, they have started from the presumption that courts should enforce contracts as they are written and have failed to find the mere assumption that insurance promotes discrimination to be sufficient grounds to depart from that presumption.

172. See Willborn, *supra* note 10, at 1010-13 (describing problems with the distinction). The concept of "intent" in employment discrimination is elusive. *Id.* at 1010 (noting that "disparate impact cases may be intent-based"). Indeed, as *Watson v. Fort Worth Bank & Trust*, 487 U.S. 977 (1988), illustrates, disparate treatment discrimination is not always "intentional" discrimination, and disparate impact discrimination is not always "unintentional" discrimination. See *infra* notes 247-56 and accompanying text. The two types of liability are in fact difficult to distinguish. See JOEL W. FRIEDMAN & GEORGE M. STRICKLER, JR., CASES AND MATERIALS ON THE LAW OF EMPLOYMENT DISCRIMINATION 297 (3d ed. 1993) ("In light of the Supreme Court's holding in *Watson* that disproportionate impact analysis can be applied to subjective employment decisions and the Court's dilution in *Wards Cove Packing* of the employer's burden in disproportionate impact cases, are the distinctions between the types of cases theoretical only?").

More important, the difference between disparate impact and disparate treatment discrimination does not reflect the rationale behind the public policy exclusion. Willborn, *supra* note 10, at 1011-12 (noting that the distinction is not "useful" because it is often impossible to tell whether a case is one for disparate impact or disparate treatment discrimination, especially when the case is settled before a trial on the merits). Like an employer insured for disparate treatment discrimination, an employer insured against liability for disparate impact discrimination can act in reliance on the availability of insurance to change its behavior in ways that increase the incidence of discrimination. The scientific proofs and validations required of an employer trying to avoid disparate impact liability are quite complex, and beyond the means of all but the largest companies. *Solo Cup*, 619 F.2d at 1188; see also Equal Employment Advisory Council, *Position Statement on Guidelines on Employee Selection Procedures*, in EMPLOYEE SELECTION: LEGAL AND PRACTICAL ALTERNATIVES TO COMPLIANCE AND LITIGATION 13-14 (Edward E. Potter ed., 2d ed. 1986) (discussing the expense associated with test validation). Rather than engaging in the expensive process of validating a test, a process that is not itself guaranteed to insulate the company from liability, see, e.g., *Richardson v. Lamar County Bd. of Educ.*, 729 F. Supp. 806, 817-25 (M.D. Ala. 1989) (assessing and denying the validity of a test developed by a trained test developer for use in hiring teachers for the Alabama public schools), *affd. sub nom.* *Richardson v. Alabama State Bd. of Educ.*, 935 F.2d 1240 (11th Cir. 1991), an employer with insurance may forgo the expense of validation because it can shift the risk of liability to an insurance company. Indeed, with the insurance company picking up the cost of defending the suit and indemnifying any liability, the employer can use tests whose validity is suspect and wait until liability is imminent before validating its employment criteria. An employer with insurance for disparate impact discrimination could, in effect, deliberately incur losses in reliance on insurance. Therefore, not only can an employer intend to commit disparate impact discrimination, but disparate impact discrimination is also the sort of wrongdoing that would be "promoted" by the availability of insurance.

employers.¹⁷³ Second, the logic used by some courts adopting the

173. The public policy exclusion often acts only as a supplement to poorly drafted intentional act exclusions. Currently, many of the insurance companies that draft policies to cover employment discrimination insurance do not explicitly exclude coverage for intentional discrimination. Some, like the Lexington Insurance Company, have excluded coverage for risks by stating that "[t]his insurance does not apply for the benefit of any individual insured who intentionally caused the harm alleged to have arisen out of an insured event." LEXINGTON POLICY, *supra* note 6, at 5. When coupled with other provisions of the policy, even this rather explicit exclusion might allow coverage for intentional discrimination in the case of imputed liability or negligent supervision liability. See *supra* note 7. Other insurance companies only exclude coverage for "risks that shall be deemed uninsurable as a matter of state law," and they leave the interpretation of this vague exclusion to the employers that purchase employment discrimination coverage. *School Dist. for Royal Oak v. Continental Cas. Co.*, 912 F.2d 844, 846 (6th Cir. 1990). Still other companies include an inartful intentional act exclusion in their policies and later invoke public policy as a stop-gap measure to contest coverage in cases in which the contractual exclusion fails. For instance, the coverage in *Ranger* resulted from an imprecise exclusion of coverage. *Ranger Ins. Co. v. Bal Harbour Club, Inc.* 509 So. 2d 940, 942 (Fla. Dist. Ct. App. 1985) (describing a policy that excluded coverage for intentional wrongdoing in the case of property damage and bodily injury but not in the case of personal injury), *rev'd.*, 549 So. 2d 1005 (Fla. 1989). The policy provided coverage for personal injuries, property damage, and bodily injury but only excluded coverage for intentional wrongdoing in the case of property damage and bodily injury. The Florida trial court therefore found, under the personal injury provisions, that the policy indemnified against liability for intentional discrimination. *Ranger*, 509 So. 2d at 942-44.

These practices create the impression that the policy provides coverage for an employer's intentional employment discrimination. Absent express language excluding coverage, employers might justifiably assume that their employment discrimination coverage includes coverage for intentional discrimination. In fact, the courts have recognized this possibility, and at least one court has found coverage for an employer's intentional employment discrimination liability on the grounds that the language of the employer's policy created a "reasonable expectation" of coverage. *Clark-Peterson Co. v. Independent Ins. Assocs.*, 492 N.W.2d 675, 677-79 (Iowa 1992). But see *Continental Ins. Co. v. McDaniel*, 772 P.2d 6, 9 (Ariz. Ct. App. 1988) (refusing to base coverage for sexual harassment upon the reasonable expectations of the insured). This expectation of coverage could itself promote wrongdoing; an employer who thinks he has coverage will be just as likely to rely on the availability of insurance to commit wrongdoing as an employer that actually has coverage.

The public policy exclusion thus rewards insurance companies for drafting vague and imprecise contractual exclusions and operates as a safety net for insurance companies that do not exclude coverage for intentional employment discrimination from their policies. Insurance companies can contest coverage under the public policy exclusion even though they have presumably charged a premium that reflects all potential losses against the policy. See *Anderson et al.*, *supra* note 5, at 120-21 (describing how insurance companies manipulate the definition of terms like "preconceived design" and "intent" to defeat coverage). Therefore, the public policy exclusion itself "promotes wrongdoing" on the part of insurance companies that can benefit from the premiums they charge on imprecise coverage. The public policy exclusion also provides insurance companies with little affirmative incentive to draft precise policies because they can always rely on public policy to preclude coverage for risks they fail to exclude. By lifting the public policy exclusion, courts might force insurance companies to draft more precise intentional act exclusions, and insurance companies in all likelihood could provide more precise and more comprehensive exclusion of coverage than courts operating at the remove of "public policy." See *First Bank (N.A.)-Billings v. TransAmerica Ins. Co.*, 679 P.2d 1217, 1222-23 (Mont. 1984) ("It is conceivable that a combination of different approaches by insurance companies may result in a delineation of the limits of coverage better than anything this Court could establish."); *KEETON & WIDISS*, *supra* note 63, § 5.4(d), at 519 ("[T]he terms of contemporary liability insurance policies probably impose a more extensive limitation or exclusion than that which would be recognized by the courts in the absence of an explicit policy provision.").

Note that the insurance companies in *Solo Cup*, 619 F.2d at 1187, and *Union Camp Corp. v. Continental Cas. Co.*, 452 F. Supp. 565, 567 (S.D. Ga. 1978), were both challenging coverage that was clearly within the scope of the policies they had drafted. In those cases, the insurance companies were boldly arguing that they should be permitted to avoid their contractual agree-

public policy exclusion is faulty. The court in *Ranger* “found” that insurance promotes wrongdoing merely by stating that “it is axiomatic in the insurance industry that one should not be able to insure against one’s own intentional misconduct.”¹⁷⁴ This axiom, however, is a statement about insurance companies, not a statement about empirical tendencies. The *Ranger* court did not indicate how this axiom *proved* that insurance for intentional torts promotes discrimination. Its proof is not appreciably greater than that offered by the similar axiom that insurance generally tends to promote negligence. To the contrary, the industry “axiom” suggests that insurance companies recognize when they need to take steps to combat the moral hazard associated with insurance for intentional wrongdoing; the “axiom” suggests that insurance companies exclude coverage for intentional wrongdoing *without the need for court intervention*.

B. *The Imputed Liability and Negligent Supervision Exceptions*

This Note does not propose any resolution to the debate summarized in section II.A. but only suggests that courts adhering to the public policy exclusion should adopt a modification that permits the enforcement of insurance to cover an employer’s imputed liability and negligent supervision liability for the intentional torts committed by its employees. In this regard, several recent cases support the development of these exceptions for insurance covering intentional employment discrimination liability.¹⁷⁵ A few courts have considered the validity of insurance that covers an employer’s liability for the sexual harassment committed by its supervisory or management personnel.¹⁷⁶ Using an approach that might equally be applied to imputed liability,¹⁷⁷ these courts addressed the enforceability of the employer’s liability under the negligent supervision exception.

In *Seminole Point Hospital Corp. v. Aetna Casualty Co.*,¹⁷⁸ the U.S. District Court for the District of New Hampshire considered whether a worker’s compensation and employer liability policy provided coverage to a hospital for the intentional sexual harassment committed by

ments — contractual agreements that expressly covered the risks involved — on the grounds that the policies they had drafted would promote wrongdoing. They argued, in essence, that they should *benefit* from the fact that they had drafted policies that violate public policy.

174. *Ranger Ins. Co. v. Bal Harbour Club, Inc.*, 549 So. 2d 1005, 1007 (Fla. 1989).

175. See, e.g., *Chicago Bd. of Options Exch., Inc. v. Harbor Ins. Co.*, 738 F. Supp. 1184, 1187 (N.D. Ill. 1990) (finding that retaliatory discharge is uninsurable, but a corporation’s vicarious liability for a retaliatory discharge would be insurable); *Seminole Point Hosp. Corp. v. Aetna Cas. & Sur. Co.*, 675 F. Supp. 44 (D.N.H. 1987) (holding that a corporation’s executive officer cannot indemnify himself against sexual harassment claims but that the corporation can indemnify itself against claims of negligent supervision).

176. See *Seminole*, 675 F. Supp. at 44; *McDaniel*, 772 P.2d at 9; *Coit Drapery Cleaners, Inc. v. Sequoia Ins. Co.*, 18 Cal. Rptr. 2d 692, 699-702 (Ct. App. 1993).

177. See *infra* section III.C.

178. 675 F. Supp. 44 (D.N.H. 1987).

the hospital's president. The underlying claim for sexual harassment was brought in state court by the president's secretary, who claimed that the president sexually harassed her by confronting her at work with "unwelcome sexual advances, requests for sexual favors, and other verbal and physical conduct of a sexual nature."¹⁷⁹ The court found that the policy provided no coverage to the *president* on the grounds that coverage was excluded under a contractual intentional act exclusion.¹⁸⁰ Without addressing the public policy implications of permitting coverage, however, the court found that, as long as the plaintiff did not establish that the *hospital* acted intentionally or with gross negligence in permitting the harassment to occur, the *hospital* could be indemnified under the policy for its "own negligent supervision and failure to undertake an investigation to find out what was taking place."¹⁸¹ The court therefore concluded that the president's intentional acts of sexual harassment "did not constitute an intentional act as to the corporation" and that the contractual exclusion only prevented coverage if the *hospital* intended for the harassment to occur.¹⁸²

The *Seminole* court did not explicitly consider invoking public policy to void the contractual coverage. The court did note, however, that the hospital's liability should be insurable, under the terms of its insurance contract, so long as the hospital was only negligent in failing to prevent its president from harassing its employees.¹⁸³ The court relied on the same logic that underlies the negligent supervision exception: if the hospital was only negligent, its liability should not be excluded from coverage under the contractual intentional act exclusion.¹⁸⁴ This logic parallels the logic underlying the negligent supervision exception to the public policy exclusion, and courts look to interpretations of contractual intentional act exclusions in determining the scope of the public policy exclusion.¹⁸⁵ Consequently, the logic of the *Seminole* decision supports the adoption of an exception to the public policy exclusion that permits employers to enforce insurance coverage for their sexual harassment liability.

Courts that have refused to enforce insurance for sexual harassment have also addressed the scope of the negligent supervision exception. In *Coit Drapery Cleaners, Inc. v. Sequoia Insurance Co.*,¹⁸⁶ the California Court of Appeal considered whether to enforce a corpora-

179. 675 F. Supp. at 46.

180. 675 F. Supp. at 46-47.

181. 675 F. Supp. at 47.

182. 675 F. Supp. at 47.

183. 675 F. Supp. at 47.

184. 675 F. Supp. at 47.

185. See *Continental Ins. Co. v. McDaniel*, 772 P.2d 6, 9 (Ariz. Ct. App. 1988); see also KEETON & WIDISS, *supra* note 63, § 5.4(d)(5), at 527-29 (describing the imputed liability exception to the contractual exclusion and suggesting the exception is tied to public policy).

186. 18 Cal. Rptr. 2d 692 (Ct. App. 1993).

tion's general liability insurance policy to cover liability incurred as the result of sexual harassment committed by its president. The plaintiff in *Coit Drapery* settled her sexual harassment claim with the corporation for slightly more than one million dollars, but the settlement required the insurance company to pay \$705,000 of that amount.¹⁸⁷ The insurance company had refused to defend the case on the grounds that liability for sexual harassment was not covered under the policy, opposing the enforcement of this settlement on the grounds that the coverage would violate public policy.¹⁸⁸ Because of the settlement, the plaintiff in *Coit Drapery* had a direct interest in convincing the court to adopt the negligent supervision exception. Nevertheless, the court applied section 533 of the California Insurance Code¹⁸⁹ to prevent the plaintiff and the corporation from enforcing the settlement against the insurance company. The court concluded that, even though the settlement would have provided compensation to an actual victim of harassment, "section 533, and the public policy it represents, bar[s] the attempt to shift liability for intentional sexual harassment . . . to an insurer."¹⁹⁰

A closer analysis of the particular facts of *Coit Drapery* sheds light on the court's decision and suggests that one can reconcile *Coit Drapery* with *Seminole*. In refusing to enforce coverage for the corporation's liability under a negligent supervision exception, the *Coit Drapery* court first noted that the plaintiff had made no allegation of negligent supervision; in fact, in a move that may have foreclosed recovery against the insurance company, the plaintiff's counsel explicitly stated that "[t]his is not an action involving negligent supervision."¹⁹¹ The court also refused to adopt a negligent supervision exception because the harassment was particularly egregious and because the corporation's board ratified and endorsed the president's behavior.¹⁹² The president had a well-established reputation for being a "dirty old man," and he repeatedly and consistently harassed and sexually assaulted his female employees.¹⁹³ More importantly, the president of the company was also the company's founder, a major shareholder, and the chairman of the board of directors.¹⁹⁴ The court cited this close connection between the president and the management

187. 18 Cal. Rptr. 2d at 696.

188. 18 Cal. Rptr. 2d at 696-97.

189. CAL. INS. CODE § 533 (West 1993).

190. 18 Cal. Rptr. 2d at 698 (emphasis added).

191. 18 Cal. Rptr. 2d at 699.

192. With respect to ratification of the president's harassment, the court in *Coit Drapery* noted that the "sexual abuse of female employees by [the president] was so widespread, well-known, and so ratified by the corporation as to constitute intentional corporate policy, which cannot be the subject of insurance coverage." 18 Cal. Rptr. 2d at 701.

193. 18 Cal. Rptr. 2d at 695.

194. 18 Cal. Rptr. 2d at 695.

of the corporation, as well as the corporation's long-standing acquiescence in the president's harassing conduct, as the primary factors in its refusal to allow coverage under the negligent supervision exception: "[T]here was no way . . . the corporate entity could have disciplined or supervised its president, chairman of the board, and major shareholder; further, the evidence showed his sexual misconduct with female employees was affirmatively known to, and ratified by, the board of directors" ¹⁹⁵ Thus, in contrast to *Seminole*, the court in *Coit Drapery* stressed that the employer was not a "separate entity" from its president and that the employer had itself implicitly engaged in intentional wrongdoing by ratifying and endorsing its president's acts of harassment.

The Arizona Court of Appeals endorsed a similar analysis and reached a similar conclusion in *Continental Insurance Co. v. McDaniel* ¹⁹⁶ without addressing the negligent supervision exception. The court in *McDaniel* considered whether liability for intentional sexual harassment committed by one of two owners of a coffee shop could be insured under a general liability policy. The plaintiff in the underlying discrimination case claimed that over the course of a year one of the owners sexually harassed her by speaking to her in a vulgar way, fondling her, and exposing his genitals to her. ¹⁹⁷ The insurance company denied coverage for the partnership's liability, claiming that sexual harassment was not a covered "occurrence" under the partnership's policy because the injuries were "expected [] or intended from the standpoint of the insured [owners]." ¹⁹⁸ Considering this claim, as well as the public policy that forbids insurance for intentional wrongdoing, the court concluded that "contractual intent and public policy coincide to prevent an insured from acting wrongfully knowing his insurance company will pay the damages." ¹⁹⁹ The court therefore held that the insurance company did not have to indemnify the coowner for his intentional acts of sexual harassment. ²⁰⁰

The Arizona court's decision in *McDaniel* is consistent with both *Coit Drapery* and *Seminole*. The two owners in *McDaniel* were not only partners, they were brothers, and they directly supervised their employees. ²⁰¹ Therefore, there was no separation between the individuals responsible for the harassing conduct and the highest levels of management and little chance that one owner could have "supervised"

195. 18 Cal. Rptr. 2d at 699.

196. 772 P.2d 6 (Ariz. Ct. App. 1988).

197. 772 P.2d at 7.

198. 772 P.2d at 7; cf. *Employers Surplus Lines v. Stone*, 388 P.2d 295 (Okla. 1963) (allowing one partner in a business to be indemnified against liability arising out of his partner's intentional assault).

199. 772 P.2d at 9.

200. 772 P.2d at 9.

201. 772 P.2d at 7.

his brother to prevent the harassment. Moreover, although the court did not recount the facts in any detail, it is clear that the harassment was egregious; the harassing conduct continued for over a year, and the court noted that “the conduct . . . was so certain to cause injury to McDaniel that [the owner’s] intent to cause harm is inferred as a matter of law.”²⁰² Therefore, as in *Coit Drapery*, the facts indicate that the employer was not a separate entity from the individual responsible for the discrimination and that the harassment was so pervasive that the employer must be held to have ratified or endorsed it.

These cases demonstrate both the scope and the limits of the negligent supervision exception. *Seminole* enforced coverage for liability a corporation incurred by negligently permitting its corporate officers to sexually harass their employees. *McDaniel* and *Coit Drapery* limit this “negligent supervision” exception in two substantial ways. First, they suggest that the exception should not apply when the employer is not in a position to “supervise” the harasser’s conduct because the harasser is also an owner of the business. Second, they suggest that at some point employer inaction amounts to more than mere negligence and that implicit employer ratification of harassing conduct should preclude the enforcement of insurance coverage.

Although the courts in these cases only consider the scope of the negligent supervision exception, courts should adopt the logic of these cases in considering the scope of the imputed liability exception as well. As noted above, the imputed liability and negligent supervision exceptions are both predicated on the same underlying rationale.²⁰³ Under both exceptions, the enforceability of the employer’s insurance coverage depends on the employer’s conduct, regardless of whether the employer’s liability derives from that conduct. Even in cases of imputed liability, in which liability stems only from the employer’s relationship to its employees, the enforceability of insurance for the employer’s liability should depend on the employer’s conduct because the relevant question with respect to the application of the public policy exclusion is whether the availability of insurance will promote an employer’s intentional wrongdoing.

III. THE IMPUTED LIABILITY AND NEGLIGENT SUPERVISION EXCEPTIONS AND INSURANCE FOR INTENTIONAL EMPLOYMENT DISCRIMINATION

Speaking to those courts that have chosen to apply the public policy exclusion, this Part advocates application of the negligent supervision and imputed liability exceptions and suggests a structure for applying these exceptions to insurance covering employer liability for

202. 772 P.2d at 8.

203. See *supra* section I.C.

intentional employment discrimination. Section III.A addresses the insurability of sexual harassment liability, the area already explored in the caselaw, and demonstrates that both quid pro quo and hostile work environment sexual harassment under Title VII fall within the exceptions. Using sexual harassment as a paradigm and applying the principles developed in the caselaw covering insurance for sexual harassment, section III.B illustrates that employer liability for other forms of disparate treatment also fits the exceptions. Section III.C proposes a structure for applying these exceptions to enforce coverage for employment discrimination liability. Specifically, section III.C suggests three factors courts should consider in limiting the exceptions to cases in which employer liability for intentional employment discrimination reflects the insured employer's negligent failure to prevent employees from discriminating rather than its intentional decision to discriminate.

A. *Applying the Exceptions to Sexual Harassment*

The few cases applying the negligent supervision exception to insurance for sexual harassment have not explored the significance of insuring all forms of sexual harassment. Rather, the courts have focused on the facts of the cases before them. This section briefly describes the law of sexual harassment in order to demonstrate more generally how employer liability for sexual harassment fits the negligent supervision and imputed liability exceptions to the public policy exclusion.

The Supreme Court has interpreted Title VII to provide for two forms of sexual harassment liability: quid pro quo and hostile work environment harassment.²⁰⁴ In quid pro quo harassment, a supervisor requires an employee to submit to sexual advances as an express or implied condition of receiving tangible employment benefits.²⁰⁵ The plaintiff must show that the supervisor "condition[ed] the granting of an economic or other job benefit upon the receipt of sexual favors from a subordinate, or punish[ed] that subordinate for refusing to comply."²⁰⁶

By contrast, a prima facie claim of hostile work environment har-

204. *Meritor Sav. Bank v. Vinson*, 477 U.S. 57, 64-65 (1986) (citing Equal Employment Opportunity Commission Guidelines on Discrimination Because of Sex: Sexual Harassment, 29 C.F.R. § 1604.11(a) (1985)).

205. *Meritor Savings*, 477 U.S. at 65-68.

206. *Lipsett v. University of P.R.*, 864 F.2d 881, 897 (1st Cir. 1988). Though *Lipsett* involved a Title IX and § 1983 discrimination claim rather than a Title VII employment discrimination claim, Barbara Lindemann and David Kadue cite it to define the cause of action for sexual harassment in employment. See BARBARA LINDEMANN & DAVID D. KADUE, *SEXUAL HARASSMENT IN EMPLOYMENT LAW* 129 (1992). In addition to *Lipsett*, Lindemann and Kadue cite several other cases for the proposition that quid pro quo harassment involves "an employer's sexually discriminatory behavior which compels an employee to elect between acceding to sexual demands and forfeiting job benefits, continued employment or promotion, or otherwise suffering

assment requires proof of five elements. The plaintiff must establish (1) that the plaintiff belongs to a protected category under Title VII; (2) that the plaintiff was subjected to unwelcome conduct that is sexual in nature; (3) that the conduct complained of affected a term, condition, or privilege of employment; (4) that the harassing conduct was made on the basis of sex; and (5) that the employer can be held responsible for the harassing conduct.²⁰⁷ Unlike quid pro quo harassment, which necessarily involves the harassing conduct of a supervisory employee, hostile work environment harassment can result from the harassing conduct of coemployees as well as that of supervisors, as long as the harassment is “‘sufficiently severe or pervasive to alter the conditions of [the victim’s] employment and create an abusive working environment,’ ”²⁰⁸ and as long as there is some basis for imputing liability to the employer.²⁰⁹

In determining whether to permit employers to enforce insurance for sexual harassment under the imputed liability and negligent supervision exceptions, courts must focus on the nature of the employer’s conduct and the basis of the employer’s liability, not upon the conduct of the individual responsible for the harassment.²¹⁰ Under the public policy exclusion, negligence is insurable while intentional wrongdoing is not. Employer liability for sexual harassment should therefore be insurable to the extent that it reflects an employer’s negligent failure to prevent discrimination and not its intentional decision to discriminate.²¹¹ The primary concern is not the label placed on the employer’s liability, but rather whether an employer’s sexual harassment liability reflects the employer’s negligent or intentional wrongdoing.

In this regard, the Supreme Court has held that traditional “agency principles” should govern decisions concerning employer lia-

tangible job detriments.” *Id.* at 129 n.2 (quoting *Highlander v. K.F.C. Natl. Mgmt. Co.*, 805 F.2d 644, 648 (6th Cir. 1986)).

207. *Robinson v. Jacksonville Shipyards, Inc.*, 760 F. Supp. 1486, 1522 (M.D. Fla. 1991) (citing *Meritor Savings*, 477 U.S. at 66-69 (1986) and *Henson v. City of Dundee*, 682 F.2d 897, 903-05 (11th Cir. 1982)). Lindemann & Kadue call these elements the “basis” for the claim, the “activity,” the “issue,” and the “causal connection.” LINDEMANN & KADUE, *supra* note 206, at 168-69. They prefer to drop the term “respondeat superior” from the fifth element of a hostile work environment claim and to focus instead upon “employer responsibility.” *Id.* at 169 & n.20. In the wake of the Supreme Court’s decision in *Meritor Savings*, several courts have recharacterized this element of a hostile work environment claim, and Lindemann and Kadue adopt “employer responsibility” because “the standard that courts actually apply incorporates negligence concepts far broader than the traditional standard of *respondeat superior*.” *Id.*; see also *Robinson*, 760 F. Supp. at 1522 n.7 (“Although this fifth element bears the label ‘respondeat superior,’ it actually embraces a negligence standard for employer liability . . .”).

208. *Meritor Savings*, 477 U.S. at 67 (quoting *Henson*, 682 F.2d at 904).

209. LINDEMANN & KADUE, *supra* note 206, at 169.

210. The question is whether the employer was grossly negligent, reckless, or willful in its failure to supervise its employees, not whether the responsible employee intended for the harassment to occur. See *supra* sections I.C, II.B; *infra* section III.C.

211. See *infra* section III.C.

bility for sexual harassment,²¹² and the Supreme Court has endorsed the *Second Restatement of Agency* as the source of these principles.²¹³ The *Second Restatement* provides that an employer should be held liable for the acts of its employees in the following circumstances: (1) when the employee committed acts of wrongdoing within the scope of his employment;²¹⁴ (2) when the employer "intended the conduct or the consequences" of the employee's actions even when the employee's conduct was outside the scope of employment;²¹⁵ (3) when the employee's acts violate a nondelegable duty of the employer;²¹⁶ or (4) when the employer has negligently failed to prevent its employees from committing wrongdoing.²¹⁷

Most courts impose liability for quid pro quo harassment directly on the employer under the first principle announced by the *Second Restatement*.²¹⁸ Supervisory employees have the authority to affect an employee's tangible job benefits, and a supervisor's acts of quid pro quo harassment fall within the scope of the supervisor's employment.²¹⁹ Courts therefore hold employers strictly responsible for a supervisor's acts of quid pro quo harassment, regardless of whether the employer intended that the harassment occur and despite any efforts the employer made to prevent the harassment.²²⁰ Consequently, em-

212. *Meritor Savings*, 477 U.S. at 72.

213. 477 U.S. at 67.

214. RESTATEMENT (SECOND) OF AGENCY § 219(1) (1957).

215. *Id.* § 219(2)(a) (1957).

216. *Id.* § 219(2)(c) (1957).

217. *Id.* § 219(2)(b) (1957).

218. The Supreme Court's pronouncement in *Meritor Savings* that employer liability should be governed by agency principles applied, on the facts of that case, only to hostile work environment claims. *Meritor Sav. Bank v. Vinson*, 477 U.S. 57, 72-73 (1986). However, like other forms of disparate treatment discrimination, see *infra* section III.B, quid pro quo harassment can be viewed as a form of strict vicarious or respondeat superior liability. See 477 U.S. at 70-71 ("[T]he courts have consistently held employers liable for the discriminatory discharges of employees by supervisory personnel, whether or not the employer knew, should have known, or approved of the supervisor's actions." (citing *Anderson v. Methodist Evangelical Hosp., Inc.*, 464 F.2d 723, 725 (6th Cir. 1972))). Because supervisory employees have the authority to affect tangible job benefits, they have at least the *apparent* authority to commit quid pro quo harassment within the scope of their employment. As the Seventh Circuit has stated,

[B]y delegating power to [a supervisor,] the "employer" and [the supervisor] essentially merged; as long as the tort complained of was caused by the exercise of this supervisory power, [the supervisor] should be deemed as acting within the scope of his employment, and the employer should be held liable for the tort.

Horn v. Duke Homes, 755 F.2d 599, 605 (7th Cir. 1985); see also LINDEMANN & KADUE, *supra* note 206, at 220-22. This form of imputed liability fits within the first "principle" announced by the *Second Restatement*; it is liability imposed on the employer for the actions of its employees taken within the scope of their employment.

219. See, e.g., *Morgan v. Massachusetts Gen. Hosp.*, 901 F.2d 186, 192 (1st Cir. 1990) (quid pro quo claim fails if alleged harasser did not possess supervisory authority over the victim); *Horn*, 755 F.2d at 605.

220. See *Henson v. City of Dundee*, 682 F.2d 897, 910 (11th Cir. 1982) ("We hold that an employer is strictly liable for the actions of its supervisors that amount to sexual discrimination or sexual harassment resulting in tangible job detriment . . ."); see also LINDEMANN & KADUE,

employer liability for quid pro quo harassment fits the paradigm of the imputed liability exception; the individual supervisor acts within the apparent authority vested in him by his employer, and his actions and intentions are strictly imputed to the employer to form the basis of the employer's liability.²²¹

The precise nature of employer liability for hostile work environment harassment is less clear. Some courts impose hostile work environment liability on an employer on the basis of the same principles applied in quid pro quo cases. They find that a supervisor has the apparent or actual authority to establish working conditions, and they therefore impute his acts of sexual harassment directly to the employer.²²² In these circumstances, liability for hostile work environment harassment should fall within the imputed liability exception. Most courts do not find, however, that supervisors have the authority to create a hostile work environment because most employers at least officially disavow any intent to discriminate. Rather, courts generally find that employer liability for hostile work environment harassment is neither respondeat superior nor vicarious liability nor direct liability stemming from the violation of a nondelegable duty.²²³

Instead, in most hostile work environment cases, the courts impose liability on the employer only if the plaintiff can establish that the employer knew or should have known of the harassing conditions created by its employees and failed to respond appropriately.²²⁴ The standard for imposing this failure to supervise liability on an employer may vary depending upon whether the harasser is a supervisory employee rather than a coworker²²⁵ and upon whether the employer has established an

supra note 206, at 152 ("The discriminatory act is imputed to the employer without regard to whether it knew or should have known of the discrimination or granted actual authority to discriminate."), 221 (stating that the "supervisor's actions are properly imputed to the employer, without regard to whether the employer knew of the supervisor's discriminatory intent or whether the supervisor had actual authority to discriminate on that basis" and that "[c]ourts generally endorse this view [of quid pro quo liability]" and citing cases from every circuit).

221. LINDEMANN & KADUE, *supra* note 206, at 221-22.

222. *Id.* at 229-30.

223. *But see* Meritor Sav. Bank v. Vinson, 477 U.S. 57, 70-71 (1986); *Henson*, 682 F.2d at 905 (interpreting respondeat superior in hostile environment cases to be limited to situations in which the employer "knew or should have known of the harassment . . . and failed to take prompt remedial action"); LINDEMANN & KADUE, *supra* note 206, at 227 ("[S]ome decisions have in fact based employer liability on the doctrine of *respondeat superior* liability, in the scope-of-employment sense, even when the court could have relied on the *sounder ground* of direct employer liability for negligence.") (emphasis added).

224. *See* Robinson v. Jacksonville Shipyards, Inc., 760 F. Supp. 1486, 1517-18 (M.D. Fla. 1991) (describing an employer's efforts, including the promulgation of a sexual harassment policy and grievance procedure, to avoid discrimination liability but concluding that "the policies and procedures . . . for responding to complaints of harassment are inadequate"); LINDEMANN & KADUE, *supra* note 206, at 192 n.160 ("Employer liability is usually a matter of failing to correct harassment.").

225. In cases of hostile work environment by a supervisor, the courts generally apply a "direct liability" standard that turns on employer negligence. LINDEMANN & KADUE, *supra* note 206, at 227. Although some courts have found that supervisors have the authority, or the appar-

effective grievance procedure to respond to employee complaints about harassment.²²⁶ Regardless of the standard applied, however, an employer's "failure to supervise" could reflect either negligence or an intent to discriminate. Employer liability for hostile work environment harassment therefore falls within either the "intended the conduct" or the "negligent failure to prevent wrongdoing" principles from the *Second Restatement*.²²⁷

Employer liability under Title VII for sexual harassment fits the paradigm for the imputed liability and negligent supervision exceptions. In both quid pro quo and hostile work environment cases, an employer's liability reflects the employer's failure to prevent harassment, and in each case the employer's liability can reflect either negli-

ent authority, to create a hostile work environment, other courts find employers liable for supervisor harassment only upon a showing that the employer knew or should have known of the harassing conduct and failed to take measures to remedy the harassment. *Id.* at 223; *see also* Hirschfeld v. New Mexico Corrections Dept., 916 F.2d 572, 577 (10th Cir. 1990) (rejecting the contention that hostile environment harassment could be imposed against an employer on the basis of supervisor conduct taken in the scope of the supervisor's employment and stating that the standard for hostile work environment cases is "employer negligence or recklessness in failing to respond to hostile work environment sexual harassment by employees . . ."). Therefore, employer liability for supervisor harassment "most often stems from a negligent failure to prevent or remedy sexual harassment" rather than respondeat superior, vicarious liability, or "automatic" liability. *See* LINDEMANN & KADUE, *supra* note 206, at 231; *id.* at 220 n.4a (distinguishing, in the context of quid pro quo harassment imputed to an employer, "automatic" imputed liability from "vicarious liability" and "strict" liability, on the grounds that strict liability connotes a lack of fault, while vicarious liability implies the "function of the doctrine of respondeat superior, a doctrine that does not adequately describe an employer's liability for sexual harassment").

The courts also apply a negligence standard in cases of coworker harassment. "The employer is not necessarily liable for co-worker harassment. Rather, the inquiry as to employer liability focuses on whether the employer had actual or constructive notice of the harassment and, if so, whether the employer acted appropriately to control the harassment." *Id.* at 234; *see also* Steele v. Offshore Shipbuilding, Inc., 867 F.2d 1311, 1316 (11th Cir. 1989) (denying liability because the employer took "prompt remedial action"); Bohen v. City of E. Chicago, 799 F.2d 1180, 1189 (7th Cir. 1986) (supporting its finding that the plaintiff had an actionable § 1983 claim against the employer by noting that the employer was aware of the harassment, took only superficial steps to address the problem, and "had no policy against sexual harassment"). The measures taken must be adequate to combat the harassment. *See* Yates v. Avco Corp., 819 F.2d 630, 636 (6th Cir. 1987) (finding that an employer's remedial measures were no defense because they were inadequate). The plaintiff can also prevail in a coworker case by establishing that the employer in fact knew of the harassment and nevertheless permitted it to persist. *See* Katz v. Dole, 709 F.2d 251, 256 (4th Cir. 1983) ("[T]he plaintiff must show that the employer knew or should have known of the harassment, and took no effectual action to correct the situation."); Equal Employment Opportunity Commission Guidelines on Discrimination Because of Sex: Sexual Harassment, 29 C.F.R. § 1604.11(d) (1993) ("With respect to conduct between fellow employees, an employer is responsible for acts of sexual harassment in the workplace where the employer (or its agents or supervisory employees) knows or should have known of the conduct, unless it can show that it took immediate and appropriate corrective action."). Therefore, courts impose liability on the employer for negligence in failing to take corrective actions to remedy harassing conditions or for failing to take effective steps to prevent hostile work environment harassment before it occurs. *See generally* LINDEMANN & KADUE, *supra* note 206, at 233-47 (describing the standard in cases of sexual harassment by coworkers).

226. LINDEMANN & KADUE, *supra* note 206, at 232.

227. *See Hirschfeld*, 916 F.2d at 576-80; RESTATEMENT (SECOND) OF AGENCY §§ 219(1), 219(2)(a) (1957). Generally, courts apply a negligence standard. *See supra* note 223.

gence or an intent to discriminate. Consequently, the only question the court must address in determining whether to enforce coverage for sexual harassment is whether an employer's "involvement" in the harassing conduct of its employees reflects an intent to harass or a mere negligent failure to prevent harassment.²²⁸ In most cases, hostile work environment liability should fall within the negligent supervision exception because "[e]mployer liability for a hostile environment most often stems from a negligent failure to prevent or remedy sexual harassment."²²⁹ Similarly, quid pro quo harassment liability will often fit the imputed liability exception because it is imposed on the employer without regard to the employer's intent to discriminate.²³⁰ Therefore, courts should enforce insurance coverage, under the imputed liability exception, for quid pro quo liability that stems from an employer's negligent failure to screen supervisors prone to discrimination and not from its intent to harass or discriminate. Likewise, to the extent that hostile work environment liability reflects a negligent failure to prevent harassment, courts should enforce insurance that covers such liability under the negligent supervision exception.

B. *Disparate Treatment Discrimination*

An analysis similar to that applied to quid pro quo sexual harassment should apply to employer liability for other forms of intentional employment discrimination.²³¹ Courts applying the public policy exclusion generally refuse to enforce insurance to cover liability for disparate treatment on the grounds that disparate treatment discrimination is intentional, and therefore uninsurable, conduct. Nevertheless, except in cases in which an employer's liability stems from an official policy to discriminate,²³² the rationale for imposing liability on the employer in disparate treatment cases is respondeat

228. See *supra* section I.C.2.

229. LINDEMANN & KADUE, *supra* note 206, at 231; see also *Hirschfeld*, 916 F.2d at 577 (holding that the standard for hostile work environment cases is "employer negligence or recklessness in failing to respond to hostile work environment sexual harassment by employees"); *Robinson v. Jacksonville Shipyards, Inc.*, 760 F. Supp. 1486, 1522 n.7 (M.D. Fla. 1991) (finding that employer liability for hostile work environment harassment "embraces a negligence standard . . . that essentially restates the 'fellow servant' rule").

230. LINDEMANN & KADUE, *supra* note 206, at 152 (noting that an employer's liability is generally considered to be *automatic* in a quid pro quo case); see also *id.* at 220 n.4a (distinguishing between automatic imputed liability and vicarious liability or strict liability).

231. Cf. *id.* at 8 (arguing that the theories of quid pro quo and hostile environment harassment "overlap" and "converge").

232. One could even argue that to the extent that the decision to adopt an official policy has to be made by some individual within the company, the company's liability for that decision should be considered a form of potentially insurable imputed liability. However, any individual sufficiently powerful to make the decision to adopt such an official policy would probably fail this Note's meaningful separation test for applying the imputed liability exception. See *infra* section III.C.1.

superior or strict vicarious liability.²³³ Therefore, just as *quid pro quo* sexual harassment liability should be insurable as long as the basis for employer liability is negligence rather than an intent to discriminate, an employer's disparate treatment liability should be insurable under the imputed liability exception as long as the employer's liability reflects a negligent failure to prevent individual employees from committing intentional acts of discrimination.²³⁴

Most courts that have considered the issue have determined that employer liability under Title VII provides a form of respondeat superior liability that is imputed directly to the employer, regardless of the employer's conduct or intent, as a result of the unauthorized acts of discrimination committed by employees.²³⁵ This view of Title VII liability appears most notably in the debate over whether Title VII affords plaintiffs a cause of action against individual supervisors or board members responsible for an employer's discrimination. Plaintiffs have pointed to section 701(b) of Title VII,²³⁶ which defines "employer" to include both the "employer" itself and the employer's "agents," and they have argued that Congress intended to provide a cause of action against the individual employees who are responsible for an "employer's" discrimination.²³⁷ The courts have split on the issue, with the Ninth Circuit holding that Title VII imposes no individual liability,²³⁸ and the Fifth Circuit holding that Title VII does

233. See *Meritor Sav. Bank v. Vinson*, 477 U.S. 57, 70-71 (1986) ("[T]he courts have consistently held employers liable for the discriminatory discharges of employees by supervisory personnel, whether or not the employer knew, should have known, or approved of the supervisor's action." (citing *Anderson v. Methodist Evangelical Hosp., Inc.*, 464 F.2d 723, 725 (6th Cir. 1972))); *Miller v. Maxwell's Intl. Inc.*, 991 F.2d 583, 587-88 (9th Cir. 1993) (stating that Congress intended to limit Title VII liability to a "respondeat superior principle"), *cert. denied*, 1994 U.S. LEXIS 1424 (Feb. 22, 1994); *Fuchilla v. Layman*, 537 A.2d 652, 663 (N.J.) (Handler, J., concurring) (drawing an analogy to Title VII in a state law employment discrimination case and stating that "the doctrine of *respondeat superior* is an integral part of the protection provided by [Title VII]. Employers are held *strictly* liable for the discriminatory employment decisions of their supervisory personnel." (second emphasis added)), *cert. denied*, 488 U.S. 826 (1988).

234. For these reasons, courts and commentators draw explicit comparisons between *quid pro quo* harassment and disparate treatment or intentional discrimination. See, e.g., *Christoforou v. Ryder Truck Rental, Inc.*, 668 F. Supp. 294, 302 (S.D.N.Y. 1987) (casting a *quid pro quo* case of sexual harassment in terms of the *prima facie* case necessary to make out a Title VII disparate treatment claim under *McDonnell Douglas Corp. v. Green*, 411 U.S. 792 (1973) and *Texas Department of Community Affairs v. Burdine*, 450 U.S. 248 (1981)).

235. See the cases cited *supra* note 233.

236. 42 U.S.C. § 2000e(b) (1988).

237. See, e.g., *Miller*, 991 F.2d at 587-88; *Hamilton v. Rodgers*, 791 F.2d 439, 442-43 (5th Cir. 1986); *LINDEMANN & KADUE*, *supra* note 206, at 514-25; *PERES*, *supra* note 168, at 1-4 (describing attempts to bring actions against individual employees in addition to the action against the employer).

238. *Miller*, 991 F.2d at 588. The Ninth Circuit held that "Congress assessed liability only against an employer under Title VII" and that "individual defendants cannot be held liable for damages under Title VII." 991 F.2d at 587. The plaintiff in *Miller* alleged sex and age discrimination, and, after settling these claims against her corporate employer, she brought similar claims against individual defendants: the CEO of the corporation, several general managers, and a few lower-level employees. 991 F.2d at 584.

afford such a remedy, at least to the extent that the action is brought against the individual in his official capacity as the employer's agent.²³⁹ Both the Ninth and the Fifth Circuit have concluded, however, that Title VII imposes a form of respondeat superior liability in which an employer's liability is ultimately predicated on its failure to prevent employees from engaging in discrimination.

An analysis of the circuit court opinions in these cases provides further support for the contention that employer liability under Title VII is a form of imputed liability that should be insurable under the imputed liability and negligent supervision exceptions. In *Miller v. Maxwell's International Inc.*,²⁴⁰ the Ninth Circuit refused to afford a cause of action against individual supervisors because "[t]here is no reason to stretch the liability of individual employees beyond the respondeat superior principle intended by Congress."²⁴¹ The court also noted that "[n]o employer will allow supervisory or other personnel to violate Title VII when the employer is liable,"²⁴² and that denying a cause of action against individual supervisors "would [not] encourage supervisory personnel to believe that they may violate Title VII with impunity."²⁴³

The Fifth Circuit in *Hamilton v. Rodgers*²⁴⁴ reached a different

239. *Hamilton*, 791 F.2d at 442-43. The Fifth Circuit has limited its holding to individuals acting in their official capacity as agents of their employer, but the logic of these decisions nevertheless supports the interpretation that employer liability under Title VII is a form of imputed liability in which an employer's liability stems ultimately from its failure to supervise its employees properly. See *Harvey v. Blake*, 913 F.2d 226, 227-28 (5th Cir. 1990) (citing *Clanton v. Orleans Parish Sch. Bd.*, 649 F.2d 1084 (5th Cir. 1981), to limit the apparently broad holding in *Hamilton* to liability imposed against supervisors in their official and not their individual capacity). The plaintiff in *Hamilton* claimed that he was subjected to racial harassment in the workplace and that he was fired in retaliation for complaining about the unwelcome working conditions created by that harassment. 791 F.2d at 441. The district court held the employer and the individual supervisors jointly and severally liable for back pay and compensatory damages under Title VII and under 42 U.S.C. §§ 1981, 1983. 791 F.2d at 441. On appeal, the Fifth Circuit affirmed the Title VII claim. Though it "recognize[d] that it is only employers that are subject to statutory liability" under Title VII, the Fifth Circuit found authority to impose liability on the individual supervisors based on the broad definition of "employer" in § 701(b). The Fifth Circuit found, essentially, that the individual supervisors were "employers" under § 701(b) in their own right. 791 F.2d at 442-43. The Fifth Circuit also held, however, that the plaintiff could not sustain a § 1983 action against the employer because the employer had no official policy encouraging racial discrimination and because "the doctrine [of respondeat superior] has no application in an action under 42 U.S.C. § 1983." 791 F.2d at 443 (quoting *Dean v. Gladney*, 621 F.2d 1331, 1336 (5th Cir. 1980), cert. denied, 450 U.S. 983 (1981) (quoting *Jones v. City of Memphis*, 586 F.2d 622, 625 (6th Cir. 1978), cert. denied, 440 U.S. 914 (1979))). Consequently, there could not have been any independent basis for imposing liability on the employer under Title VII. Nevertheless, the court found both the individual employees and the employer responsible for violating Title VII. 791 F.2d at 443. Therefore, the employer's liability had to have been predicated on the acts of discrimination committed by its supervisors, and it had to have been imputed to the employer under an agency theory of liability.

240. 991 F.2d 583 (9th Cir. 1993), cert. denied, U.S. LEXIS 1424 (Feb. 22, 1994).

241. 991 F.2d at 588.

242. 991 F.2d at 588.

243. 991 F.2d at 588.

244. 791 F.2d 439 (5th Cir. 1986).

result but applied a logic similar to that applied by the Ninth Circuit in *Miller*. The court held that an employer is not liable under Title VII unless there is some "predicate" liability against the individual employee responsible for the discrimination.²⁴⁵ As commentators interpreting *Hamilton* have explained:

Corporate liability can result under the doctrine of *respondeat superior* only because an employee of the corporation is directly liable because of that employee's own wrongful conduct Thus, the offending employee must necessarily also be liable as an individual, because individual liability is the predicate for invoking the doctrine of *respondeat superior*.²⁴⁶

Both *Miller* and *Hamilton*, therefore, support the argument that employer liability for intentional employment discrimination is a form of respondeat superior liability that should be insurable under the imputed liability exception.

The Supreme Court's treatment of "subjective hiring criteria" in *Watson v. Fort Worth Bank & Trust*²⁴⁷ provides further illustration. In *Watson*, a black woman who was a bank teller brought a Title VII suit claiming she was denied a promotion on the basis of her race.²⁴⁸ The employer had delegated authority over promotions to its supervisory employees, who repeatedly passed over the plaintiff for promotions.²⁴⁹ The plaintiff claimed that the individual supervisors intentionally discriminated against her, but she claimed that the employer should be liable for *disparate impact* as well as disparate treatment discrimination.²⁵⁰ The plaintiff's disparate impact theory was that the employer had chosen a facially neutral employment practice — delegation of employment decisions to a supervisor — that resulted in the disproportionate exclusion of black and female applicants from promotions.²⁵¹ The Supreme Court approved this theory and held that the use of "subjective hiring criteria" could form the basis of a disparate impact claim under Title VII.²⁵²

The plaintiff in *Watson* therefore pursued her claim under both a disparate impact and a disparate treatment theory. She asserted that the employer's delegation of decisionmaking authority resulted in the disproportionate exclusion of women and minorities from supervisory positions²⁵³ and grounded her claim in a disparate impact analysis.

245. See *supra* note 239.

246. LINDEMANN & KADUE, *supra* note 206, at 517.

247. 487 U.S. 977 (1988).

248. 487 U.S. at 983.

249. 487 U.S. at 982.

250. 487 U.S. at 984.

251. 487 U.S. at 989.

252. 487 U.S. at 989; see also 487 U.S. at 991-99 (plurality opinion) (describing the standard to be applied in these cases).

253. 487 U.S. at 984.

Alternatively, she also asserted that the individual supervisors intentionally discriminated against her by refusing to promote her to a supervisory position and that liability for that intentional discrimination should be imputed to the corporate employer under a disparate treatment theory.²⁵⁴

The facts of *Watson* could argue either for or against the application of the public policy exclusion, depending on their characterization. The employer might have intended for the individual supervisors to discriminate and instructed its supervisors not to promote minorities to managerial positions. The employer also might have intentionally delegated the authority to make employment decisions to supervisors it knew to be prone to discriminate. Under either of these characterizations of the facts, the employer's conduct should be viewed as intentional wrongdoing, and it thus should be uninsurable under the public policy exclusion. On the other hand, the employer might have intended that the hiring practice be *nondiscriminatory* but *failed* to take measures to prevent supervisors from intentionally discriminating. If this were the case, the employer's liability would be better characterized as a form of insurable negligence for failing to screen supervisors who are prone to discriminate. *Watson* therefore illustrates that simply labeling the employer's conduct disparate treatment discrimination does not mean that the employer intended the discrimination to occur.²⁵⁵ An employer could be strictly liable as a matter of respondeat superior or vicarious liability for the unauthorized and illegal disparate treatment discrimination committed by its supervisory employees.²⁵⁶

This reliance on the characterization of liability under Title VII highlights a serious problem with the approach taken by the *Solo Cup* line of cases.²⁵⁷ Under a rigid public policy exclusion like that applied in *Solo Cup*,²⁵⁸ the enforceability of an employer's insurance for Title

254. 487 U.S. at 983-84.

255. Courts have long recognized that employers can be held liable for disparate treatment liability in cases in which they have not intended that the discrimination occur, and even in cases in which the employer made a good faith effort to avoid incurring liability. See Note, *Sexual Harassment and Title VII: The Foundation for the Elimination of Sexual Cooperation as an Employment Condition*, 76 MICH. L. REV. 1007, 1025 & nn.131-34 (1978) (describing the various circumstances in which the courts have held employers responsible for the discriminatory acts of supervisors notwithstanding the employer's efforts to avoid discrimination).

256. By contrast, disparate impact discrimination is not always unintended by the employer because the facially neutral practice of delegating employment decisions to supervisors could reflect an employer's intent to discriminate. Take for example the "disparate impact" cases in which height and weight requirements have been struck down as discriminating against women. See, e.g., *Dothard v. Rawlinson*, 433 U.S. 321, 331-32 (1977). In these cases, it is plausible given the lack of a job-related explanation for the requirement that the "facially neutral" requirement was adopted by an employer in order to exclude women from the positions.

257. See *supra* section II.A.

258. *Solo Cup Co. v. Federal Ins. Co.*, 619 F.2d 1178 (7th Cir.), cert. denied, 449 U.S. 1033 (1980).

VII liability would depend upon the characterization given the cause of action and not upon proof of the employer's intent to discriminate. If the court in *Watson* were to find the bank liable under a disparate impact theory, the bank's liability would be insurable as "unintentional discrimination," regardless of whether the individual supervisors or the bank intended to discriminate.²⁵⁹ By contrast, if the court were to find the bank liable under a disparate treatment theory, the bank's liability would be uninsurable as "intentional" discrimination even if the bank was unaware of its supervisors' discriminatory practices.²⁶⁰

On the other hand, courts applying the imputed liability exception would look to the actual intent and conduct of the employer, not the intent of the individual employees responsible for the liability or the characterization given to the cause of action.²⁶¹ For these courts, application of the public policy exclusion is fact dependent. If the employer directed the discrimination — for instance, if the supervisors in *Watson* were complying with a formal company policy that required them to favor white men when making promotion decisions — then the exceptions obviously would not apply and the courts would refuse to enforce coverage. The courts would recognize the employer's liability as stemming from the employer's own intentional decision to discriminate. On the other hand, if an employer faced imputed liability as a result of a supervisor's unauthorized decision to discriminate, the employer's liability would be insurable under the imputed liability exception, at least to the extent that liability only reflected the employer's negligence.²⁶²

C. A Proposed Approach

The premise of this argument for adopting the imputed liability and negligent supervision exceptions for intentional employment discrimination has been that an employer can act only through employees who act on the employer's behalf,²⁶³ and that these employees can choose to engage in discriminatory conduct that reflects liability upon

259. See 619 F.2d at 1187 ("With respect to the coverage of disparate impact liabilities, there is clearly no basis for voiding or limiting the contract.").

260. See 619 F.2d at 1187 (reserving the question); *Legg Mason Wood Walker v. INA*, 23 Fair Empl. Prac. Cas. (BNA) 778, 782 n.12 (D.D.C. 1980) ("An insurance policy covering intentional discrimination by the insured would likely violate public policy and thus be held unenforceable." (citing *Union Camp Corp. v. Continental Cas. Co.*, 452 F. Supp. 565, 567-68 (S.D. Ga. 1978))).

261. See *supra* sections I.C, II.B; *infra* section III.C.

262. The employer may not be in fact merely negligent in failing to prevent the discrimination, however, and for this reason courts should inquire into the employer's conduct and motivation for failing to prevent the discrimination. See *infra* sections III.C.2, III.C.3.

263. See *Hunter v. Allis-Chalmers Corp.*, 797 F.2d 1417, 1422 (7th Cir. 1986) ("to say that the 'corporation' has committed some wrong . . . simply means that someone at the decision-making level in the corporate hierarchy has committed the wrong").

the employer regardless of whether the employer endorses or ratifies their behavior. Employer liability may be strict liability in the sense that employers are directly liable for a supervisor's intentional discrimination, or in the sense that employer liability stems from the violation of a nondelegable duty. However, employer liability may also reflect an employer's negligence in failing to prevent discrimination rather than in its intent to discriminate. An employer can be held liable absent its own intent to discriminate. Therefore, the pivotal question in determining whether courts should enforce insurance for intentional employment discrimination under the imputed liability and negligent supervision exceptions is whether and to what extent the employer has intended the discrimination to occur. Courts must inquire whether the employer has "participated" in the wrongdoing of its employees.²⁶⁴

Most courts applying the public policy exclusion have not taken a fact-specific approach to the public policy exclusion, and cases other than those dealing directly with insurance for intentional discrimination provide little guidance as to how courts should approach this question of fact. The courts have been unable to define the precise point at which employer involvement in the wrongdoing of its employees becomes intentional wrongdoing within the meaning of the public policy exclusion.²⁶⁵ Some courts have tried to arrive at this distinction by defining a simple standard for determining the degree of employer misconduct required to destroy the exceptions. For instance, some courts have distinguished gross from simple negligence as the standard for enforceability.²⁶⁶ Other courts have reached a similarly rigid, but ultimately unhelpful, standard by distinguishing a willful or reckless failure to supervise from mere negligence.²⁶⁷ In this as in other circumstances, however, the "distinction between intent and negligence obviously is a matter of degree,"²⁶⁸ and simply formulating a verbal

264. See *Beaver v. Country Mut. Ins. Co.*, 420 N.E.2d 1058, 1061 (Ill. App. Ct. 1981) (allowing insurance for imputed liability, but only if "'the employer did not participate in the wrong'" (quoting *Northwestern Natl. Cas. Co. v. McNulty*, 307 F.2d 432, 440 (5th Cir. 1962))); *supra* section I.C.

265. See *supra* sections I.C, I.D.

266. See *Dayton Hudson Corp. v. American Mut. Liab. Ins. Co.*, 621 P.2d 1155, 1161 (Okla. 1980) ("We think the ultimate answer depends in each instance on whether prior knowledge makes the master's negligence 'ordinary' or 'gross.'"). The court in *Dayton Hudson* did not have occasion to apply the distinction, nor did the court provide any guidance as to how other courts should distinguish simple from gross negligence. See 621 P.2d at 1161.

267. See JERRY, *supra* note 21, § 65[f], at 353 ("Where punitive damages are vicariously imposed, the public policies against coverage of punitive damages are much less compelling . . . The employer [may have] no meaningful ability to prevent the conduct of an employee bent on acting in a destructive way. At best, the employer was simply negligent — not reckless or grossly negligent — in failing to supervise the employee.").

268. See KEETON ET AL., *supra* note 47, at 36; see also *McNulty*, 307 F.2d at 444 ("The borderline between willful and wanton injury and injury as the result of simple negligence is often a hairline distinction.").

standard does not provide the courts with any guidance as to how they should approach difficult fact patterns.

The best courts can do in trying to define the scope of the imputed liability and negligent supervision exceptions is to approximate the standard for the public policy exclusion itself. The rationale underlying the public policy exclusion suggests that the validity of an employer's imputed liability insurance should turn on whether the employer's conduct is "a type that will be encouraged by insurance."²⁶⁹ Courts do not apply the public policy exclusion to preclude coverage for negligence, even though insurance creates an incentive for negligent wrongdoing.²⁷⁰ Rather, courts apply the public policy exclusion to void coverage for wrongdoing that is, by some definition, "intentional."²⁷¹ Negligence, therefore, is insurable generally, and it should be insurable under the exceptions as well.

The cases addressing the enforceability of insurance for sexual harassment and the general purpose of the public policy exclusion suggest the following structure for determining whether the exceptions should apply: First, courts should consider whether an employer simply failed to supervise its employees or actually decided to discriminate. In making this determination, courts should inquire whether any meaningful separation exists between the employer and the individual responsible for the discrimination. If there is no meaningful separation — that is, if the employee responsible for the discrimination *is* the employer for the purposes of assessing the impact of insurance coverage on the employer's conduct — then the inquiry should go no further. Courts should apply the public policy exclusion to refuse to enforce coverage for liability stemming from what is essentially the employer's intentional decision to discriminate. If, however, the court finds that there is a meaningful separation between the employer and the responsible employee, and the employer's liability stems from its failure to prevent an employee from discriminating, the courts should inquire into an employer's motivation for permitting the discrimination to occur; they should determine whether the employer *intentionally* rather than *negligently* failed to prevent its employees from discriminating. In conducting this second level of inquiry, courts should first consider whether the employer's failure to prevent the discrimination resulted from an implicit endorsement or authorization of the employee's conduct. They should therefore inquire whether the employer failed to respond to blatant, long-standing, or pervasive patterns of discrimination. Alternatively, courts should consider whether an employer in fact acted in reliance on insurance when it decided to

269. See *Ranger Ins. Co. v. Bal Harbour Club, Inc.*, 549 So. 2d 1005, 1007 (Fla. 1989); see also *supra* notes 48-54 and accompanying text.

270. See *supra* notes 42-47 and accompanying text.

271. See *supra* notes 48-54 and accompanying text.

permit its employees to discriminate — whether an employer has acted with a “calculating intent” to gain from the availability of insurance.²⁷² Below, this section explores this structure and considers each of these factors in turn.

1. *Meaningful Separation*

If the individual responsible for the discrimination is the company's alter ego²⁷³ — that is, if the individual discriminator essentially is the employer — then the rationale for applying the imputed liability and negligent supervision exceptions to enforce coverage for the employer's liability does not apply.²⁷⁴ The reason for inquiring into this meaningful separation is simple. If the “employer” cannot prevent an individual employee or agent from committing intentional acts of discrimination, and if the individual responsible for the discrimination benefits personally from the availability of insurance to cover the company's liability, then the availability of insurance can be expected to promote the individual's intentional discrimination. The public policy exclusion removes the incentive an insured employer may otherwise have to commit intentional wrongdoing by eliminating the potential that the employee might “benefit” from intentionally engaging in insured wrongdoing. The negligent supervision and imputed liability exceptions apply when the interjection of a third party removes the need for courts to impose this disincentive.²⁷⁵ The individual employee who causes an employer to incur imputed liability does not personally benefit from the availability of insurance to cover the employer's liability, and even an insured employer has an incentive to prevent its employees from discriminating.²⁷⁶ If there is no separation between the employer as a distinct entity and the individual responsible for the discrimination — if an individual controls the employer's decision

272. One commentator has suggested that this factor, which he terms the employer's “calculating intent” to gain from insurance, should govern the application of the public policy exclusion in all cases. See Willborn, *supra* note 10, at 1014-18.

273. Courts have applied a similar limitation on the imputed liability exception to prevent the enforcement of insurance in cases in which the individual responsible for the wrongdoing is in fact the alter ego of the corporation. See Sam P. Rynearson, *Exclusion of Expected or Intended Personal Injury or Property Damage Under the Occurrence Definition of the Standard Comprehensive General Liability Policy*, in *THE COMPREHENSIVE GENERAL LIABILITY POLICY* 3, 13-14 (Arthur J. Liederman ed., 1985) (citing cases in which the alter ego or managing agents incurred liability for their intentional wrongdoing and in which the corporation's vicarious liability for this liability was deemed to be intended for the purposes of a contractual exclusion).

274. The court in *McLeod v. Tecorp Intl., Ltd.*, 844 P.2d 925 (Or. Ct. App. 1992), noted that when the issue is the interpretation of coverage under a contractual exclusion, [i]t is the insured's actual conduct, not the imputed conduct of another, that determines coverage. A corporation can be denied coverage because of the intentional acts of a shareholder or officer only when the shareholder or officer so dominates and controls the officers of the corporation that the corporate entity must be disregarded. 844 P.2d at 927 n.3.

275. See *supra* section I.C.

276. See *supra* section I.C.

whether to sanction individuals who discriminate or benefits personally from the availability of insurance — then insurance coverage for the employer's liability resembles personal insurance for an intentional decision to discriminate. Similarly, if the individual responsible for the discrimination benefits financially from the availability of insurance to cover the company's liability, then coverage for the individual's liability resembles coverage for an individual's liability for his own intentional discrimination. The availability of insurance allows this controlling employee to commit intentional discrimination without facing either an internal or external sanction; the controlling employee can discriminate without the threat of any deterrent liability because his investment in the company is protected by insurance and because he knows the company will not impose any internal sanctions against him.

Coit Drapery and *McDaniel* illustrate these limitations on the negligent supervision and imputed liability exceptions. Each case involved harassers who exhibited significant control over the company and who stood to gain personally from the availability of insurance to cover the company's liability.²⁷⁷ In *Coit Drapery*, the individual responsible for the harassment was the corporation's founder, its president, and a major shareholder.²⁷⁸ He benefited personally from the corporation's failure to police his sexual harassment of his employees; he satisfied his urge to harass.²⁷⁹ He also benefited financially from the decision to buy insurance; as a major shareholder, he would have borne the brunt of an uninsured liability judgment. The harassing partner in *McDaniel* was in a similar position. He controlled the partnership's decision to discriminate, both in the sense that he was the one who decided to harass his employees, and in the sense that his significant ownership interest in the business made it unlikely his partner would stop the harassment.²⁸⁰ Like the president in *Coit Drapery*, the harassing partner in *McDaniel* also benefited financially from the decision to buy insurance; the partnership's insurance protected his personal investment in the business. Therefore, in both *Coit Drapery* and *McDaniel*, the responsible individual controlled the employer's decision whether to permit its employees to discriminate, and in each case the availability of insurance provided a financial incentive for the individual to harass his employees.

Coit Drapery and *McDaniel* therefore suggest two factors courts should consider in deciding whether a meaningful separation exists be-

277. See *supra* section II.B.

278. *Coit Drapery Cleaners, Inc. v. Sequoia Ins. Co.*, 18 Cal. Rptr. 2d 692, 695 (Ct. App. 1993).

279. See Willborn, *supra* note 10, at 1015 (suggesting that the decision to discriminate can be motivated by an urge to satisfy a personal predilection for discrimination).

280. The two partners in *McDaniel* were brothers. *Continental Ins. Co. v. McDaniel*, 772 P.2d 6, 7 (Ariz. Ct. App. 1988).

tween the responsible individual and the employer. First, courts should consider the responsible individual's place within the company. If an employee is low in the chain of command, it is unlikely the employee will be able to influence the employer's decision whether to impose sanctions on employees who discriminate.²⁸¹ Therefore, if a low-level supervisor decides to harass one of his subordinates, and the employer fails to respond to that harassment, courts should view the resulting liability as liability for the employer's failure to supervise rather than the employer's decision to discriminate. In contrast, if the individual responsible for the discrimination is a high-level supervisor or a manager, the employer's liability might be recast; the more senior the individual responsible for the discrimination, the more likely it is that individual has the authority to decide to discriminate on the employer's behalf.²⁸²

Coit Drapery and *McDaniel* also suggest a second, more important factor: whether the individual responsible for the discrimination has a significant ownership interest in the company. If the responsible individual has a substantial financial stake in safeguarding the employer from liability — for instance, when the individual is a partner or a major shareholder who bears the company's losses and profits — then the existence of insurance may influence that individual's decision whether to engage in discrimination. In this respect, it is significant that the president in *Coit Drapery* was also a major shareholder,²⁸³ and that the harasser in *McDaniel* was a partner.²⁸⁴ In these cases, the responsible individual was not only insulated from employer supervision by his position of power within the firm, but also faced only one other deterrent — the prospect of reduced profits for the firm as a whole — which was also removed by the availability of insurance. In this situation, there is no reason for the courts to enforce insurance under an imputed liability exception because the rationale for that exception simply does not apply. The situation is indistinguishable from that in which the individual responsible for the discrimination has obtained insurance against his own liability.

281. For instance, if the responsible individual is a low-level foreman, like the line foremen responsible for the discrimination in *Robinson v. Jacksonville Shipyards, Inc.*, 760 F. Supp. 1486 (M.D. Fla. 1991), then the court should presume that the individual does not have the ability to control the employer's decision to discriminate. See 760 F. Supp. at 1527 (describing the standard for imposing "employer liability" in hostile work environment cases and stating: "Because these principles [of employer liability] are so broad . . . they should be applied with an eye toward finding liability only against individuals who exercise effective control in the workplace — those persons who make or contribute meaningfully to employment decisions.").

282. This likelihood would increase, for instance, if the responsible individual owns the business, as did the defendants in both *Coit Drapery* and *McDaniel*. See also Rynearson, *supra* note 273, at 13-14; section II.B.

283. *Coit Drapery Cleaners, Inc. v. Sequoia Ins. Co.*, 18 Cal. Rptr. 2d 692, 695 (Ct. App. 1993).

284. *McDaniel*, 772 P.2d at 7.

2. Evidence of Employer Intent

Courts considering whether to enforce insurance for intentional discrimination liability under the imputed liability or negligent supervision exception should also consider whether the employer intentionally failed to supervise its employees, or whether the employer directed or authorized the discriminatory conduct of its employees. If an employer directed the discrimination, or if the discrimination occurred as a result of the employer's official policy to discriminate, the court should invoke the public policy exclusion and void coverage on the grounds that the employer intentionally discriminated. Similarly, if an employer fails to prevent its employees from discriminating in a way that suggests the employer intended for the discrimination to occur — even if the employer does not expressly direct them to discriminate — the courts should refuse to enforce insurance coverage for the resulting liability.

This proposition is easy to announce but may prove difficult to apply because direct proof of an employer's intentional failure to supervise will be rare.²⁸⁵ Therefore, courts will have to consider circumstantial evidence of the employer's intent to discriminate and decide if this evidence indicates the sort of intentional misconduct that courts have held uninsurable in other contexts. *Coit Drapery* illustrates how courts might make this assessment. In *Coit Drapery*, there was no direct evidence that the board participated in the harassment committed by the company's president, nor was there any direct evidence to suggest that the other members of the board ratified the president's harassment of his employees. The harassing conduct, however, was pervasive, long-standing, and obviously within the knowledge of the other members of the board.²⁸⁶ The president, moreover, had a well-established and well-publicized reputation as a "dirty old man," with a long-standing habit of harassing and even assaulting his female employees.²⁸⁷ Given the board's inexplicable failure to take any action to restrain the president from discrimination, the court inferred that the corporation had ratified or acquiesced in the president's harassing conduct.²⁸⁸ It was reasonable for the court to use this finding of ratification as an approximation of the sort of intentional wrongdoing courts have held uninsurable under the public policy exclusion.

The court may also reasonably infer an employer's intent to discriminate in cases in which employees have repeatedly complained about harassing conditions on the job,²⁸⁹ or in which the employer has

285. Evidence of an employer's intent to discriminate would be entirely within the employer's control, and the "smoking gun" memorandum is rare.

286. See *Coit Drapery*, 18 Cal. Rptr. 2d at 695.

287. 18 Cal. Rptr. 2d at 695.

288. See 18 Cal. Rptr. 2d at 701-02; see also *supra* section II.B.

289. See, e.g., *Robinson v. Jacksonville Shipyards, Inc.*, 760 F. Supp. 1486 (M.D. Fla. 1991)

repeatedly been held liable for discrimination and has done nothing to improve its practices. These considerations might vary depending on the type of discrimination involved. In the sexual harassment context, the court should focus on the employer's indifference to complaints of sexual harassment and on the measures an employer takes to avoid or allay the problem of sexual harassment. If an employer has developed an effective grievance procedure, responded promptly to complaints about sexual harassment, and educated its employees about the importance of avoiding sexual harassment, the courts should be reluctant to conclude that the employer intentionally failed to prevent harassment from occurring. By contrast, if an employer repeatedly ignores complaints about harassing conditions, forgoes training seminars for its employees because they are too expensive, and refuses to adopt an effective grievance procedure, courts should find that the employer intentionally failed to prevent the harassment.²⁹⁰ Courts might also inquire into other measures an employer might have taken to prevent its employees from discriminating depending on the context. For instance, a court inquiring into the employer's participation in *Watson*²⁹¹ might inquire whether the employer took any steps to review the decisions made by its supervisors or issued any specific instructions not to make decisions on the basis of race.

In short, the inquiry should focus on any circumstantial evidence that indicates the employer acquiesced in its employee's decision to discriminate or consciously failed to take measures to safeguard against discrimination. Focusing on these factors, the courts should determine whether an employer intentionally failed to prevent its employees from engaging in discrimination or whether the employer's conduct constituted mere negligence.²⁹²

3. *Insurance as a Cause of the Employer's Conduct*

Because courts invoke the public policy exclusion to void coverage in cases in which one could expect insurance to promote wrongdoing, courts should consider a third factor in limiting the imputed liability exception: the causal connection between the availability of insurance and the prohibited conduct.²⁹³ In this regard, courts should consider

(holding an employer liable for hostile work environment after the employer's supervisors repeatedly ignored, and even patronized, a woman who complained about the hostile work environment).

290. In other words, the court should infer an employer's intent from the employer's conscious ignorance of the discriminatory conduct.

291. See *supra* notes 247-55 and accompanying text.

292. This standard has the beneficial effect of forcing employers that want to obtain liability insurance to institute effective measures to combat discrimination in the workplace because a failure to institute such measures would result in an inference that the employer intended discrimination to occur and in the avoidance of coverage under the public policy exclusion.

293. See Willborn, *supra* note 10, at 1014-15 (suggesting that courts should void coverage under the public policy exclusion in cases in which the insured's wrongdoing can be explained as

whether the existence of insurance has in fact changed an employer's response to the threat of discrimination liability and whether the employer has acted with a calculating intent to gain from its employee's intentional acts of discrimination.²⁹⁴ An insured employer acts with a calculating intent to gain from the availability of insurance if it forgoes preventative measures in reliance on insurance.²⁹⁵ In contrast to "designing intent," which is the sort of "intent to gain from the availability of insurance" that underlies the public policy exclusion in first-party insurance, "calculating intent" is reliance upon insurance as the deciding factor in an insured's decision to commit wrongdoing.²⁹⁶

Like evidence of an employer's intentional failure to supervise, direct evidence of such a calculating intent to discriminate in reliance on insurance would be rare.²⁹⁷ Courts could infer an employer's calculating intent, however, by studying the employer's response to the economic incentives created by insurance. Courts could find that an employer has acted with calculating intent to gain from insurance "when the employer would obtain economic benefits through insurance coverage,"²⁹⁸ or when an employer "discontinue[d] . . . anti-discrimination efforts when it obtains insurance coverage."²⁹⁹

the product of insurance); Anastassiou, *supra* note 10, at 196 ("The test [for the public policy exclusion] is not simply whether the insured acted intentionally or unintentionally, but rather whether he may have been stimulated by the prospect of indemnification.").

294. This standard of "calculating intent to gain" comes from Willborn, *supra* note 10, at 1014-15, 1027-30. Willborn argues that the public policy exclusion should be applied to void coverage in all cases in which an employer's liability for discrimination can be seen as resulting from an employer's "calculated intent." *Id.* An insured acts with "calculating intent" to benefit from insurance when it commits intentional acts of discrimination that it would not have committed but for the availability of insurance. *Id.* The inquiry, therefore, is not whether the employer stands to "gain" from the availability of insurance but whether the insured has bought insurance in order to allow it to satisfy some nonmonetary urge to discriminate. *Id.* at 1015 ("Rather [than intending to 'gain' from the availability of insurance], the employer had other motives, possibly to satisfy a desire for discrimination or to maintain a contented workforce." (footnotes omitted)).

295. *Id.* at 1015.

296. *Id.*

297. *Id.* at 1028 (citing *Herschensohn v. Weisman*, 119 A. 705, 705 (N.H. 1923)).

298. *Id.* Willborn offers the following example of an employer that stands to benefit economically from the availability of insurance:

An employer employing men and women to do equal or comparable work, for example, may decide that women would be willing to work for a lower wage rate than men. In the absence of insurance, the employer may hesitate to lower the wage rate for women employees, because such action would violate the law, and the employer, if prosecuted, would be liable to each woman employee for the difference in pay With insurance the employer may be more likely to lower the wage rate for women employees; by doing so, the employer would reap an immediate economic benefit by paying women less, and if the employer is later found liable for the wage disparity, the insurance would pay the damages.

Id. at 1028-29 (footnotes omitted). Obviously, this sort of "calculating intent" standard, if it were to be applied as the standard by which courts were to determine the validity of insurance for employment discrimination, would void coverage in many cases in which damages were calculated as back pay damages. In adapting this standard for use in limiting the imputed liability exception, courts should require a more direct showing of economic benefit.

299. *Id.* at 1029 (footnotes omitted).

Courts should refuse to enforce insurance to cover an employer's imputed liability if an employer has relied on the availability of insurance to forgo taking measures to prevent its employees from discriminating.³⁰⁰ In this regard, courts should consider whether the employer has undertaken to prevent its employees from discriminating in spite of the availability of insurance to cover its liability, or whether the employer has bought insurance in lieu of taking such measures.³⁰¹ To this end, courts should look to quantifiable measures of an employer's efforts to avoid discrimination. Once an employer obtains insurance it might "discontinue anti-discrimination workshops for its supervisors or repeal an internal grievance procedure designed to handle sexual harassment complaints."³⁰²

The correlation between the decision to forgo preventative measures and the availability of insurance might also be established in other ways — for instance, through the timing of the decision to buy insurance. If an employer did not have a history of discrimination before buying employment discrimination insurance, it might be reasonable to infer that a spate of discrimination cases resulted from the employer's calculated decision to forgo previously adopted measures to avoid discrimination. By contrast, if an employer had a history of discrimination liability before buying insurance but bought insurance as part of a comprehensive risk management plan that effectively reduced the employer's exposure to discrimination liability, courts might make the opposite inference.

D. *Summary*

The above three factors provide a coherent framework within which courts applying the public policy exclusion should consider whether to enforce coverage for intentional employment discrimination liability under the imputed liability and negligent supervision exceptions. Courts should first consider whether an employer simply failed to prevent discrimination or decided to discriminate. If the employer promulgates an official policy to discriminate, or if there is no meaningful separation between the employer and the individual responsible for the intentional discrimination, the court should find that the employer has intentionally decided to discriminate and should refuse to enforce coverage under the exceptions. If, however, the court finds that the employer has been held liable for a failure to prevent

300. *Id.* at 1018 n.82 ("[T]he employer may have acted with calculating intent . . . if the employer because of the protection provided by insurance coverage relaxed its active, anti-discrimination supervision of employees, and that relaxation resulted in the discrimination creating the insured loss.").

301. *See* Anastassiou, *supra* note 10, at 195-96 (suggesting that the insurability of employment discrimination liability should turn on the employer's "good faith efforts" to avoid discriminating).

302. Willborn, *supra* note 10, at 1029 n.147.

discrimination, it should proceed to a second inquiry designed to determine whether the employer intended the discrimination to occur. This second inquiry into employer intent itself has two elements. Courts should determine whether there is any circumstantial evidence that the employer intentionally failed to supervise its employees or whether an employer's intent that the discrimination occur can be inferred from its calculated effort to gain from the availability of insurance.

IV. "EXPRESSIVE" CONCERNS

In keeping with the approach taken by the majority of courts, this Note has argued that the primary reason that courts impose a public policy exclusion to void coverage for intentional employment discrimination is to maintain the deterrent effect of discrimination liability. Therefore, in arguing that courts should modify the public policy exclusion, this Note has focused on purely utilitarian concerns. The question addressed has been whether insurance covering an employer's imputed liability and negligent supervision liability should be declared void as a matter of public policy on the grounds that it would promote discrimination by insured employers. This Note has argued that insurance for these forms of employer liability would not promote wrongdoing, within the meaning of the public policy exclusion, because these forms of liability often reflect an employer's negligence rather than an intent to discriminate. Courts should therefore adopt an exception to the public policy exclusion that permits the enforcement of insurance for some forms of imputed liability and negligent supervision liability for intentional employment discrimination.

Proponents of a rigid public policy exclusion might counter these proposals by arguing that courts should void insurance for intentional employment discrimination, regardless of whether that insurance can be expected to promote wrongdoing, because insurance is inconsistent with the "expressive purpose" behind the antidiscrimination laws.³⁰³ The antidiscrimination laws represent our society's collective expression that discrimination is wrong, and the prohibition against discrimination is animated by a strong desire to stigmatize discrimination.³⁰⁴ Proponents of the public policy exclusion might argue that this stigma

303. See Willborn, *supra* note 10, at 1030 n.156 ("[A]lthough the cases do not discuss it, insurance coverage for employment discrimination liability may be limited in part to express social disapproval of illegal employment discrimination."); cf. Sunstein, *supra* note 171, at 820-24 (arguing that law has an expressive function that may take precedence over its consequences).

304. Though Title VII is largely ineffective at reaching "private prejudice and biases," it is generally accepted that one purpose of Title VII is to "inform[] people that the expression of racist or sexist attitudes in public is unacceptable." *Davis v. Monsanto Chem. Co.*, 858 F.2d 345, 350 (6th Cir. 1988), *cert. denied*, 490 U.S. 1110 (1989). "Thus, Title VII may advance the goal of eliminating prejudices and biases in our society" at large by stigmatizing employers that discriminate and expressing opprobrium at discrimination. 858 F.2d at 350.

would disappear if discriminators could “buy the right to discriminate.”³⁰⁵ According to this argument, courts should void coverage for any employer liability arising out of intentional acts of discrimination by its employees. Courts should refuse to adopt the exceptions, the argument goes, because “society would like to condemn discrimination quite apart from consequentialist arguments” about the tendency of insurance to promote wrongdoing and because insurance casts the injuries caused by discrimination in monetary terms.³⁰⁶

This argument for a public policy exclusion based on expressive rather than utilitarian concerns about the availability of insurance for discrimination could draw on the debate over the validity of child life insurance. Critics of child life insurance decried the availability of that insurance on the grounds that it might promote wrongdoing. They argued, in essence, that child life insurance would create perverse incentives for parents to kill their own children.³⁰⁷ Critics of child life insurance also aimed their barbs at the meaning the insurance expressed about society’s valuation of the lives of children: the condemnation of child life insurance went “beyond the arguments of possible child neglect or murder,” because “it was not the danger of death but the profanation of the child’s life that was at stake.”³⁰⁸ Proponents of the public policy exclusion for employment discrimination insurance could frame a similar argument and claim that insurance “profanes” the victims of discrimination by suggesting that employers can buy the right to cause their injuries. The concern is not utilitarian — whether the availability of insurance would promote discrimination — but expressive — whether the availability of insurance would inappropriately express a willingness to tolerate discrimination.

This argument about the expressive quality of insurance for employment discrimination fails on several grounds. First, the real problem with employment discrimination insurance is not that it allows employers to buy the right to discriminate, but that it allows employers to buy that right at a discount. Unless insurance companies perfectly monitor their policies, an employer bent on discrimination could pay a premium for insurance that is lower than the employer’s expected liability for employment discrimination. This capacity to buy the right to discriminate exists, however, regardless of whether an employer has insurance for employment discrimination liability. Uninsured employers are also perfectly capable of buying the right to discriminate, simply by absorbing the costs of employment discrimination liability or by self-insuring against them. Moreover, liability in-

305. See Sunstein, *supra* note 171, at 850 (“[I]f discriminators could buy the right to discriminate, perhaps discrimination would not be stigmatized in the way we want.”).

306. *Id.*

307. ZELIZER, *supra* note 167, at 117-21.

308. *Id.* at 121.

surance does not itself cause a victim's injuries to be cast in monetary terms. Unlike child life insurance, which would require the calculation of a parent's insurable interest in the life of a child, insurance for discrimination profanes the victims of discrimination only to the extent that their injuries are necessarily calculated as part of a tort recovery.³⁰⁹ Any profanation, therefore, occurs during the calculation of damages rather than in the performance of the insurance contract.

In addition, the argument based on expressive concerns proves too much with respect to the nature of the public policy exclusion. Courts applying the public policy exclusion have not considered expressive concerns, either in their specific application of the exclusion to insurance for discrimination or in their application of the exclusion to other types of insurance.³¹⁰ Thus, for example, courts have applied the public policy exclusion to prohibit coverage only for disparate treatment and not for disparate impact discrimination.³¹¹ This distinction between disparate impact and disparate treatment discrimination cannot be justified on the basis of expressive concerns. Congress passed Title VII to eradicate all forms of discrimination in employment,³¹² and, although Congress in 1991 amended Title VII to afford greater remedies to the victims of intentional discrimination,³¹³ these amendments do not warrant a diminished concern with unintentional discrimination.³¹⁴ Indeed, in 1991 Congress explicitly recognized and codified

309. See generally JERRY, *supra* note 21, § 41.

310. Willborn, *supra* note 10, at 1030 n.156.

311. *Id.* at 1008-09.

312. Price Waterhouse v. Hopkins, 490 U.S. 228, 243 (1989) (plurality opinion of Brennan, J.) (describing "Title VII's goal to eradicate discrimination while preserving workplace efficiency: 'The broad, overriding interest, shared by employer, employee, and consumer, is efficient and trustworthy workmanship assured through fair and racially neutral employment and personnel decisions. . . . [I]t is abundantly clear that Title VII tolerates no racial discrimination, subtle or otherwise.'" (quoting McDonnell Douglas Corp. v. Green, 411 U.S. 792, 801 (1973)) (emphasis added)); H.R. REP. NO. 914, 88th Cong., 2d Sess., pt. 1, at 26 (1963), *reprinted in* 1964 U.S.C.C.A.N. 2355, 2391, 2401 ("The purpose of this title is to eliminate . . . discrimination in employment based on race, color, religion, or national origin." (emphasis added)); see also Albermarle Paper Co. v. Moody, 422 U.S. 405, 417-18 (1975) (noting that the provision of the back pay remedy under Title VII was intended to "'provide the spur or catalyst which causes employers and unions to self-examine and to self-evaluate their employment practices'" (quoting United States v. N.L. Indus., Inc., 479 F.2d 354, 379 (8th Cir. 1973))).

313. See Civil Rights Act of 1991, Pub. L. No. 102-166, sec. 102, § 1977A, 105 Stat. 1071, 1072-74 (codified at 42 U.S.C. § 1981A (Supp. III 1991)) (providing for punitive and compensatory damages in cases of intentional discrimination); H.R. REP. NO. 40, 102d Cong., 1st Sess., pt. 1, at 14 (1991), *reprinted in* 1991 U.S.C.C.A.N. 549, 552 (commenting on the purpose of the 1991 amendments and stating that the amendments were intended to "provide monetary remedies for victims of intentional employment discrimination").

314. Rather, Congress has reaffirmed its commitment to eradicating discrimination in employment. See H.R. REP. NO. 40, 102d Cong., 1st Sess., pt. 1, at 14 (1991), *reprinted in* 1991 U.S.C.C.A.N. 549, 552 (stating that the concern behind the amendments was to increase compensation and deterrence for intentional discrimination and to "respond to the Supreme Court's recent decisions" impairing the ability of plaintiffs to recover in disparate impact cases); H.R. REP. NO. 40, at 23-32, *reprinted in* 1991 U.S.C.C.A.N. at 561-70 (citing the need to overturn *Wards Cove* and other cases "diluting" the standard of business necessity in a disparate impact

the disparate impact theory of recovery.³¹⁵ It would be incongruous, therefore, to distinguish the validity of insurance for intentional employment discrimination from the validity of insurance for unintentional employment discrimination on the basis of the expressive quality of liability for intentional discrimination.

Indeed, this argument based on expressive concerns would require a reformulation of the public policy exclusion itself. Courts have applied the public policy exclusion to other forms of liability insurance in a way that is inconsistent with concerns about the expressive quality of the liability. For instance, in spite of the expressive quality of criminal liability, courts do not necessarily void insurance for civil liability arising out of criminal misconduct,³¹⁶ and several courts have even enforced insurance to cover civil liability for criminal sexual assault.³¹⁷ Society can no more clearly express its condemnation of conduct than by declaring it criminal, and, if the public policy exclusion is to be applied consistently with expressive concerns, courts would have to void insurance for all civil liability arising out of criminal conduct. Even the courts that first developed the public policy exclusion have rejected this expansive approach, however, primarily on the grounds that the penal code does not always precisely reflect the degree of opprobrium society attaches to a particular form of wrongdoing.³¹⁸ No court has shown itself willing to rank the different forms of criminal liability according to their expressive quality, and no court is equipped to undertake a similar ranking for the different forms of civil liability.³¹⁹

CONCLUSION

This Note has sought to clarify the standard by which courts judge

case); H.R. REP. NO. 40, at 47-48, reprinted in 1991 U.S.C.C.A.N. at 585-86 ("Legislation is needed to restore Title VII's comprehensive ban on *all* impermissible considerations of race, color, religion, sex or national origin in employment.").

315. See Civil Rights Act of 1991, Pub. L. No. 102-166, § 105(a), 105 Stat. 1071, 1074 (codified at 42 U.S.C. § 2000e-2(k)(1)(B)(i) (Supp. III 1991)).

316. See 43 AM. JUR. 2D *Insurance* § 260 ("[I]t has long been held that insurance policies providing for indemnity to an insured against the civil consequences of his own willful criminal acts, of injuries to others that he actually intends, are not necessarily violative of public policy."). But see *Haser v. Maryland Cas. Co.*, 53 N.W.2d 508, 512 (N.D. 1952) (refusing to enforce insurance to cover liability arising out of rape).

317. See *supra* note 70 and accompanying text.

318. See *Messersmith v. American Fidelity Co.*, 133 N.E. 432, 433 (N.Y. 1921) (noting that insurance coverage for some forms of wrongdoing should be barred by "the fundamental principle that no one shall be permitted to take advantage of his own wrong," but refusing to apply this principle to preclude coverage for an automobile accident merely because the accident involved the violation of a traffic code).

319. Cf. *First Natl. Bank v. Fidelity & Deposit Co.*, 389 A.2d 359, 365 (Md. 1978) ("[T]he legislature is the normal policy-declaring department of government." (citing 5 SAMUEL WILLISTON & GEORGE J. THOMPSON, A TREATISE ON THE LAW OF CONTRACTS § 1629A, at 4558 n.4 (rev. ed. 1937))).

the validity and enforceability of insurance for intentional employment discrimination. Courts refuse to enforce insurance coverage for liability arising out of the intentional misconduct of the insured on the grounds that the availability of that form of insurance coverage promotes wrongdoing. The rationale behind the public policy exclusion is utilitarian — courts invoke public policy only to refuse enforcement of liability insurance that can be expected to promote wrongdoing, and courts do not refuse enforcement of insurance for negligence because they do not assume that such insurance promotes wrongdoing. Therefore, the public policy exclusion in liability insurance does not reflect a concern with the “expressive” quality of insurance.

Drawing on the utilitarian rationale behind the public policy exclusion, some courts have developed exceptions to the public policy exclusion that permit enforcement of insurance for imputed liability and liability stemming from an employer’s negligent failure to prevent its employees from committing intentional torts. Employer liability for many forms of intentional employment discrimination fits these exceptions. Adopting appropriate limitations that preclude enforcement of coverage for an employer’s intentional decision to discriminate, courts should enforce coverage for an employer’s discrimination liability when that liability stems from the employer’s negligent failure to prevent its employees from engaging in intentional discrimination. To determine whether an employer has merely been negligent in failing to prevent its employees from committing intentional discrimination, courts should ensure that three conditions are met: the court must find that there is a meaningful separation between the employer and the individual responsible for the discrimination, that the employer did not intentionally fail to supervise its employees to prevent them from discriminating, and that the employer did not act with a calculating intent to gain from the availability of insurance in permitting the discrimination to occur. Enforcing coverage in these narrow circumstances is consistent with the concerns that animate the public policy exclusion.