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First Wednesday

By Jeffrey A. Snyder

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Jeff is a Shareholder of Thoits, Love, Hershberger and McLean, specializing in employment law and related litigation.

He can be reached at:
(650) 327-4200 – Phone
(650) 325-5572 – Fax
jsnyder@thoits.com

Employment Law Group:
Jeffrey A. Snyder
Erin L. McDermit
Anne E. Senti-Willis
Stephen C. Gerrish

Managing Risk in a Down Economy Through Employment Practices Liability Insurance (EPLI)

A down economy naturally lends itself to more employee lawsuits. In difficult times, ex-employees, and even current employees, will tend to look backwards for money rather than moving forward with their lives and jobs. One way for employers to manage risk is to purchase employment practices liability insurance, or EPLI. These policies often provide defense and coverage for employment cases.

Whether or not a company should purchase EPLI depends on its risk tolerance and desire to control the defense and settlement of employee-related cases. If negotiated up front with the insurer, employers can buy EPLI and still retain the ability to choose their own counsel for individual cases.

EPLI coverage is relatively new. It came on the scene as a separate type of insurance about 25 years ago. For private companies, EPLI is often sold as a special endorsement to Directors' and Officers' ("D&O") and professional liability policies. Since employment-related practices and claims are not covered by the typical business owner's liability policy, and workers' compensation insurance won't cover civil actions for wrongful termination, harassment, discrimination, etc., EPLI was created to fill this gap. This bulletin will summarize the main issues to consider when evaluating EPLI policies.

The Definition of "Wrongful Act"

An EPLI policy covers a laundry list of "wrongful acts," defined by the policy and typically including discrimination, harassment, wrongful termination, failure-to-hire, constructive discharge and retaliation theories of liability. Typically excluded from coverage are wage disputes and other compensation claims, such as overtime, bonus and contractual severance claims. Claims arising under ERISA, OSHA, WARN and certain other federal and state statutes are often excluded. These are not all-inclusive lists. Before buying the policy, the "wrongful act" triggers of coverage and list of exclusions should be reviewed closely to make certain the employer understands the basic scope of coverage and exclusions. The employer should also review the scope of "defense coverage" to determine when the insurer's duty to defend lawsuits and claims will arise.

Definition of "Insured"

The "insured" definition is very important because if the named insured, or an additional named insured, is not named as a defendant in the lawsuit brought by the employee, then there will be difficulty securing coverage. Each entity within the employer's enterprise should be named in the policy. It is also important that the company's executive officers, directors and employees be included within the definition of "insured," since many employee lawsuits are brought against managers, supervisors, officers and other co-employees in their individual capacities. These individuals will then tender defense to the company who, in turn, will want the EPLI insurer to provide the defense.

Definition of "Employee"

This issue is important because the company will want to secure coverage for lawsuits brought by not only its employees and ex-employees, but also by part-time or temporary employees, and applicants for employment. It may be the case that the employee bringing the suit was "leased" on temporary assignment from an employment agency. The policy definition should also be broad enough to cover lawsuits brought by applicants who never became employees, who may bring "failure-to-hire" cases.

Policy Limits and Deductibles

These amounts are usually listed in the policy's declarations pages, but the fine-print policy conditions and definitions need to be studied to determine how they are applied. For example, many policies will have a $1 million per-claim limit, and possibly $1 million for all claims in the aggregate over a one-year policy period. The deductible, or a "self-insured retention," is the amount the employer will have to pay before the insurance company has to pay anything toward a particular claim. The attorneys' fees paid for defense are often applied toward the deductible and also reduce the policy limits, known as a "burning limits" policy. For example, if the policy limits are $1 million, and the deductible is $50,000, then the first $50,000 in defense fees or settlement, or some combination of both, is paid by the employer, <u>not</u> the insurer. $950,000 is now the policy limit. If another $100,000 is spent toward defense fees, the insurer pays it but the policy limit (available to pay settlements or judgments) is then further reduced.

Settlement Decisions

EPLI policies often provide that the insurer can only agree to a final settlement with the employer's consent. A consent clause is important from an employer's perspective because an employer may want a case vigorously defended instead of settled early, for several good reasons. First, if the employer has insurance coverage to pay its defense costs, and didn't do anything wrong to justify the lawsuit, then it may want to have the case defended to make a valid point affecting its personnel policies in general. Second, employers faced with employment litigation do not want to be seen as a "soft target" by settling cases too readily. If word leaks out about the settlement, then other plaintiffs might come forward with lawsuits. To address the interests of both insurer and employer, the policy often includes a so-called "hammer" clause, so that if the insurer wants to settle a claim but the employer withholds consent, then the insurer's maximum liability will be capped at the amount it was willing to pay in settlement.

Claims-Made Versus Occurrence Policies

Most EPLI policies are written on a claims-made basis. This means that the claim must have been made against the employer during the time of the policy period for there to be any potential for coverage. A "claim" includes not only a filed lawsuit, but also the receipt of a demand letter and sometimes a phone call or e-mail from plaintiff's counsel. Most policies also require that the claim be <u>reported</u> to the insurer during the same policy period. Thus, it is extremely important to report all claims to the insurer immediately upon receiving the claim. Occurrence-based policies are rare in EPLI and are triggered when the occurrence (the action causing the injury) happened, regardless of when the claim is ultimately made.

Coverage for Prior Acts

Some policies that are "claims-made" will also give the employer the option of purchasing "prior acts" coverage. This coverage makes sense for companies that are especially risk-averse or can anticipate the possibility of a filing based on past personnel decisions.

Choice of Counsel

Who gets to choose which defense lawyer will defend the employer in the lawsuit? This is an important issue for

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employers. Most insurance companies have pre-existing relationships with law firms, referred to by the insurers as "panel counsel." Insurance companies prefer to use panel counsel for a variety of reasons, including lower cost (typically), past relationships with adjusters and the lawyer's familiarity with insurance billing and reporting practices. On the other side, employers prefer to have input regarding the choice of counsel, so as to pick someone experienced with the company's managers and unique style of handling cases, and to make sure someone the employer can trust is hired for this important task affecting the employer and its personnel policies. Whenever possible, employers should attempt to negotiate for their choice of counsel at the front end, when purchasing the policy, rather than wait for a claim to be filed. This important detail should not be left for resolution during the crunch time of a lawsuit.

Conclusion

Whether or not a company should buy EPLI coverage depends on many factors unique to each company and industry. As a general rule, when a company approaches 50 employees, it becomes more likely that the company will be exposed to employee-related lawsuits. At 50 employees or more, companies become subject to the Family and Medical Leave Act, California Family Rights Act and sexual harassment training laws. The sheer number of employees make these companies more of a target for lawsuits. Lastly, current economic conditions means that EPLI should be considered now as a risk management strategy.

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JEFFREY A. SNYDER
Thoits, Love, Hershberger & McLean
285 Hamilton Avenue, Suite 300
Palo Alto, California 94301
Telephone: (650) 327-4200
Facsimile: (650) 325-5572
E-mail: jsnyder@thoits.com

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