WHOSE EMPLOYEE IS IT? OR DOES IT MATTER? THE BATTLE OVER COVERAGE AND THE EMPLOYER EXCLUSION

Jay Barry Harris is a Shareholder and Hema Patel Mehta is an Associate with Fineman Krekstein & Harris, P.C. Their practice focuses upon insurance coverage litigation, trucking litigation, employment law, premises liability, product liability, construction law and professional liability. Mr. Harris is a former member of the DRI Board of Directors and chair of the Trucking Law Committee and member of the Insurance Law Committee. Mr. Harris is also a member of the International Association of Defense Counsel, Philadelphia Association of Defense Counsel, Pennsylvania Defense Institute, American Board of Trial Advocates and Federation of Defense & Corporate Counsel.

INTRODUCTION

An employers liability exclusion typically excludes coverage for injuries arising out of the employment relationship. A common question courts must resolve is whether the exclusionary clause applies only to employees of the named insured or to employees of additional insureds as well. From 1967 to 2015, Pennsylvania courts held that this exclusion served to bar coverage not only to an insured for claims of bodily injury by its own employees, but also to an additional insured under the same policy, even though it did not employ the injured party. Until recently, the Pennsylvania Supreme Court had not addressed the viability of its rule in light of the clearer, more specific severability clauses appearing in insurance contracts. Last year the Supreme Court of Pennsylvania changed direction on the employers liability exclusion in a commercial general liability policy and effectively overruled its 48 year old decision. In *Mutual Benefit Insurance Company v. Politsopoulos*, the court refused expansive construction of the term "the insured" to be equivalent to "any insured" in an employers liability exclusion.

ARTICLE

Commercial General Liability policies typically contain what is commonly referred to as the "employers liability exclusion" for injuries arising out of the employment relationship. The language of the exclusion generally provides that the policy does not apply to "bodily injury" sustained by an "employee" of the insured arising out of or in the course of employment or while performing duties related to the insured's business, whether the insured may be liable as an employer or in any other capacity.

This exclusion seeks to preclude coverage for injuries "to any employee of the insured arising out of and in the course of their employment by the insured . . ." Some courts interpret this language as excluding all employment-related claims. Other courts, however, rule that this exclusion only bars coverage for employment-related claims that are covered under the applicable state workers' compensation laws.

The basic purpose of the exclusion is to prevent a commercial general liability policy from being converted into an employers liability insurance policy, and to avoid duplication of coverage typically provided by a workers' compensation and/or employers liability policies. Workers' compensation policies provide coverage for the insured's statutory liability under state and federal workers' compensation laws, while employers liability policies are typically broad based and designed to cover defense costs and provide indemnity for virtually any employment based tort liability. Further, employers can secure a third-party coverage endorsement, for example an additional insured endorsement, to expand coverage to protect against legal actions asserted by third parties, such as vendors and/or customers.

The primary issue that courts grapple with in these cases is whether the alleged wrong was sufficiently related to the "employment relationship" to come within the scope of the exclusion. In order for the employers liability exclusion to apply, the claim against the insured must involve bodily injury to an "employee." A common question courts must resolve is whether the exclusionary clause applies only to employees of the named insured or to employees of additional insureds as well. Courts addressing the issue often resort to analyzing the policy's severability clause, which operates to extend coverage "separately to each insured who is seeking coverage or against whom a claim or suit is brought." The severability clause has been construed to impact the meaning of "the insured" in the employers liability exclusion.

A majority of jurisdictions considering the issue, reason that the severability clause's separation of coverage requires the term "the insured" to be read as that insured seeking coverage. Under this interpretation, the exclusion does not apply to bar coverage for an additional insured where the injured claimant was employed by the named insured; that is, the exclusion is triggered only by an employee's claim against his or her insured employer. For example, courts applying New Jersey law limit the employee exclusion to the actual employer only where the exclusion refers to "any employee of *the* insured arising out of and in the course of his employment by the insured . . ." *Michael Carbone, Inc. v. General Accident Ins. Co.*, 937 F. Supp. 413, 418 (E.D. Pa. 1996) (emphasis added) (applying New Jersey law and citing *Maryland Casualty Co. v. New Jersey Manufacturers Casualty Ins. Co.*, 145 A.2d 15 (N.J. 1958) and *Erdo v. Torcon Construction Co.*, 275 N.J. Super. 117, 645 A.2d 806 (App. Div. 1994)). These cases look to the separation of insureds clause in supporting that conclusion.

A minority of jurisdictions, however, read identical provisions and arrived at the opposite conclusion: that "the insured" refers to "any insured." See *Northland Ins. Co. v. Zurich Am. Ins. Co.*, 743 N.W.2d at 150 (S.D.); *Hancock v. Tri-State Ins. Co.*, 858 S.W.2d 152, 154–55 (Ark. Ct. App. 1993) (holding that "the insured" always includes the named insured, even when it is not the insured party seeking coverage); and *Travelers Ins. Co. v. Am. Cas. Co.*, 441 P.2d 177, 180 (Mont. 1968) ("The issue has been around for many years. If the industry intended the construction [that the exclusion could operate to provide more coverage to an additional insured than a named insured] … the addition of two words, 'claiming coverage,' would have made it clear.").

Until recently, Pennsylvania case law took the minority approach in the additional insured context, holding that this exclusion served to bar coverage not only to an insured for claims of bodily injury by its own employees, but also to an additional insured under the same policy, even though it did not employ the injured party. This is so despite the use of the phrase "the insured" (suggesting that the exclusion applies only with respect to bodily injuries suffered by employees of the specific insured whose rights are at issue) as opposed to the phrase "any insured" (which might support a denial of coverage if the claimant were an employee of any party qualifying as an insured under the policy).

There is a line of cases that is seemingly dictated by the Pennsylvania Supreme Court's 40-year-old decision *Pennsylvania Manufacturers' Association Insurance Co. v. Aetna Casualty & Surety Insurance Co.*, 233 A.2d 548 (Pa. 1967) ("PMA"). These cases involved the interaction between the older standard form language of the employers liability exclusion, which excluded "'Bodily Injury' to: (1) An employee of ***the*** insured arising out of and in the course of: (a) Employment by ***the*** insured; or (b) Performing duties related to the conduct of ***the*** insured's business…", (emphases added) and the separation of insureds provision. The critical issue in these cases was that the employers liability exclusion used the language "employee of ***the*** insured." Insureds who were not the actual employer of the injured party argued that the exclusion should not apply to them because they were not the employer and they should be treated distinctly under the separation of insureds clause as a result. In *PMA*, the Court rejected this argument, and found that the language "the insured" covered both employers of the injured parties, as well as non-employer insureds.

Specifically, in *PMA*, PMA insured Harry B. Niehaus, Jr., pursuant to a standard automobile injury liability policy as well as a separate workers' compensation policy. Harry B. Niehaus, Jr. operated a business in which his employees, in the ordinary course of his business, operated vehicles owned by Niehaus. Aetna, in turn, insured Delaware Wool Scouring Company under a comprehensive bodily injury policy.

A Niehaus employee, while acting in the course of his employment, drove a Niehaus truck to the premises of Delaware Valley. A Delaware Valley employee, in the course of unloading the Niehaus truck, negligently operated a forklift, thereby injuring the Niehaus employee. The Neihaus employee sued Delaware Valley. The question the court addressed was whether Delaware Valley was covered by Niehaus' insurance or its own insurance.

Aetna insured Delaware Valley for comprehensive bodily injury liability, however, its policy provided that if Delaware had other insurance against the loss covered by Aetna's policy, the Aetna policy would only provide excess insurance coverage if the loss arose out of the use of any non-owned vehicle.

The PMA policy contained an employee exclusion which provided that the policy did not apply to bodily injury of any employee of the insured. The policy also included a separation of insureds clause which provided that the term "the insured" should be used severally and not collectively.

The parties agreed that the PMA policy would apply unless the employers liability exclusion in the PMA policy excluded coverage for bodily injury to a Niehaus employee. Aetna argued that the term "the insured" in the employers liability exclusion meant the insured claiming coverage, e.g. Delaware Valley. Since the injured party was not an employee of Delaware Valley, the employers liability exclusion in the PMA policy would not apply and, therefore, PMA's policy would apply.

The Pennsylvania Supreme Court rejected Aetna's argument and held PMA's employers liability exclusion was applicable and precluded coverage for Delaware Valley, positing that the term "the insured" was limited to Niehaus, the named insured. Without discussing its meaning and applicability, the state's high court dismissed Delaware Valley's argument that the separation of insureds clause dictated a contrary result; that the clause dictates that an insurance policy be read as if a separate policy were issued to each qualifying insured. Instead, the court substantially based its analysis on the intention of the parties. Specifically, the court concluded that it would be unreasonable for Niehaus to have intended to cover his employee with liability insurance where he had already covered his employees with a workmen's compensation policy. *PMA* concluded that an employers liability exclusion limiting claims brought by an employee of "the" insured applied to every insured, even where an insured did not employ the injured party.

Since issuing *PMA in 1967*, the Pennsylvania Supreme Court had not addressed the viability of that decision until recently. As such, *post-PMA*, federal courts, which are constrained to follow controlling Pennsylvania Supreme Court precedent, criticized but reluctantly followed *PMA* despite the evolution of policy language. *See Brown & Root Braun, Inc. v. Bogan, Inc.*, 54 Fed. Appx. 542; 2002 U.S. App. LEXIS 27347 (3d Cir. 2002), *Brewer v. United States Fire Insurance Co*., 446 Fed. Appx. 506; 2011 U.S. App. LEXIS 20072 (3d Cir. 2011); *Scottsdale Insurance Co. v. City of Easton*, 379 Fed. Appx. 139; 2010 U.S. App. LEXIS 9663 (3d Cir. 2010); *and Markel Insurance Co. v. Young*, 2012 U.S. Dist. LEXIS 81800 (E.D. Pa. 2012). These cases addressed the fundamental question of what "employee of *the* insured" meant, and whether that language can exclude every insured or only the actual employer or named insured as actual employer.

In contrast, state courts routinely distinguish *PMA*. In 1990, a Pennsylvania appellate court in *Luko v. Lloyd's London*, 573 A.2d 1139 (Pa. Super. 1990), distinguished *PMA* when an employee of one named insured brought an action against another named insured on the same insurance policy, and reached the same conclusion as the majority of jurisdictions. *Luko* was decided by the Pennsylvania Superior Court approximately twenty-three years after the *PMA* opinion. In *Luko*, two companies, Independent Pier Company and Independent Terminal Company, were both named insureds under a policy that included an employers liability exclusion. The policy also included a severability clause which provided that "the insurance afforded applies separately to each insured against whom claim is made or suit is brought."

When Luko, an Independent Pier Company employee, sued Independent Terminal Company for an injury he sustained, the insurer argued that it was not obliged to provide coverage to Independent Terminal Company based on the employers liability exclusion.

The trial court rejected this argument, and the Pennsylvania Superior Court affirmed, finding that the policy included a bargained-for endorsement that modified the exclusion. The exclusion stated that the policy does not apply to "bodily injury to any employee of the insured", however, the "persons insured" provision was amended to include any employee of the named insured while acting within the scope of his duties – this provision modified the standard employee exclusion.

Further, the court explained in dicta that even if it had not relied on that endorsement, Independent Terminal Company would still be entitled to coverage based on the severability clause. The language of the severability clause provided that coverage "applies separately to each insured against whom claim is made or suit is brought, except with respect to the limit of the company's liability". Insured was defined as "any person or organization qualifying as an insured" and "the insurance afforded applies separately to each insured against whom claim is made or suit is brought". The court reasoned that because Luko was not an employee of Independent Terminal Company, the severability clause provided coverage for Luko's injury with respect to Independent Terminal Company, the entity against whom Luko sought to collect damages. Therefore, the *Luko* court found coverage for two reasons: (1) the insurance policy was amended to include injured employees of the named insured in the definition of "persons insured"; and (2) the insurance policy contained a severability clause.

Even in the dissenting opinion (concerning an unrelated issue), the dissenting justice agreed with the majority that an insurance policy's severability clause limits the application of the employee exclusion to claims brought by an employee of the insured seeking coverage. While the dissenting opinion noted that "a contrary result was reached under slightly different circumstances" in *PMA,* it also explained that "recent decisions in other jurisdictions, however, have abandoned such a broad interpretation of the word 'insured' and, in reliance upon the severability clause, have held that 'the insured' means the person or entity against whom the claim has been made." The decision of the *Luko* court showed that Pennsylvania state courts realized that *PMA* was outdated and contrary to the majority of jurisdictions.

In *United States Steel Corp. v. National Fire Insurance of Hartford,* 2011 Pa. Dist. & Cnty. Dec. LEXIS 488 (Pa. Ct. Com. Pl., Dec. 28, 2011), employees of an independent contractor, Power Piping, were injured when there was an explosion at the facility. The injured employees sued the owner of the premises, U.S. Steel. National Fire/Continental issued an insurance policy to the independent contractor. The owner, through an endorsement was expressly included as an additional insured on the National Fire/Continental policy. The exclusion provided that coverage for bodily injury to an insured's employee arising out of, and in the course of, employment by the insured was precluded. The policy also contained separation of insureds and severability clauses akin to *Luko*. Specifically, the separation of insureds clause provided that the policy applies "as if each named insured were the only named insured" and "separately to each insured against whom claim is made or suit is brought."

National Fire/Continental argued that *PMA* applied, while the owner argued that *Luko* applied. The court found that *Luko* applied noting that, where there are two named

insureds, it would have been the expectation of each insured that it would be covered if sued for injuries to an employee of the other named insured.

Despite the *Luko* and *U.S. Steel* decisions, the Pennsylvania Supreme Court had not responded to the criticisms leveled by its own Superior Court against *PMA*. From 1967 to 2015, the Pennsylvania Supreme Court had not addressed the viability of its rule in light of the clearer, more specific severability clauses appearing in insurance contracts *post-PMA.*

Last year the Supreme Court of Pennsylvania changed direction on the employers liability exclusion in a commercial general liability policy effectively overruling its 48 year old decision in *PMA*. In *Mutual Benefit Insurance Company v. Politsopoulos*, the court refused to expansively construe the term "the insured" in an employers liability exclusion. In that case, the owners of a commercial real estate building leased space to Leola Restaurant. The lease required that the property owners be named as additional insureds on the restaurant's umbrella liability policy. While the owners were not specifically designated on the declarations page, the policy was designed to extend coverage to entities that Leola agreed in writing to provide insurance coverage.

In December 2007, a restaurant employee fell from an outside set of stairs and was injured. She sued the property owners and the restaurant, alleging they were negligent in maintaining the stairs in an unsafe and dangerous condition. The property owners and the restaurant both sought defense and indemnification from the insurer pursuant to Leola's umbrella commercial liability insurance policy. The insurer denied the request, relying on an employers liability exclusion which excluded coverage for any injury to an employee of the insured arising out of and in the course of employment by the insured. The insurer argued that the policy's broad definition of "insured" encompassed the property owners and that the exclusion therefore applied.

The property owners countered that the exclusion was unclear and ambiguous because it used the term "the insured" as opposed to "any insured" to refer to the particular insured against whom a claim is asserted. They also argued that the separation of insureds provision applied. That separation of insureds provision provided that it applied "separately to each insured against whom claim is made or suit is brought."

The property owners filed a declaratory judgment action and the insurer moved for summary judgment arguing that coverage should be denied based on the employers liability exclusion. The trial court, believing that it was bound by *PMA*, granted the insurer's motion for summary judgment. An appellate panel reversed as to the owners. The appellate court focused on the severability clause, and interpreted it as requiring coverage to be applied as though there were only one insured. The court reasoned that coverage should be evaluated as if the restaurant did not exist, and consequently, "if the person injured is not employed by the lone insured as to whom coverage is to be tested, the employers exclusion simply does not come into play."

An appeal of the appellate court's decision followed. The Supreme Court found *PMA* distinguishable and agreed with the majority of jurisdictions. The court took a narrower view of the employers liability exclusion as it relates to employees of "the insured." The court explained that "a majority of jurisdictions recognize potential

differences in meaning which may be taken from the selective use of definite and indefinite articles in association with the word 'insured' as employed in insurance policy exclusions." "Such potential differences, where recognized by the courts, have been taken to reflect ambiguities, thus requiring construction of salient policy language on the terms most favorable to the insured."

Upon consideration of the decisions in the majority of jurisdictions and the reasoning that they provide, which were not considered in *PMA*, the court declined to extend *PMA's* expansive construction of the term "the insured" to be equivalent to "any insured." Further, the court was "persuaded that, at least where a commercial general liability policy makes varied use of the definite and indefinite articles, this, as a general rule, creates an ambiguity relative to the former, such that 'the insured' may be reasonably taken as signifying the particular insured against whom a claim is asserted." The court stated that the separation of insureds clause only served to reinforce this understanding.

Concerns expressed by the insurer that this decision would result in "double payment" for employees with coverage from an employer's insurer as well as workers' compensation did not sway the court. The court explained that the public policy argument "downplays both the diversity in the interests present and the potential impact of an employer's subrogation rights relative to workers' compensation payments."

The court concluded that the employers liability exclusion in the umbrella policy was ambiguous. The court stated that, by applying governing principles of insurance policy construction, the ambiguous exclusionary language can be read to apply to claims asserted by employees of "the insured" against whom the claim is directed. The court added that this understanding gains further support by reference to the policy's separation of insureds provision. The court concluded that since the owners were not the injured party's employer, the employers liability exclusion was inapplicable.

Further, the court commented on employers liability exclusions that exclude claims brought by the employee of "any" insured, rather than "the" insured. In line with a majority of jurisdictions that apply the rule that a separation of insureds clause does not negate the effect of a plainly worded exclusion, the court indicated that independent of the separation of insureds provision, an exclusion as to the employee of "any" insured will apply to all insureds, whether they are the actual employer or not.

The court's comments are in line with other cases that have interpreted an employee exclusion that stated "any insured" rather than "the insured". For example, in New Jersey, in *Gabriele v. Lyndhurst Residential Cmty., L.L.C.*, 43 A.3d 1169 (N.J. Super. 2012), the New Jersey Superior Court Appellate Division addressed the scope of the phrase "employee of any insured" in a policy. In that case, an employee of the named insured was killed during the course of his work, and an additional insured on the policy sought coverage in the death action. The court observed that, although exclusions are to be narrowly construed if an exclusion is "specific, plain, clear, prominent, and not contrary to public policy," it will be enforced as written. The court observed that standing by itself, the phrase "employee of any insured" is crystal clear. "Any" does not mean "the" insured, it means "any" insured, which, of course, is its ordinary meaning.

Therefore, the plain language of this exclusion would bar coverage for the non-employer insureds absent some other reason not to apply that language.

In light of the clarity in using "any insured" rather than the insured, many insurers have amended their employers liability exclusion to preclude coverage for employees of "any insured" as opposed to "the insured." This distinction is vital. Although the injured party is not an employee of the additional insured, the exclusion precludes coverage for employees of "any insured" and, therefore, there would be no coverage for the additional insured.

In addition, the use of "any insured" provides clarity and meaning to the employers liability exclusion. Specifically, when "the insured" is used in the employers liability exclusion, the separation of insureds clause alters the meaning of the exclusion. An exclusionary reference to "the insured" makes the exclusion applicable only to the insured which is seeking coverage under the policy. An exclusionary reference to "*any* insured," on the other hand, applies the exclusion to any person or organization qualifying as an insured under the policy. That means that, despite the presence in the policy of a separation of insureds provision, an exclusion that applies to "any insured" will be applied as written. Amending "the insured" to "any insured" gives meaning to both the exclusionary clause and the separation of insureds clause.