



OCTOBER 12, 2004

What Do You Know About Your **EPLI** Coverage?

Employment practices liability insurance can play a key role in a risk management scheme.

BY **RAYMOND T. MAK**

A DECADE AGO, most employers faced with employment claims would instinctively react by arranging for their defense through either outside or in-house counsel. Insurance for the defense of employment litigation was virtually unheard of, and although it has become increasingly popular today, there are still many employers that, for different reasons, have not yet embraced it as a tool of risk management philosophy, or do not fully understand the insurance product they have purchased.

For some employers, the cost of such a product, commonly known as employment practices liability insurance, or EPLI, may weigh against its purchase and is seen as a luxury on the balance sheet. Others simply may have an underappreciation or even a lack of understanding of the product. Indeed, even employers that may have already purchased EPLI may not fully understand how the product works, especially, for example, in larger corporations where insurance is purchased and administered by a risk management or human resources department, but claims that are covered by insurance are defended and/or supervised by the law department attorneys.



Raymond T. Mak

With employment claims and jury awards ever increasing,¹ employers would be remiss in not having at least a basic understanding of EPLI in determining whether it fits within their risk management scheme.

What to Have and Why?

Not unlike other insurance policies, an EPLI policy has a variety of provisions and options to consider, ranging from limits of liability, the size of the deductible or self-insured retention, coverage and exclusions, to counsel selection and control of litigation. While these components can vary greatly, all of them relate directly to one key consideration: cost. As with anything else, the more you pay, the more you get.

At the same time, however, another adage comes into play: How much do you realistically need? In order to address this in a meaningful fashion, one must assess an abundance of factors such as the size of the employer, its workforce, its demographics, the geography of employment, employment policies and procedures, and claims experience, the last of which should include frequency and severity. No one factor is determinative or scientific. However, consideration of these elements of risk provides a rational basis in assessing the need and scope of EPLI.

There are many components in an EPLI policy. The following are some of the fundamental ones to be aware of.

Limits of Liability. This is usually defined as a specific amount, set forth in the policy, that the insurer is obligated to pay for a claim during the policy's effective period. It is distinguished from the "aggregate limit," which most EPLI policies also contain, that applies to

all claims during the policy period.

Recognition of this distinction is critical because, almost without exception, the expenditure of defense costs and indemnity is considered "losses" under an EPLI policy and reduces its limits of liability. So, while a policy may cover the loss incurred in a single claim of, for example, \$1 million, the policy will be insufficient to cover other claims if the policy's aggregate limit is that same \$1 million, which has been eroded by the insurer's payout of the covered loss.

EPLI policies typically have aggregate limits that are higher than that provided for a single claim, for example, a \$1 million limit of liability for each claim, but a \$5 million limit in the aggregate during the policy period. Employers that experience frequent employment claims must seriously consider this component of an EPLI policy in light of their claims experience.

"Pure" EPLI policies are those that are stand-alones. In other words, their coverage is independent and exclusive of any other type of claim. They are frequently more expensive, as they not only provide a greater spectrum of coverage of employment claims, but also because their limits of liability apply only to such claims.

This is in contrast to policies such as directors and officers liability (D&O), errors and omissions (E&O), and others that provide employment practices liability coverage merely as an endorsement or extension to the primary intended coverage of other claims. While some advantages to having EPLI coverage as a "combined" component with other claims include its cost effectiveness, consistent defense provisions and ease of program administration, the drawback is the lack of coverage breadth. EPLI endorsements or extensions do not provide as much coverage and have much more severe policy restrictions for employment claims than a stand-alone policy.

Of equal importance, due to the very nature of such a policy's coverage for a combination of

Raymond T. Mak is a partner in the labor and employment practice in the New York office of Epstein Becker & Green, and is responsible for the management of the firm's employment practices liability insurance business. He can be reached at 212-351-4541 or by e-mail at rmak@ebglaw.com

different types of claims, the potential deletion of policy limits is that much greater. The consequence becomes crucial when, for instance, an employer is battling a D&O litigation under which the loss incurred may exhaust the policy's limits of liability and may result in no coverage for the employment claims, or vice versa. Just envision a board of directors meeting where a risk manager has to inform the board that the D&O policy coverage evaporated because there was an EPL class action claim. Thus, it is important that employers consider all the implications of utilizing EPL endorsements or extensions as a substitute for an independent EPLI policy.

Self-Insured Retentions & Coinsurance. Not unlike other types of policies, self-insured retentions or deductibles in EPLI policies are common, excepting only for those underwritten for some nonprofit organizations. Even with those types of employers, the trend indicates increases in the amount or size of the deductible.²

The deductible is obviously a key component of an EPLI policy — not only does the employer bear the obligation of payment up front (unless it is agreed otherwise by the insurer, sometimes in “duty to defend” policies, to advance defense costs), but the deductible applies to each separate claim. There are, although less common, policies containing a single deductible that applies during the entire policy period, regardless of the number of claims tendered.

Employers should also be aware that many policies contain coinsurance obligations. Such provisions would require the employer to pay a portion of both defense and indemnity expenses associated with all claims. This is independent of, and in addition to, the deductible. Depending upon the insurance carrier, the amounts in such coinsurance clauses can vary from 5 to 25 percent. Under some policies, the employer has the option to select the percentage of the coinsurance provision. Not surprisingly, this option is typically reflected in the premium/cost of the policy.

Coverage Trigger — Claims Made Versus Claims Made and Reported Policies. Unlike homeowners and general liability policies under which coverage is occurrence based, EPLI policies are generally written as claims made and reported policies, whereby, in order to obtain coverage, insurers require that a claim be both made against the employer and reported to the insurer during the policy period.

However, most of these “claims made and reported” provisions also contain a reporting “window,” either 30 or 60 days, which preserves coverage if claims made against the insured

during the policy period are reported to the insurer within the specified window period after the policy expires.³ An insurer can disclaim an otherwise covered claim for late notice.⁴ Thus, it is critical for an employer to tender notice (i.e., advice in writing to the carrier) whenever it becomes aware of any facts or circumstances that could lead to a claim.

Other EPLI policies trigger coverage with “pure” claims made provisions. Such policies do not require a specific period during which claims must be reported to the insurer (although they require notice “as soon as practicable”), a mechanism that, for obvious reasons, is preferable to the claims made and reported policies.

Scope of Covered Claims & Exclusions. For purposes of EPLI coverage and exclusions,

◆ **‘P**ure’ EPLI policies are
... stand-alones ... coverage is
independent and exclusive of
any other type of claim. ◆

employment claims can be categorized into three general classifications, those arising pursuant to statutory liability, tort theories, and contract-based claims.

Federal and state statutory liabilities are the sources of claims of:

- discrimination and harassment for protected categories (i.e., race, ethnicity, gender, age, religion, national origin, pregnancy, disability, veteran status, and sexual orientation);
- equal pay and wage and hour claims;
- OSHA claims; and
- claims pursuant to the Family and Medical Leave Act and the National Labor Relations Act.

Employment claims under tort theories include wrongful termination, retaliation, misrepresentation, negligent hiring, supervision, and retention; intentional and negligent infliction of emotional distress; employment-related slander and defamation; invasion of privacy; and interference with contractual relationships.

Finally, contract-based claims include breaches of employment agreements, handbooks, and benefits and compensation plans.

EPLI policies today provide for much greater coverage for employment liability claims than when the product was first introduced to the market some 17 years ago. Undoubtedly, the growth in the EPLI market

can be attributed to enhancements in policy coverage and exclusions.

While they still do not provide for “all-risk” coverage, most policies now include catch-all phrases that eliminate potential disclaimers of coverage, such as, for example, language that specifies “all other protected classes” in the definition of covered discrimination claims, and “other similar state laws” when defining employment claims pursuant to federal law.

Some insurers even offer third-party coverage that protects an employer in connection with claims made by nonemployees, such as customers or employees of vendors. Employers should note that there may be sub-limits to such coverage — a separate limitation on what an insurer will pay for third-party claims.

As is the case with coverage provisions, employers should be aware of a policy's exclusions from coverage. Although recent improvements to coverage implicitly eliminate exclusions contained in “less mature” policies, there are exclusions that are common to almost all EPLI policies.

They include the cost to comply with the accommodation provisions under the Americans with Disabilities Act, WARN Act liability, wage-based claims, workers' compensation and similar laws, severance payments, assault and battery and bodily injury (even if employment-related), and the cost of reinstatement. Coverage for either intentional acts or punitive damages can be prohibited by states (either by regulation or as contrary to public policy).

There are 17 states that prohibit or restrict coverage for punitive damages and/or intentional acts, including New York, California, Florida and Illinois.⁵ Most insurers offer separate coverage to fill in such coverage gaps, either by “most favorable venue” provisions or with an offshore wraparound in a jurisdiction such as Bermuda that does not restrict such coverage.⁶

Consent to Settle. Because EPLI is a risk-transfer mechanism, there is an element of transfer of control as well. Almost all EPLI policies include a provision that requires the insurer's consent to settle employment claims. As a practical matter, when the loss incurred is within a policy's deductible, there is less, if any, concern on the part of the insurer to withhold consent to settle. Conversely, when the claim exposure is near or exceeds the deductible limit, the interests of the employer and the insurer may differ greatly.

Employment claims differ from other types of claims in that factors other than money are at issue. Preservation of employee morale and respect may require spending more to defend a

personnel decision than the employee could recover if she prevailed. Concomitantly, the reinstatement of a former employee as part of a proposed settlement may be, for a variety of reasons, completely at odds with an employer's interests. An employer may also wish to pursue an aggressive defense and reject even nominal settlement terms, if it desires to discourage what it perceives as frivolous, copy-cat, or precedent-setting claims.

On the other hand, an insurer will most likely be unconcerned with such considerations, considered unique to the employer, and may not be willing to fund such battles. Instead, it would view a proposed settlement in purely economical terms in light of the claim's exposure with respect to defense costs and liability.

To protect the insurer against the employer's "litigate at all costs" philosophy, an EPLI policy may contain a "hammer" clause that allows a carrier to limit its claim payment to no more than the amount the claim could have settled for plus defense costs. More recently, in recognition that such provisions cause strain upon the relationship, some policies have been modified to include so-called soft hammer clauses, which share the cost between the insurer and the employer.

Selection of Counsel. The differing interests of the employer and insurer with respect to the control of litigation also come into play in the selection of counsel. An employer may have a long-standing relationship with an employment law firm that knows its business as well as its policies and procedures, and thus would be better equipped and more efficient in handling its employment claims. However, many employers are unaware of their important right to select their own defense counsel to handle claims under their EPLI policies.

Insurance companies prefer to choose their own lawyers from a list of "panel" counsel who, in the insurer's view, are better qualified and/or more cost effective, and who are willing to accept rates that are deeply discounted in exchange for a steady flow of new assignments from the insurer. An insurer's right to select panel counsel is sometimes specifically set forth in the policy. Often, however, an employer learns this for the first time when a request for its own counsel is declined by the insurer.

EPLI policies that are written on a duty-to-defend basis, under which the insurer has the right and duty to defend any covered claim, inherently provide the insurer the right to select counsel. However, an insurer may

give up such a right by separate agreement or a specific endorsement to a policy. Insurers are more likely to make such agreements with larger companies (that presumably retain well-reputed employment defense counsel and that have large policy deductibles). Conversely, there is no such right when the policy is one that is written on an indemnification or "pay on behalf of" basis with the employer retaining the right to select counsel subject to the insurer's consent, which shall not be unreasonably withheld.

Employers should carefully review their policies to determine and understand their counsel selection rights. Ideally, the best time to resolve any issues with the insurer is prior to the policy's underwriting, and certainly before any claim arises.

Ethical & Conflicts Issues. Even when the insurer agrees to the employer's choice of counsel, the employer may be confronted by yet a different issue: Its counsel may be unwilling to accept the insurer's rate structure unless the employer agrees to pay the difference between the insurer's rates and its regular, presumably higher, rates. Moreover, counsel may be unfamiliar with, or unwilling to abide by, the insurer's litigation guidelines, which may require preapprovals of certain litigation strategies and expenses, restrict or limit payment of certain administrative — but deemed necessary by counsel — expenses, and require provision of status, liability assessment, and litigation budget reports on the claim.

Counsel may believe that such requirements are onerous and, in fact, interfere with the ability to exercise independent discretion and professional judgment in properly defending a case. Additionally, counsel may be concerned that the release for review of any required reports or defense bills to the insurer, a third party to a litigation, may constitute a waiver of any recognized privileges.

Finally, conflicts may arise when there are disagreements in the strategy to be used for the defense of a case or where the insurer has agreed to claim coverage only under a reservation of rights. In the latter instance, there would be a legitimate concern that the insurer's primary interest is to deny coverage for a claim, thereby resulting in a conflict with defense counsel's ability to zealously defend all claims against its client, the employer. Indeed, courts have recognized this concern as a legitimate ethical dilemma and fashioned different approaches in response to it.⁷

Conclusion

When used effectively, an EPLI policy can limit the high costs of employment practice claims. It can be a vital part of almost all employers' insurance plans and their overall risk management scheme.

While cost is undoubtedly a factor in the purchase decision, that alone should not be the determining factor in the selection of the various options offered. Employers should be realistic in light of their needs and have a good understanding of the product, regardless of whether they are in the market for its potential purchase or for renewal, or already have a policy in effect.



1. According to the June 2004 report issued by Jury Verdict Research, the median jury award for employment cases increased 18 percent in 2003. The report, *Employment Practices Liability: Jury Awards and Statistics (2004 Edition)*, analyzes jury verdict trends for various employment claims and also provides an analysis of plaintiffs' recovery trends.

2. See Richard S. Betterley, *American Agent & Broker (May 2004)*, at p.251.

3. Most insurance carriers are willing to extend the reporting period for an additional premium.

4. See, e.g., *Specialty Food Sys., Inc. v. Reliance Ins. Co. of Ill.*, No. Civ. A-98-2595 (E.D.La. July 19, 1999).

5. See *Punitive Damages Review (2001)*, self-published by the law firm of Wilson, Elser, Moskowitz, Edelman & Dicker, LLP.

6. Despite a state's public policy prohibition against the insuring of punitive damages, coverage may nonetheless be obtained through the purchase of a "most favored jurisdiction" endorsement to the policy. This endorsement would state that, with respect to the insurability of punitive damages, the law of the jurisdiction most favorable to the insurability of punitive damages will apply, provided it meets one of the following criteria: It is the jurisdiction (1) where punitive damages were awarded; (2) where the act giving rise to the punitive damages award occurred; (3) where the insured is incorporated or maintains its principal place of business; or (4) where the insurer is incorporated or maintains its principal place of business.

7. The most commonly known approach is that taken by the California Court of Appeals in *San Diego Federal Credit Union v. Cumis Ins. Soc'y, Inc.*, 208 Cal. Rptr. 494 (Cal. Ct. App. 1984), where it was held that an insurer is responsible for paying the insured's reasonable costs in hiring independent counsel when the insured and insurer have divergent interests as a result of the insurer's reservation of its rights to deny coverage. This holding has been codified in California law (California Civil Code §2860), and the insured's counsel, who is referred to as "Cumis counsel," is required by statute to meet certain minimum qualifications.

This article is reprinted with permission from the October 12, 2004 edition of the GC NEW YORK. © 2004 ALM Properties, Inc. All rights reserved. Further duplication without permission is prohibited. For information, contact American Lawyer Media, Reprint Department at 800-888-8300 x6111. #099-10-04-0004



EPSTEIN BECKER & GREEN P.C.

OFFICES

Resurgens Plaza
945 East Paces Ferry Road
Suite 2700
Atlanta, GA 30326-1380
TEL: (404) 923-9000
FAX: (404) 923-9099

111 Huntington Avenue
26th Floor
Boston, MA 02199-7610
TEL: (617) 342-4000
FAX: (617) 342-4001

150 North Michigan Avenue
Suite 420
Chicago, IL 60601-7553
TEL: (312) 499-1400
FAX: (312) 845-1998

Lincoln Plaza
500 N. Akard Street
Suite 2700
Dallas, TX 75201-3306
TEL: (214) 397-4300
FAX: (214) 397-0702

Wells Fargo Plaza
1000 Louisiana
Suite 5400
Houston, TX 77002-5013
TEL: (713) 750-3100
FAX: (713) 750-3101

1875 Century Park East
Suite 500
Los Angeles, CA 90067-2506
TEL: (310) 556-8861
FAX: (310) 553-2165

Wachovia Financial Center
200 South Biscayne Boulevard
Suite 2100
Miami, FL 33131
TEL: (305) 982-1520
FAX: (305) 982-1521

Two Gateway Center
12th Floor
Newark, NJ 07102-5003
TEL: (973) 642-1900
FAX: (973) 642-0099

250 Park Avenue
New York, NY 10177-1211
TEL: (212) 351-4500
FAX: (212) 661-0989

One California Street
26th Floor
San Francisco, CA 94111-5427
TEL: (415) 398-3500
FAX: (415) 398-0955

One Landmark Square
Suite 1800
Stamford, CT 06901-2681
TEL: (203) 348-3737
FAX: (203) 324-9291

1227 25th Street, NW
Suite 700
Washington, DC 20037-1175
TEL: (202) 861-0900
FAX: (202) 296-2882