EPL: UNDERSTANDING THE EXPOSURES AND INSURANCE COVERAGE

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EPL: Understanding the Exposures and Insurance Coverage

Contents

Introduction

This course is designed to give a moderately experienced insurance person a detailed look at (1) the liability exposures that give rise to employment-related claims and (2) the insurance policies that have been developed to cover these exposures.

The first part of the course begins by describing the most important common law (i.e., law based on judicial decisions) exposures to employment litigation and continues by discussing the leading statutory exposures to such claims. Next, the underwriting of employment practices liability (EPL) insurance is analyzed, followed by a description of methods to control employment claims. The first part of the course concludes by examining the various sources of EPL insurance (EPLI) coverage.

The second part of the course takes a detailed look at the specific coverage terms within EPLI policy forms, including covered persons/organizations and covered acts provisions. Next, it discusses third-party liability coverage, along with "damages" and "claim" definitions. Claims management, defense cost, and "special conditions" are also described. The course concludes with an analysis of exclusions and coverage triggers contained within the policies.

- Chapter 1 discusses three of the five most important common law exposures to EPL claims: discrimination, wrongful termination, and sexual harassment.
- Chapter 2 continues with the discussion of common law exposures to EPL claims and examines the other two prominent common law exposures to employment claims: retaliation and inappropriate employment conduct.
- Chapter 3 discusses the statutory liability sources of discrimination claims. The most important statutes include Title VII of the Civil Rights Act of 1964, the Age Discrimination in Employment Act (ADEA) of 1967, the Americans with Disabilities Act (ADA) of 1992, and the Family and Medical leave Act (FMLA) of 1993.
- Chapter 4 explores the key factors that insurers use to price and underwrite EPL coverage, including jurisdiction, industry, number of employees, profitability, mix of exempt/nonexempt employees, and claim history.
- Chapter 5 describes ways to reduce the exposures to EPL claims, including effective hiring, using protective legal documents, reducing risks associated with terminations, correct ways to provide references, and methods of preventing sexual harassment claims.
- Chapter 6 describes the three sources of EPL coverage: (1) stand-alone EPL forms, (2) management liability package policies, and (3) endorsements to businessowners policies (BOPs).
- Chapter 7 begins the course's detailed discussion of EPL policies, examining the covered organizations, covered persons, and covered acts provisions in the policies.
- Chapter 8 analyzes the third-party liability, covered damages, and covered claim definition found in EPL policies.
- Chapter 9 discusses the claims management, defense cost, and special conditions provisions within EPL policies.
- Chapter 10 describes the exclusions contained in EPL policy forms and explains the significance of exception language within these exclusions.

- Chapter 11 analyzes the manner in which an EPL policy's coverage triggers apply. Concepts such as claims first made, retroactive dates, discovery provisions, and extended reporting provisions are discussed.

A glossary, which follows Chapter 11, provides definitions of many terms and acronyms used in this course. Refer to the glossary if you have difficulty understanding any of the terms or remembering what the various acronyms stand for.

Course Objectives

Upon successful completion of this course, you will be able to

- identify five key common law exposures to EPL claims;
- recognize the significance of the various kinds of "inappropriate employment conduct" and how such conduct produces employment-related claims;
- list the most important federal statutes relating to workplace discrimination and recognize the employment-related exposures such statutes create;
- identify the key factors used to price EPLI coverage and recognize the importance of such factors within the underwriting process;
- given relevant case information, identify effective methods of reducing exposures to employment liability claims and recognize how such methods can also lower claim settlement amounts;
- compare the various methods of obtaining EPLI coverage;
- recognize how the covered persons/covered organizations/covered acts provisions function within EPL policies;
- recognize the scope of coverage provided by (a) third-party liability provisions, along with the (b) "claim" and (c) "damages" definitions included within the policies;
- recognize the function of the (a) claims management, (b) defense cost, and (c) special conditions provisions within EPL policies;
- identify the most important exclusions found within EPL policies and recognize the operation and significance of the key "exception" wording commonly found within these exclusions; and
- recognize the major components of the claims-made coverage triggers used to write EPL coverage.

Chapter 1
Common Law EPL Exposures (Part 1)

Overview

Employment liability claims made under common law (i.e., law based on judicial decisions, as opposed to statutes) typically arise from one of the following five broad categories of conduct: (1) discrimination, (2) wrongful termination, (3) sexual harassment (although legally, sexual harassment is a form of discrimination), (4) retaliation, and (5) inappropriate employment conduct (also sometimes referred to as "miscellaneous workplace torts"), a "catchall" term that includes but is not limited to such perils as constructive discharge, invasion of privacy, failure to promote, and defamation.

Chapter 1 discusses the first three of these common law claim sources: discrimination, wrongful termination, and sexual harassment. Chapter 2 examines the latter two common law exposures (retaliation and inappropriate employment conduct).

Chapter Objectives

On completion of this chapter, you should be able to

- recognize the characteristics of discrimination, wrongful termination, and sexual harassment claims and
- identify potential defenses against discrimination, wrongful termination, and sexual harassment claims.

Discrimination

Lawsuits alleging employment-related discrimination can be grouped into one of two broad categories: (a) disparate treatment discrimination claims and (b) disparate impact discrimination claims.

Disparate Treatment Discrimination Claims

Disparate treatment discrimination claims involve illegal, deliberate discrimination against an individual, such as failing to promote an otherwise qualified employee based on race.

Disparate Impact Discrimination Claims

Disparate impact discrimination claims involve seemingly neutral company policies that have the actual effect of discriminating against a certain *class of persons*—rather than against an individual (as is the case with disparate treatment discrimination). For example, if a city required all police officers to be at least 5 feet 10 inches tall, a female applicant might allege that this requirement unfairly discriminated against females because the average woman is considerably shorter than 5 feet 10 inches tall.

A claimant who successfully alleges disparate impact must also demonstrate that, in addition to disproportionally impacting a certain class of persons, the policy must bear little or no relationship to the ability to actually perform the job in question. The example below illustrates this point.

The Policy Must Impact the Ability to Perform the Job: Two Key Examples

A notable example of disparate impact discrimination was the US Supreme Court case of *Griggs v. Duke Power Co.,* 401 U.S. 424 (1971). Here, an employer's requirement that all job applicants have a high school education or pass a standardized intelligence test, while racially neutral, was found to constitute disparate impact discrimination. This was because it had a disproportionately negative impact on minorities and, importantly, was *unrelated* to actual job performance for the positions to which the requirement pertained.

A different result was reached in a more recent case heard by the US Supreme Court in 2009. In *Ricci v. DiStefano* (557 U.S., 129 S. Ct. 2658, 174 L. Ed. 2d 490 (2009)). Here, the court found that a promotional exam, used by the New Haven, Conn. Fire Department to select lieutenants and captains, was not racially discriminatory. This was despite the fact that 22 of the test-takers were African American, yet none scored high enough to qualify for promotion to either type of position. In a 5–4 vote, the court ruled that (1) the exam was job-related and that (2) no equally valid—but less discriminatory—exam existed.

In the first case, Duke Power's requirement that all job applicants have a high school education was held to be discriminatory because a high school education was not relevant to perform many jobs within the company. On the other hand, in the second case, the New Haven Fire Department's exam for lieutenants and captains was not held to be discriminatory, because it did test areas that were important to these jobs.

Exceptions to Laws Barring Disparate Treatment Discrimination

In a small handful of circumstances, courts have allowed employment practices that would otherwise be considered discriminatory under both common and federal employment laws. For example, in a 2012 ruling in the case of *Hosanna-Tabor Evangelical Lutheran Church & Sch. v. EEOC,* 132 S. Ct. 394 (2012), the US Supreme Court held, 9–0, that a church had a right to terminate a lay teacher, despite the fact that the termination violated the Americans with Disabilities Act (ADA), as well as other federal and state laws barring discrimination. By means of the doctrine known as the "ministerial exception" to the ADA, the court ruled that churches have wide latitude in determining which persons they choose to employ and retain, even if otherwise discriminatory practices are used in making such decisions.

Wrongful Termination

Wrongful termination is the act of terminating an employee in a manner that is against the law.

Wrongful termination also encompasses so-called *constructive discharge*. In these situations, the employee retains his or her job. However, the employee's work environment is intentionally made so difficult that he or she is forced to resign to protect his or her financial or physical and emotional well-being (e.g., an employee is forced to work excessive hours in physically unsafe conditions or for substantially less money than he or she was previously earning).

Two key factors have triggered a marked increase in claims alleging wrongful termination: (1) the restructuring of corporate America (i.e., mergers and acquisition in which large-scale layoffs result, especially among employees of the acquired firm) and (2) the erosion of the employment-at-will doctrine.

Corporate Restructuring

Beginning in the 1970s, the large-scale restructuring of corporate America has taken a number of forms, including downsizing (much of which resulted from increased use of automation), outsourcing, mergers and acquisitions, plant closings, and the transfer of manufacturing to non-US locations. In combination, such activities have resulted in substantial elimination of jobs, which, in turn, has produced allegations that employees were wrongfully terminated.

Employment-at-Will Doctrine

Historically, in the absence of a written employment contract, employment relationships in the United States were “at will”—that is, either the employer or employee was free to terminate the employment relationship at any time, for any reason, or for no reason at all. The majority of the states continue to follow the at-will doctrine, although the employment-at-will rule has eroded somewhat due to modern trends in the courts and legislatures that have expanded employees’ rights to sue for wrongful termination.

There are, however, three legal grounds upon which wrongful discharge claims can be made and which can therefore be considered “exceptions” to the employment-at-will doctrine. These legal grounds include (1) violation of public policy, (2) breach of an express or implied contract to discharge only for good cause, and (3) breach of an implied covenant of good faith and fair dealing. These bases are discussed as follows.

Violation of Public Policy

Under this theory, which is recognized in more than two-thirds of all states, an employee can pursue a wrongful discharge claim when his or her discharge affects a public right. Public policy claims often stem from refusal to participate in illegal activities (e.g., padding the cost of services delivered under a government contract), refusal to perform a lawful act (e.g., not consenting to undergo alcohol or drug testing where such refusal is protected by law), reporting employer wrongdoing (e.g., “whistleblowing”), or refusing to perform an act that public policy condemns (e.g., lying under oath).

Breach of an Express or an Implied Contract

An employee allegedly terminated in violation of a contract must be able to prove that (1) the employer and employee had entered into an agreement sufficiently definite and certain regarding the conditions of employment; (2) the employer breached the contract; (3) the employee performed his or her side of the bargain; and (4) the employee has suffered injury as a result of the employer’s breach. (In most breaches, the nature of the alleged injury will be financial. That is, termination caused the ex-employee to lose income; although, in a minority of claims, the alleged injury is damage to the ex-employee’s reputation.) If an employee proves that he or she is entitled to damages under breach of contract, the employee is still obligated to mitigate the potential damages by actively seeking comparable employment.

Even in the absence of a written contract of employment, courts have found non-written employment contracts to exist under certain circumstances. Employment manuals or handbooks have been found to create an implied contract between an employee and the employer in cases where the employer sets out grievance procedures for employees, either before or after termination. For example, in *Toussaint v. Blue Cross & Blue Shield*, 408 Mich. 579 (1980), the Michigan Supreme Court held that, by establishing personnel policies and practices with respect to termination, the employer had created legitimate expectations by its employees that they would not be dismissed without cause. Other factors that a court may look at to find an implied contract for employment include (1) material contained in a job offer letter, (2) outstanding praise of an employee’s work, (3) favorable performance reviews, and (4) length of employment with the company.

Breach of an Implied Covenant of Good Faith

Even in the absence of an implied contract of employment, a handful of states have found that there exists an implied covenant within the employee-employer relationship. This covenant serves to prevent the employer from unjustifiably engaging in conduct that would deny an employee the reasonably anticipated benefits of an employment relationship. An example of such a claim would include one for which there was no basis for terminating an employee, other than to replace the terminated worker with a relative of the supervisor.

Sexual Harassment

Sexual harassment includes a variety of conduct such as unwelcome sexual advances, requests for sexual favors, and verbal, visual, and/or physical conduct of a sexual nature. There are two types of sexual harassment that occur within a workplace context: (1) quid pro quo sexual harassment and (2) hostile environment sexual harassment.

It should also be mentioned that, while sexual harassment is actually a form of discrimination, it has become such a common employment-related cause of action that it is usually considered a separate category unto itself.

Quid Pro Quo Sexual Harassment

Quid pro quo sexual harassment occurs when sexual contact is made a condition of employment, meaning that an employee is required to provide sexual favors in return for keeping a job or receiving certain benefits or privileges. Case in point: A supervisor commits quid pro quo sexual harassment when he or she obtains sexual favors from one of his or her employees in return for a promotion or a raise. If proven, employers are almost always *strictly liable* (i.e., automatically liable, and, thus, the employer would have no valid defense) for quid pro quo sexual harassment.

Hostile Environment Sexual Harassment

Hostile environment sexual harassment, which is far more commonly alleged than quid pro quo sexual harassment, is conduct of a sexual nature that creates an intimidating, hostile, or offensive working environment or impedes an individual's work performance. Comments, threats, jokes, and pictures are frequently the basis on which such claims are made.

Factors in Assessing Whether an Environment Is Hostile

The Equal Employment Opportunity Commission (EEOC) examines the following six factors in assessing whether a working environment is hostile: (1) whether the conduct was verbal or physical or both, (2) the frequency of the conduct, (3) whether the conduct was hostile or potentially offensive, (4) whether the offensive conduct was by a coworker or supervisor, (5) the number of persons involved in the harassment, and (6) whether the harassment was directed at more than one individual.

The following points also characterize sexual harassment liability.

- **A Single Event Can Constitute Hostile Environment Sexual Harassment.** Some courts have held that a single incident, if sufficiently egregious, can create a hostile environment. For example, in *Radtke v. Everett*, 442 Mich. 368, 501 N.W.2d 155 (1993), the Michigan Supreme Court held that a sexual assault created a hostile environment. The case involved a veterinary technician who was in a situation where she was working alone with a veterinarian, who attempted to seduce her in a hospital lounge.
- **Employer Failure to Protect an Employee from Sexual Harassment by a Nonemployee.** One subcategory of hostile environment sexual harassment claims includes those arising from an employer's failure to protect an employee from sexual harassment by a nonemployee. Typically, sexual harassment claims arise when one employee alleges that another employee harassed him or her. However, employees sometimes make claims charging harassment by nonemployee third parties such as customers, clients, vendors, or independent contractors.

  For example, in *Powell v. Las Vegas Hilton Corp.*, 841 F. Supp. 1024 (1992), a casino worker claimed hostile work environment sexual harassment because customers repeatedly told her that she had a "nice body," stared at her, and made suggestive remarks. She *contended*, and the court agreed with her, that her employer was liable because her employer knew of the harassment and failed to promptly take necessary steps to stop it. As a general rule, once an employer has knowledge that an employee is being harassed by one or more third parties, the business has an obligation to put a stop to such harassment and protect the employee. Failure to take such actions—once it is aware of the problem—increases the probability that the employer will be found liable.

- **Employer Liable for Harassment Despite Lack of Knowledge If Adverse Action Occurs.** In June 1998, the US Supreme Court issued an important ruling regarding sexual harassment in *Farragher v. City of Boca Raton,* 524 U.S. 775 (1998). The plaintiff, Beth Ann Farragher, brought a claim asserting that her supervisors had created a sexually hostile atmosphere in which she and other female lifeguards were offensively touched. In addition, Ms. Farragher stated that one of her supervisors said that he would never promote a woman unless she dated him. The ruling in this case established that a company will be held liable for sexually harassing actions taken by its employees—despite the company's lack of awareness of such actions—if these actions result in an "adverse tangible employment action," which, in this case, involved a requirement that the plaintiff date the supervisor to secure a promotion.
- **But, a Defense Is Available under Certain Circumstances.** On the other hand, the court in *Farragher* did indicate that, when no "adverse tangible employment action" has taken place, employers do have a defense to liability if they can show that a well-publicized and effectively implemented sexual harassment policy was in place.

  In effect, *Farragher* indicates that a company will be held liable for sexual harassment if the harassment is accompanied by an "adverse tangible employment action." But, *in the absence* of sexual harassment that includes an adverse employment action, a company does have a valid defense to liability if it can show the existence of an effective and well-publicized sexual harassment policy.
- **No Need to Prove Psychological Harm.** The US Supreme Court held in *Harris v. Forklift Sys., Inc.*, 510 U.S. 17, 114 S. Ct. 367, 126 L. Ed. 2d 295 (1993), that a plaintiff does not have to prove that he or she suffered permanent or long-term psychological harm as a result of harassment to recover damages. Eliminating this requirement greatly increases the chance that a plaintiff will be able to successfully establish a hostile environment sexual harassment claim.
- **Jury Trials and Monetary Recoveries Permitted.** The Civil Rights Act of 1991 amended the Civil Rights Act of 1964, which previously contained significantly fewer remedies for sexual harassment. The Civil Rights Act of 1991 now allows (1) jury trials in hostile environment sexual harassment cases and (2) punitive damages.

An Employer Is Not Strictly Liable for Harassment by Non-Supervisor

In *Vance v. Ball State Univ.*, 133 S. Ct. 23 (2012), by a 5–4 majority, the US Supreme Court found that an employer is not "strictly liable" for the acts of a non-supervisor when an employee asserts a claim for workplace harassment. In contrast, an employer is subject to strict liability when a supervisor harasses an employee.

The court found that since the offending employee did not have the power to "hire, fire, demote, promote, transfer, or discipline" Ms. Vance, she was therefore not Ms. Vance's "supervisor." As a result, unless Ms. Vance could prove that BSU was negligent in preventing the alleged harassment (i.e., that BSU was aware of the ongoing harassment and did nothing to stop it), it was not liable for Ms. Davis's actions.

The issue of whether a business could be held strictly liable for a non-supervisor's conduct was an open question—until this case. Now, as a consequence of this ruling, where a coworker is the harasser, an employer is liable for the harassment *only* if the employer was negligent in not preventing the coworker's offensive behavior. (The court's ruling in *Vance* mirrors the current federal standard that was already applicable in Arkansas, Illinois, Indiana, Iowa, Maine, Massachusetts, Minnesota, Missouri, Nebraska, New Hampshire, North Dakota, Rhode Island, South Dakota, and Wisconsin.)

Affirmative Defenses to Hostile Environment Sexual Harassment Claims

The case of *Madray v. Publix Supermarkets*, 208 F.3d 1290 (2000), established that if an employer has developed, communicated, and enforced a sexual harassment policy but an employee fails to avail him or herself of that policy by not reporting sexual harassment, the company has a valid defense to a hostile environment sexual harassment claim.

Sexual Harassment Policy—by Itself—Not a Defense

The *Madray* ruling does not, however, hold that a comprehensive sexual harassment policy, in itself, is sufficient to defend against all hostile work environment claims. Therefore, employers not only must create, communicate, and enforce sexual harassment policies and procedures but also must *act promptly and appropriately* to investigate all harassment claims. The extent to which an employer takes each of these actions will add to the strength of its defense in any sexual harassment claim.

Superior-Subordinate Sexual Harassment: The Ultimate Taboo

Although allegations of sexual harassment can arise in any relationship, a business is especially susceptible to claims when these allegations result from a superior-subordinate relationship. Serious liability exposure is more likely to arise when office romances involve a *disparate power relationship*.

Sexual Harassment Claims Alleging "Favoritism"

Office relationships have also been the source of claims alleging a hostile work environment based on the assertion that a person who is romantically involved with a superior will receive *unduly favorable treatment* relative to his or her peers and coworkers. Accordingly, these kinds of circumstances have been the source of so-called favoritism claims.

Costs Associated with Sexual Harassment Claims

The law firm of Littler Mendelson, P.C., and Employment Law Learning Technologies conducted a study in which they developed a list of both "hard" (i.e., quantifiable) and "soft" (i.e., nonquantifiable) costs associated with sexual harassment claims. These costs are outlined in Exhibit 1.1.

Exhibit 1.1
Sexual Harassment Claims Costs

Hard Costs

- Attorneys' fees, settlement costs, or jury awards (if the case is not settled)

Soft Costs

- Employee distraction and reduced morale
- Management time expended in the claim resolution process
- Employee time expended in the claim resolution process
- Employee time spent investigating the claim
- Employee time spent preparing for trial
- Increased future insurance premiums
- Increased future insurance deductibles/retentions
- Lowered stock price and damage to corporate reputation
- Potential of copycat lawsuits due to internal and external publicity
- Increased difficulty in attracting top employees given negative publicity

Chapter 1 Review Questions

1. Although Joe Boss insists he treats all employees equally, Carmen Ghia believes Joe routinely assigns the most challenging and rewarding assignments to her coworkers, all of whom are male. Carmen's discrimination claim against Joe probably alleges

    A. conscious bias.

    B. desperate impact.

    C. disparate impact.

    D. disparate treatment

2. According to the traditional employment-at-will doctrine, the owner of PM Cafe may do any of the following, except

    A. hire only waitresses with long hair.

    B. terminate cooks for any reason.

    C. terminate cooks without stating a reason.

    D. terminate waiters at any time.

3. Because employees are never given a written contract of employment, Chart Pie Company's management believes it can fire employees without facing breach-of-contract claims. Despite the absence of written employment contracts of employment, the courts may find an implied contract of employment in any of the following, except

    A. Chart Pie's employee handbook.

    B. favorable performance reviews.

    C. a job offer letter from Chart Pie.

    D. Social Security's normal retirement age.

4. Knowing that Prudence is easily offended by sexual innuendos of any kind, her coworkers take great delight in repeating off-color jokes in her presence. What kind of sexual harassment does Prudence face?

    A. Destructive discharge

    B. Hostile environment

    C. Quid pro quo

    D. Violation of public policy

5. Meredith Tan, an intern, brought a sexual harassment claim against Tacoma Grace Hospital alleging that continuous sexual activity among her colleagues creates a hostile environment. Which of the following is a sufficient defense against this claim?

    A. Tacoma Grace has a comprehensive sexual harassment policy.

    B. Tacoma Grace recently discharged a doctor who inappropriately touched a patient.

    C. Tacoma Grace's comprehensive sexual harassment policy is clearly communicated and enforced.

    D. Tacoma Grace's comprehensive sexual harassment policy is clearly communicated and enforced, and all sexual harassment claims are promptly and appropriately investigated.

Answers to Chapter 1 Review Questions

1.

   A. This answer is incorrect. Joe does not seem to be aware of any bias.

   B. This answer is incorrect. The information given does not suggest that Joe is acting out of desperation.

   C. This answer is incorrect. In assigning jobs, Joe does not have a specific criterion that affects women more than men.

   D. That's correct! Carmen apparently believes Joe deliberately slights her because of her gender.

2.

   A. That's correct! The employment-at-will doctrine deals with termination practices, not hiring practices.

   B. This answer is incorrect. Under the employment-at-will doctrine, employers are free to terminate an employee's employment for any reason.

   C. This answer is incorrect. It is not necessary to give a reason for firing someone.

   D. This answer is incorrect. Employees can be laid off or fired at any time.

3.

   A. This answer is incorrect. The handbook might establish policies and practices that imply employees will not be dismissed without cause.

   B. This answer is incorrect. A favorable performance review may be taken as an implied agreement to continue one's employment.

   C. This answer is incorrect. A job offer letter may imply employment security.

   D. That's correct! The right to Social Security benefits from the government has no bearing on an individual employer's agreement with its employees.

4.

   A. This answer is incorrect. Destructive discharge is not a type of sexual harassment.

   B. That's correct! Hostile environment sexual harassment, which may include jokes of a sexual nature, is conduct of a sexual nature that creates an offensive working environment.

   C. This answer is incorrect. Quid pro quo harassment occurs when sexual consent is made a condition of employment, and that is not the case here.

   D. This answer is incorrect. Public policy claims, more common in wrongful termination claims, typically stem from refusal to participate in illegal activities.

5.

   A. This answer is incorrect. Merely having a policy is not a sufficient defense.

   B. This answer is incorrect. One anecdote does not qualify as a defense.

   C. This answer is incorrect. These are steps in the right direction, but an additional element will bolster Tacoma Grace's defense.

   D. That's correct! Employers not only must create, communicate, and enforce sexual harassment policies and procedures but also must act promptly and appropriately to investigate all harassment claims.

Chapter 2
Common Law EPL Exposures (Part 2)

Overview

Chapter 2 discusses the two additional common law claim sources of employment-related claims: retaliation and inappropriate employment conduct.

Chapter Objectives

On completion of this chapter, you should be able to

- recognize the characteristics of retaliation and inappropriate employment conduct claims and
- identify potential defenses against retaliation and inappropriate employment conduct claims.

Retaliation

The number of employment-related claims alleging retaliation has exploded over time. Such claims usually consist of two distinct parts. The first part of the claim will allege that an employee was discriminated against based on a protected status, such as race, gender, or disability. The second portion of the claim will assert that, *in retaliation for making such a claim*, the employee was treated adversely. For example, after receiving a poor performance review, an employee is demoted. Following the demotion, she makes a claim alleging that the demotion was based on racial discrimination. Shortly after the claim is filed, the employee is retaliated against by being actively “shunned” by her boss and co-workers.

One especially problematic aspect of retaliation claims is that they can remain viable even after a court rejects the first portion of the employee’s complaint alleging discrimination or another “standard” employment practices allegation. Thus, in the example above, a court could rule that there was no discrimination on the basis of race in making the decision to demote the employee but that the “shunning” *did* constitute retaliation for having made the discrimination claim.

Retaliation can also occur under a variety of other circumstances, such as an employee being retaliated against for making a workers compensation claim, whistleblowing, or criticizing management.

Elements of a Retaliation Claim

A successful claim of retaliation must prove three elements: (1) that the employee engaged in a protected activity; (2) that the employee suffered an adverse action; and (3) that there was a causal connection between the adverse action and the protected activity.

Protected Activities

Examples of protected activities include alleging employment discrimination; opposing employment discrimination; threatening to file a formal complaint concerning illegal corporate practices; requesting a religious or disability accommodation; or making a complaint to a manager, union official, or newspaper reporter about discrimination against oneself or others.

Adverse Actions

Examples of obvious types of adverse actions include denial of a promotion, refusal to hire, demotion, suspension, and discharge. Other examples of adverse action include threats, reprimands, negative evaluations, harassment, and change in hours. Adverse actions are not limited to situations in which a person is currently employed by a given organization. In addition, adverse actions can take place *after* an individual is no longer with a company. Examples of post-employment retaliation include giving an unjustified negative job reference, refusing to provide a job reference, or informing an individual's prospective employer about the individual's protected activity (e.g., having made a complaint to a manager).

Causal Connection

To establish a causal connection between the protected activity and the adverse action, an employee may, for example, provide evidence that the day after she testified against her employer in a racial discrimination case, she received a demotion and was transferred to a new location.

Important Court Decisions on Retaliation Claims

Exhibit 2.1 lists a number of important court decisions addressing whether a specific employer action constitutes retaliation. Based on these and numerous other state and federal courts' rulings, it becomes apparent that what, exactly, constitutes retaliation often comes down to a close analysis of case-specific facts. Indeed, retaliation for legal purposes is often difficult to determine.

Exhibit 2.1
What Constitutes Retaliation? Key Court Decisions

Issue and Court Ruling	Case Citation
Negative Performance Review Does Not Constitute Retaliation Absent Some Harm to the Employee	*Lloyd v. Swifty Transp., Inc.*, 552 F.3d 594 (7th Cir. 2009)
Counseling "Write-Ups" Do Not Constitute Retaliation Absent Some Harm to the Employee	*Ludwig v. Rochester Psychiatric Center*, 550 F. Supp. 2d 394 (W.D.N.Y. 2008)
Written "Performance Plan" Found to Constitute Retaliation	*Michael v. Caterpillar Fin. Servs.*, 496 F.3d 584 (6th Cir. 2007)
But "Close Monitoring" and Related "Fault-Seeking" Actions *Do Not* Constitute Retaliation	*Hall v. FMR Corp.*, 559 F. Supp. 2d 120 (D. Mass. 2009)
Transfers with No Changes in Pay or Benefits *May* Constitute Retaliation	*Patterson v. Indiana Newspapers, Inc.*, 589 F.3d 357 (7th Cir. Dec. 8, 2009)

"Whistleblower" Claims

Retaliation claims can also be brought independently by people who are not in a protected category, based on an assertion that the person was penalized for complaining of or opposing certain employer actions (e.g., billing practices on a government contract), refusing to engage in illegal or unethical conduct, or exposing such conduct via testimony at a trial or administrative hearing. Such claims are a subcategory of retaliation claims and are sometimes called "whistleblower" claims.

Inappropriate Workplace Conduct

In some instances, work-related claims are made that do not allege discrimination, wrongful termination, sexual harassment, or retaliation.

Claims alleging inappropriate workplace conduct sometimes produce even larger damages awards and settlements than do claims of wrongful termination, discrimination, sexual harassment, or retaliation. This is because compensation is not merely based on the plaintiff's loss of salary (as is the case with these four types of claims) but also on the extent of personal injury resulting from the inappropriate conduct, usually including emotional distress damages, which in some claims is alleged to have caused actual physical injury, such as a heart attack or a stroke. Additionally, in some states, punitive damages can be awarded for successful claims of inappropriate workplace conduct.

Exhibit 2.2 provides a listing of the most common allegations that constitute inappropriate workplace conduct. They are discussed in more detail in the pages that follow.

Exhibit 2.2
Representative Inappropriate Workplace Conduct

- Unlawful requests for social media access
- Defamation
- Invasion of privacy
- Fraud, misrepresentation
- Negligence
- Intentional/negligent infliction of emotional distress
- Bullying
- Breach of an employment contract
- Coercion
- Wrongful failure to employ
- Wrongful failure to promote
- Wrongful discipline
- Wrongful deprivation of a career opportunity
- Wrongful failure to grant tenure
- Wrongful failure to grant a partnership
- Negligent evaluation

The term "miscellaneous workplace torts" is also sometimes used as a synonym for the variety of acts referred to as "inappropriate workplace conduct."

Unlawful Employer Requests for Social Media Access

Corresponding with the rise of social media, a number of employers have asked both employees and job applicants for their Facebook passwords. For example, in April 2012, a teacher's aide in Michigan was suspended after refusing to provide access to her Facebook account following complaints over a picture she posted.

As reported in "Six States Outlaw Employer Snooping on Facebook," an article by Dara Kerr that appeared in *CNET News* on January 2, 2013, six states have passed laws barring requests for social media passwords. These states include California, Delaware, Illinois, Maryland, Michigan, and New Jersey. Numerous cases have been brought before the National Labor Relations Board involving employer workplace policies pertaining to social media. Courts and legislatures will increasingly dictate and clarify the extent to which employers have a right to access or monitor employees' social media activity or to limit employees' speech on social media.

Defamation

Defamation, which is an untrue statement about a person, can be written (libel) or oral (slander). A defamatory statement must be communicated to a third person to give rise to a claim. A statement (written or oral) made by one person to another does not constitute defamation unless at least one other person becomes aware of the statement.

Defamation claims most commonly arise during disputes following employee terminations. In this situation, the employee will allege that his or her professional reputation was damaged as a result of false comments made to colleagues by supervisors or managers following the termination.

Defamation claims also arise when the former employer is asked to give a reference about the ex-employee, and the former employer provides derogatory information. (It is therefore recommended that employers only provide objective reference information that confirms the employer's wage rate, dates of employment, and job requirements.)

Less common are defamation claims that result when an employee is demoted or sanctioned in some other way on the basis of a false accusation by another employee. (While it should be recognized that truth can be a defense to defamation claims, even true statements or information, if disclosed with malicious intent, can be valid grounds for a defamation claim.)

Invasion of Privacy

A number of situations produce invasion of privacy claims. These include (a) intrusion into non-work-related personal affairs; (b) intrusion into employee electronic communications; (c) divulging of private information; (d) unreasonable search of personal property/premises; and (e) negligent release of financial, identity-related data.

Intrusion into Non-Work-Related Personal Affairs

An employee can recover damages if an employer unreasonably intrudes into his or her personal affairs or when his or her termination is based on lawful conduct that occurred away from the workplace and had nothing to do with the employment itself. An employer could, however, legally terminate an employee for a felony conviction if it could show that the conduct producing that conviction was related to the nature of the employee's job. For example, a school could likely terminate a teacher who was convicted of indecency with a minor but not necessarily if the conviction was for writing a bad check.

Intrusion into Employee Electronic Communications

In *City of Ontario v. Quon*, 130 S. Ct. 2619 (2010), a SWAT officer in Ontario, California, sued the city for invading his privacy by reading personal e-mail messages on his city-issued pager. Many of the messages were sent and received during work hours. The plaintiff brought suit, despite having received the city's "Computer Usage, Internet and E-Mail Policy" that gave the city "… the right to monitor and log all network activity including e-mail and Internet use, with or without notice. Users should have no expectation of privacy or confidentiality when using these resources."

By an 8–1 majority, the US Supreme Court ruled that the City of Ontario had a valid justification for searching Mr. Quon's messages and had not violated his privacy. However, the court declined to offer any specific guidelines as to what, exactly, constitutes a violation of an employee's privacy as regards electronic communications.

Divulging of Private Information

Invasion of privacy claims can also arise if an employer divulges information concerning the employee to third parties, even though the information is true. For example, employers may be found liable for providing information contained in an employee's personnel file, medical records, or drug or polygraph test results.

Unreasonable Search of Personal Property/Premises

Other claims can involve unreasonable searches of an employee's possessions or places where the employee had a reasonable expectation of privacy. Such claims arise if the intrusion would be highly offensive to a "reasonable person." In one case, an employer searched an employee's locker, which was secured with a personal lock. The search was held to constitute an invasion of privacy because the employer did not maintain a policy allowing access to the employees' lockers.

Negligent Release of Financial, Identity-Related Data

One of the least considered sources of the data needed to commit identity theft is records kept by corporate human resources (HR) departments. The misuse of such information creates a significant exposure for employers because victimized employees can claim that their privacy was violated and/or that the employer committed a breach of confidentiality in allowing such information to be accessible and subsequently misused. Liability for invasions of employee privacy may also apply in situations where confidential employee data are obtained by electronic hacking. This is especially true in situations where it can be proven that the employer's failure to take reasonable preventive measures was the direct cause of the privacy breach.

Fraud/Misrepresentation

An employer may incur liability for unfounded promises made in forming the employment relationship.

When Fraud/Misrepresentation Occurs

A misrepresentation claim typically arises in two cases: (1) when an employee is rejected for a position with a new employer based on misrepresentations made by his or her current employer during the reference checking process and (2) when an employee changes employers based on the misrepresentations made by a prospective employer, thereby leaving an otherwise advantageous position.

How Fraud/Misrepresentation Occurs

Promises made during hiring negotiations may form the basis for a fraud or misrepresentation claim. To prevail under this cause of action, the employee must prove that (1) the employer made a false representation to the employee, (2) the employer knew that the representation was false or had the means or duty to know that it was false, and (3) the employee justifiably relied on the misrepresentations to his or her detriment. In addition, as noted above, fraud/misrepresentation may occur when statements or promises (e.g., a specific salary increase or promotion) are made to an existing employee as an inducement to remain with an organization, when, in fact the employer did not intend to honor such promises.

Negligence

Negligence is now a common claim type in the employment arena. Workplace-related negligence claims (as is true of all negligence claims) are based on the following four elements: (1) a duty owed, (2) a breach of that duty, and (3) damages (4) directly caused by a breach of that duty. For instance, if an employer steadfastly refuses to provide an employee with protective equipment and the employee is injured as a direct result of such refusal, the employee (in certain states) would have a valid claim of negligence against the employer, because the employer breached a common law duty to provide a safe workplace and the employee was injured as a result.

Negligent Hiring, Training, or Supervision

Negligence claims often seek to impose liability on an employer for wrongful acts of supervisors or other employees, alleging that the employer negligently hired, trained, or supervised an employee. Several negligent hiring cases have held that employers have an affirmative duty to investigate an applicant's employment history to determine whether there is any reason not to hire the applicant. These suits have usually arisen following incidents of violence or harassment, wherein the injured employee maintains that the employer knew—or should have known—that another employee had a history of violence or sexual harassment in the workplace but failed to protect the other employees.

Negligent Retention

Negligent retention cases arise when an employer fails to discharge an employee who management knew or should have known had a propensity toward violence or sexual harassment, and that employee causes injury to another person.

Intentional or Negligent Infliction of Emotional Distress

Allegations of intentional infliction of emotional distress are difficult to prove, because most states require the plaintiff to show extreme and outrageous conduct on the part of the employer. States vary, however, on what constitutes "outrageous conduct," so employers should avoid any unnecessary behavior that would humiliate or embarrass an employee.

Bullying

Bullying is considered to involve one person harassing another and is characterized by a pattern of deliberate, hurtful, and menacing behaviors repeated over time. It can have the two following aspects.

> *Physical*—making intimidating physical threats, pushing, shoving, invading an individual's personal space
>
> *Psychological*—psychological violence that is mostly covert, including joking or initiation rites that may mask sadistic behavior

Other examples of bullying include the following.

- Staring or glaring in a hostile manner
- Treating another in a rude, demeaning, or disrespectful manner
- Interfering with or sabotaging work activities
- Shunning or otherwise giving someone the "silent treatment"
- Failing to give or giving little professional feedback on performance
- Withholding of critical information necessary for work performance
- Lying or misrepresentation regarding workplace assignments, events, or opportunities
- Preventing or impeding an individual from expressing himself or herself

Breach of an Employment Contract

Employee allegations that an employer has breached the terms of an employment agreement are of two basic types.

Breach of a Written Employment Contract

Claims asserting breach of a written contract are generally triggered by an employee's termination, in which it is alleged that (a) the terms of the contract prohibit termination without cause and (b) the employee's termination was without sufficient cause. Such contracts are almost always for a specific number of years, and compensation for that period is specifically indicated.

As will be noted in the coverage section of this course, virtually no EPL policies cover damages associated with written employment contracts, and only a handful cover defense costs involving assertions that an employer breached a written employment contract.

Breach of an Implied Employment Contract

Claims asserting breach of an implied contract of employment usually assert that a contract was established by an offer letter, statements in an employee handbook, statements made by a manager/supervisor (often during an annual review), or as a result of an employee's tenure with a company.

As will be noted in the coverage section of this course, most but not all EPL policies cover damages associated with implied employment contracts, and virtually all cover defense costs involving such claims.

Coercion

Claims alleging coercion are those in which an employer attempts to force an employee to engage in knowingly illegal conduct. For example, this might involve a demand that an employee provide testimony in a court of law that the employee knows to be false. Or coercion could take the form of pressuring an employee into intentional overbilling on a government contract.

Wrongful Failure to Employ

Such claims (which are also sometimes combined with discrimination claims) allege that an employer refused to hire an applicant who is qualified to perform a specific job.

Wrongful Failure to Promote

Claims alleging wrongful failure to promote (which, again, are often combined with discrimination claims) assert that a qualified employee was denied a promotion.

Wrongful Discipline

Claims of wrongful discipline assert either that (1) an employee was disciplined for an infraction that did not occur or, (2) if the employee did commit the infraction, that the discipline meted out for the infraction was excessive.

Wrongful Deprivation of a Career Opportunity

Claims alleging wrongful deprivation of a career opportunity most often involve a failure to provide specific types of training that will advance an employee's career. For example, if a first-line supervisor is not permitted to enroll in a course for managers, this could give rise to such a claim.

Wrongful Failure to Grant Tenure

Wrongful failure to grant tenure claims are typically made in college or university settings, whereby a professor claims to have been denied tenure, despite having met all of the requirements for tenure.

Wrongful Failure to Grant a Partnership

A similar type of allegation may be made against law, accounting, or other professional firms, in which a claimant asserts that he/she was wrongfully denied a partnership, despite having met all of the qualifications required for such a position. (Note that coverage for failure to make partner under EPLI policies, especially those written to cover professional firms, is not always included within such policy forms and must therefore be added by endorsement if required.)

Negligent Evaluation

Negligent evaluation claims assert that an employee's performance evaluation was excessively negative and therefore did not reflect the employee's actual level of performance.

Chapter 2 Review Questions

1. Boomerang Corporation has just learned that it must respond to a two-part claim by a disgruntled employee alleging both discrimination and retaliation. The retaliation portion of the claim may allege

   A. discrimination on the basis of the employee's disability.

   B. discrimination on the basis of the employee's race.

   C. that the employee was penalized for making the discrimination claim.

   D. that the employee was penalized for working too hard.

2. Winnie's employer tried to retaliate against Winnie after she formally complained about workplace conditions. Which of the following actions does not constitute an obvious adverse action on the employer's part?

   A. Assigning Winnie to the undesirable overnight shift

   B. Giving an unjustifiably negative job reference to her prospective employer after Winnie quit and attempted to find another job

   C. Offering confidential psychiatric counseling at the employer's expense as an employee benefit

   D. Reprimanding Winnie in front of her coworkers

3. Unhappy with the environment at Employer A's Minnesota home office, Rich accepted Employer B's offer for a better-paying job in Texas. Upon receiving his resignation, Employer A assured Rich it would match Employer B's pay offer and permit him to continue his current job by telecommuting from Texas. Rich accepted Employer A's offer and moved to Texas. Six months later, Employer A downsized and fired him. For Rich's subsequent fraud or misrepresentation claim against Employer A to prevail, he must demonstrate all the following, except:

   A. Employer A's representations were false.

   B. Employer A intended to honor its promises to Rich.

   C. Employer A knew or should have known that its representations were false.

   D. Rich justifiably relied on Employer A's representations to his detriment.

4. Most EPL policies cover

   A. breach of a written employment contract but not breach of an implied employment contract.

   B. breach of an implied employment contract but not breach of a written employment contract.

   C. breach of neither written nor implied employment contracts.

   D. breach of both written and implied employment contracts.

5. As soon as the notice went up on the company bulletin board, Kramer mailed his registration for an advanced-skills class, offered by his employer, that would qualify Kramer for a higher position. The employer rejected Kramer's registration, stating that the class was already filled to capacity by others in his department who had registered by e-mail. Kramer's claim against the employer will most likely assert

    A. breach of an employment contract.

    B. coercion.

    C. negligent training.

    D. wrongful deprivation of a career opportunity.

Answers to Chapter 2 Review Questions

1.
   - A. This answer is incorrect. This is part of the discrimination claim.
   - B. This answer is incorrect. Racial discrimination would be part of the discrimination claim.
   - C. That's correct! Retaliation claims often allege adverse treatment for making a discrimination claim.
   - D. This answer is incorrect. This allegation would be part of the discrimination claim.
2.
   - A. This answer is incorrect. A change in hours can be an obvious type of adverse action.
   - B. This answer is incorrect. This is an example of post-employment retaliation.
   - C. That's correct! The confidential counseling offer presumably represents a positive attempt to address some types of employee issues.
   - D. This answer is incorrect. A reprimand, especially if it is public, is an obvious adverse action.
3.
   - A. This answer is incorrect. To prevail, the employee must prove that the employer's representations were false.
   - B. That's correct! Fraud or misrepresentation occurs when the employer has no intention of honoring its promises.
   - C. This answer is incorrect. Rich must be able to prove that the employer knew its representations were false when they were made.
   - D. This answer is incorrect. Rich must be able to show that he was harmed by relying on the promise that he could keep his job and telecommute from Texas.
4.
   - A. This answer is incorrect. Relevant contracts need not be in writing.
   - B. That's correct! Most EPL policies cover damages and defense costs associated with implied employment contracts.
   - C. This answer is incorrect. Breach of employment contracts is covered.
   - D. This answer is incorrect. Coverage does not apply to breach of written contracts.
5.
   - A. This answer is incorrect. Since this training opportunity was optional, access does not appear to be a contractual right.
   - B. This answer is incorrect. There is no evidence of coercion.
   - C. This answer is incorrect. Since Kramer's training had not yet started, he could hardly suggest that the training itself was negligent.
   - D. That's correct! Claims alleging wrongful deprivation of a career opportunity often involve not permitting an employee to enroll in training that will advance the employee's career.

Chapter 3
Statutory Law EPL Exposures

Overview

Chapter 3 examines the key statutes that form the basis for a substantial number of employment-related claims.

Chapter Objectives

On completion of this chapter, you should be able to

- identify key statutes that form the basis for many employment-related claims;
- recognize the protections provided to employees by various statutes; and
- given case information, determine the likely outcome of an EPL claim.

In the United States, a great deal of employment-related litigation is brought under the federal statutes enacted to protect against discriminatory acts in the workplace, most significantly Title VII of the Civil Rights Act of 1964 (amended by the Civil Rights Act of 1991), the Americans with Disabilities Act (ADA), and the Age Discrimination in Employment Act (ADEA). Allegations under these acts are often coupled with numerous individual state civil rights laws.

A majority of states have also passed legislation similar to these federal laws. But for the sake of simplicity, this chapter will focus on the federal statutes. The most important ones, noted below in Exhibit 3.1, are discussed in the pages that follow.

Exhibit 3.1
Federal Statutes Relating to Workplace Discrimination

- The Fair Labor Standards Act (FLSA) of 1938
- The Equal Pay Act of 1963
- Title VII of the Civil Rights Act of 1964
- Age Discrimination in Employment Act (ADEA) of 1967)
- The Pregnancy Discrimination Act (PDA) of 1978
- The Worker Adjustment and Retraining Notification (WARN) Act of 1988
- The Civil Rights Act of 1871 (as amended by the Civil Rights Act of 1991)
- Americans with Disabilities Act (ADA) of 1992
- Americans with Disabilities Act Amendments Act of 2008 (ADAAA)
- The Family and Medical Leave Act (FMLA) of 1993
- The Uniformed Services Employment and Reemployment Rights Act (USERRA) of 1994
- The Genetic Information Nondiscrimination Act (GINA) of 2008

The Fair Labor Standards Act of 1938

The FLSA requires most employers in the United States to comply with minimum wage and hour standards. Often, comparable state laws apply requirements that are even more stringent. The FLSA's basic requirements (1) govern the payment of overtime wages for nonexempt employees (i.e., employees eligible for overtime pay) working more than 40 hours per workweek, (2) specify employment limitations for children, and (3) mandate record keeping by employers.

The two types of claims made under the FLSA are

- misclassification claims and
- pay practices claims.

Both types of claims are referred to as "wage and hour" claims.

Misclassification Claims

The FLSA established two broad classifications of employees, as follows.

- **Exempt employees:** those ineligible for and, thus, "exempt" from receiving overtime pay
- **Nonexempt employees:** those not exempt from and, thus, eligible to receive overtime pay

Misclassification claims center around one central question: whether an employer wrongly failed to pay overtime because the employer mistakenly classified an employee as "exempt" and thus erroneously considered the employee ineligible to receive overtime pay under the FLSA.

Exempt versus Nonexempt Employees

To be exempt from eligibility for overtime pay, employees must meet certain tests regarding job duties and responsibilities. They must also be compensated "on a salary basis" at not less than stated amounts (according to individual state laws). Such tests, however, are highly confusing, and even workers paid on a salary basis can sometimes be eligible for overtime pay. Generally, salaried workers in managerial positions who earn more than the current federal threshold of $23,660 are exempt from receiving overtime pay. The Obama administration attempted to raise the threshold to $47,476 effective December 1, 2016, but a federal judge blocked its implementation just before it was to take effect. As of this writing, the Labor Department is appealing the injunction.

In addition, the following five categories of employees are "exempt" from receiving overtime pay.

1. Executives
2. Administrative personnel
3. Professionals
4. Computer-related employees
5. Outside sales employees

A detailed explanation of these classifications is beyond the scope of this course. To obtain such an explanation, go to the US Department of Labor's website at https://www.dol.gov.

Pay Practices Claims

One of the most pervasive misconceptions regarding wage and hour claims is that they are solely confined to “failure to pay overtime“ situations based on “exempt” versus “nonexempt” misclassification errors (as explained above). In fact, there are numerous additional causes of wage and hour claims, which are termed “pay practices claims.” Exhibit 3.2 provides examples of these claims.

Exhibit 3.2
Types of Pay Practices Claims

- **Misclassifying employees as independent contractors** and not paying them overtime (since independent contractors are ineligible for overtime pay)
- **Not properly paying employees for overtime:** not paying compensation for hours worked in excess of 8 hours in a given day (the California standard, for example) or more than 40 hours in a week
- **Miscalculating the amount of wages owed:** applying the wrong rate, improperly/inaccurately crediting tips
- **Allowing employees to work “off the clock”:** not paying for time spent for opening tasks or closing duties, before and after the official workday, or for time spent donning/doffing uniforms or equipment, or for attending seminars
- **Not allowing employees to take meal or rest breaks.** Notably, some state laws require an unpaid, 30-minute, uninterrupted meal period whenever the employee works 5 or more hours (with a second meal period for workdays of 10 hours or longer). Such laws also mandate a paid 10-minute rest period for each 4 hours of work.
- **Not paying employees on a timely basis:** such as when an employer falls far behind in paying wages earned and thus owed
- **Not paying all wages due and owing at the time of termination.** These delays could result in “waiting time” penalties so that the employee’s wages continue to accrue each day he or she is paid late—up to 30 additional days.
- **Docking exempt employees’ salaries for absences**

Source: “What Are You Doing To Protect Your Company Against Wage and Hour Lawsuits?“ by Katherine S. Catlos, Esq., *Employment Practices Liability Consultant*, Winter 2008, International Risk Management Institute, Inc. **http://www.irmi.com/online/eplic/ch000010/2008wint/08win030.aspx#jd_what_are_you_doing_to_protect_your_company_against_wage_and_hour_lawsuits**

“Working off the Clock”: For What Duties Must Employees Be Paid?

One issue that frequently arises in conjunction with pay practices claims is the question whether employers are required to pay workers for tasks that do not directly involve their actual job functions and yet are undeniably related to the nature of their work.

The case of *Integrity Staffing Solutions, Inc. v. Busk,* 135 S. Ct. 513 (U.S. 2014), which was decided by the US Supreme Court in December 2014, examined the question of whether Integrity Staffing, a contractor for Amazon that supplied workers who fulfilled orders at Amazon’s warehouses, was required to pay those workers for the time they spent waiting in line to go through security screenings before going home. Because workers were sometimes required to wait for as long as 25 minutes, counsel for the workers argued that they should be paid for such time. The US Supreme Court did not agree. Justice Clarence Thomas, writing for the Court’s 9–0 majority, noted that “The screenings were not an intrinsic element of retrieving products from warehouse shelves or packaging them for shipment,” which was the essence of the workers’ jobs.

Despite the holding in this case, the question of whether an employer is required to pay its employees for activities not directly related to but nevertheless involving their work remains a situation/fact-based, rather than a rule-based, issue.

In short, the problem for businesses created by wage and hour exposures is twofold. First, the provisions of the federal (FLSA) wage and hour law are extremely complex. Second, individual state variations on federal law make it even more difficult to comply with the maze of regulations that may be applicable in any given situation.

Independent Contractor or Employee?

Another type of pay practice claim may arise when an employer classifies its workers as independent contractors rather than employees. This “gig economy,” or “1099 economy,” named for the tax forms that independent contractors file in place of the W-2, has risen to prominence across many industries, with statistics from the US Department of Labor’s Wage and Hour Division showing that 10 percent to 30 percent of employers may misclassify their workers as a result of their jobs being structured in this way.

When workers are classified as employees rather than independent contractors, additional costs for employers may include (a) income taxes, (b) Social Security and Medicare taxes, (c) unemployment taxes, (d) workers compensation, and (e) employee benefits, among others. Additionally, an employer may be able to pass maintenance, insurance, gas, and other “upkeep” expenses on to workers that are classified as independent contractors rather than employees.

When determining what makes a worker an employee or an independent contractor, the degree of control and independence between the employer and worker is a crucial factor. Different state and federal agencies have different tests to determine this, but a webinar from Strafford broke the control and independence factor into three general divisions: (1) behavioral control, (2) financial control, and (3) relationship of parties.

Court cases involving Uber, Lyft, FedEx, and Instacart have all demonstrated how growth of the 1099 economy will give rise to increasing numbers of misclassification allegations.

The High Cost of Wage and Hour Claims

Two key points should be recognized with regard to wage and hour claims.

First, they are, from a pure dollar standpoint, the costliest of all types of employment-related claims. According to the Seyfarth Shaw Annual Workplace Class Action Litigation Report (2016 Edition), the monetary value of the top 10 private plaintiff wage and hour class action settlements entered into or paid in 2015 was $463.6 million, a significant increase from the top 10 settlements in 2014, which totaled $215 million, and in 2013, which totaled $248.45 million.

Second, coverage for wage and hour claims is excluded by standard EPLI policy forms. A handful of such policies do offer defense-only coverage for wage and hour claims but only at relatively small limits ($100,000 to $250,000) and on a sublimited basis. Several insurers have begun writing wage and hour indemnity coverage, but they require high self-insured retentions, with $250,000 representing the lowest self-insured retention available and $1 million the most common figure required by the small group of insurers that write wage and hour indemnity coverage. (The topic of coverage for wage and hour claims is addressed in more detail in Chapter 8 of this course.)

The Equal Pay Act of 1963

The Equal Pay Act prohibits pay discrimination against employees because of their gender. The Act compels businesses to pay equal wages to employees performing “substantially equal jobs,” regardless of the sex of the individual employees. “Substantially equal jobs” means jobs that require equal skill, effort, and responsibility and that are performed under similar working conditions. Pay differentials may be based on merit, seniority, or any lawful factor other than sex.

Equal Pay Act Application

The Equal Pay Act applies to all businesses regardless of the number of workers they employ.

Damages Recoverable under Equal Pay Act

The Equal Pay Act provides for the recovery of the difference in pay, back pay, attorneys' fees, and costs, had there not been a violation of the Act. If the court finds that the employer's conduct was willful, it may double the damages award, unless the employer demonstrates that it acted in a sincere and reasonable belief that its conduct was lawful. Also, awards generally are limited to 2 years' back pay, but if the court determines that the violation was willful, then the back pay award may be extended to 3 years.

Title VII of the Civil Rights Act of 1964

Title VII of the Civil Rights Act of 1964, which was amended by the Civil Rights Act of 1991, prohibits discrimination by private sector employers. The Civil Rights Act of 1991 broadened Title VII to allow aggrieved employees the right to a jury trial and the right to recover compensatory and punitive damages. Prior to the Civil Rights Act of 1991, successful claimants were entitled only to awards of back pay and benefits but not punitive damages or a jury trial.

Title VII prohibits an employer from discriminating on the basis of race, color, religion, sex, or national origin in hiring, discharge, or compensation and with regard to any terms, conditions, or privileges of employment.

Title VII Application

An "employer" is defined under Title VII as any person "engaged in an industry affecting commerce who has 15 or more employees for each working day in each of 20 or more calendar weeks in the current or preceding calendar year." An "employer" can be a sole proprietor, partnership, or corporation. A partner is not considered an employee under Title VII. (Although Title VII only applies to employers with 15 or more workers, state or local laws against discrimination, depending on jurisdiction, may apply to employers of fewer workers.)

Definition of "Agent": Individual Supervisor Liability

The Title VII definition of "employer" also includes any "agent" of the employer. For years, a debate has raged as to whether the inclusion of the term "agent" in the definition of "employer" was meant to impose individual liability on supervisors, including directors and officers.

The Majority Rule

The majority of federal courts, following the case of *Miller v. Maxwell's Int'l Inc.*, 991 F.2d 583 (1993), do not interpret the term "agent" as creating individual liability on the part of supervisors and directors and officers. Rather, the courts following *Miller* have concluded that the term "agent" was included to ensure that an employer could be held liable for the acts of its agents.

The Minority Rule

A minority of federal courts hold that a supervisor may be personally liable for discriminatory acts. The leading case is *Cross v. Alabama*, 49 F.3d 1490 (11th Cir. 1995), where the court ruled that supervisors who engage in discriminatory acts and who have actual authority to hire and fire employees are "employers" themselves under Title VII and therefore are subject to personal liability.

Religious Discrimination

The federal Civil Rights Act of 1964 (Title VII), as well as many state and local laws and ordinances, prohibits discrimination against employees (or potential employees) because of their religion. This prohibition includes hiring, firing, and other terms and conditions of employment (e.g., job assignment, compensation, etc.). Thus:

- Employers may not treat employees or applicants more or less favorably than other employees because of their religion.
- Employees cannot be forced to participate in a religious activity as a condition of employment.
- Employers must reasonably accommodate employees' sincerely held religious beliefs unless doing so would impose an undue burden on the company.
- Employers must allow employees to engage in religious expression if employees are permitted to engage in other personal expression at work unless the religious expression would impose an undue hardship on the employer.
- Employers must take steps to prevent religious harassment of their employees.

"Reasonable Accommodation": A Case Study

The case of *Equal Emp't Opportunity Comm'n v. Abercrombie & Fitch Stores, Inc.,* 135 S. Ct. 2028 (U.S. 2015), involved Samantha Elauf, a 17-year-old practicing Muslim, who applied and interviewed for a sales position at an Abercrombie store while wearing a head scarf.

At no time during the interview was she asked about either her religion or whether she would wear a head scarf while working on the job (if she were to be hired). Ms. Elauf was later turned down for the position because the head scarf that she wore to the interview conflicted with Abercrombie's Look Policy, which prohibited its salespeople from wearing "caps" or anything that covered their heads. The EEOC brought a lawsuit on Ms. Elauf's behalf, claiming that she had been the victim of religious discrimination in violation of Title VII of the Civil Rights Act of 1964.

In finding for the plaintiff by an 8–1 majority, the US Supreme Court held that it was not necessary for the plaintiff to prove that Abercrombie had *actual knowledge* of the need to grant Ms. Elauf a religious accommodation. Rather, to make a valid claim for religious discrimination under Title VII of the Civil Rights Act of 1964, a plaintiff must only show that her need for an accommodation was a *motivating factor* in a prospective employer's decision not to hire.

Exceptions to the Law: When Religious Discrimination Is "Legal"

Despite the prohibition against religious discrimination in employment, courts have recognized that religious organizations themselves, under the doctrine known as the "ministerial exception," do have the right to make employment decisions that conflict with local, state, and federal law prohibiting religious-based discrimination (see Chapter 1).

Gender Discrimination

Under Title VII, it is unlawful to discriminate against any employee—or applicant—for employment because of his or her sex in regard to hiring, termination, promotion, compensation, job training, or any other term, condition, or privilege of employment. Title VII also prohibits employment decisions based on stereotypes and assumptions about abilities, traits, or the performance of individuals on the basis of sex. In addition, Title VII bars both intentional discrimination and neutral job policies that disproportionately exclude individuals on the basis of sex and that are not job related.

There have been several important gender discrimination cases brought against major corporations, including Home Depot, Morgan Stanley, Boeing, Novartis, and Wal-Mart.

The Home Depot Case

On September 19, 1997, Home Depot agreed to pay $65 million in order to settle a class action gender discrimination case involving more than 25,000 women who worked in or had applied to its West Coast Division stores.

The Morgan Stanley Case

On July 12, 2004, Morgan Stanley agreed to pay $54 million to current and former female employees, all of whom were victims of sex discrimination.

The Boeing Case

On July 14, 2004, Boeing made an agreement, on similar grounds, to pay up to $72.5 million. The ultimate size of the Boeing settlement is a function of the number of women who eventually submit claims.

The Novartis Case

On May 19, 2010, in *Velez v. Novartis Corp.*, No. 04 Civ. 9194 (S.D.N.Y.), a federal jury in New York rendered what was, at the time, the largest-ever verdict in a gender discrimination case. The case against Novartis Pharmaceutical Corporation, which was originally filed as a class action in 2005, was brought on behalf of 5,600 potential female claimants. The verdict called for $250 million in punitive damages, along with $3.37 million in compensatory damages, payable to 12 former female sales representatives, the lead plaintiffs in the case. Following the jury's verdict, a settlement was reached between the plaintiffs and Novartis in the amount of $152 million, plus approximately $22 million in special programs aimed at changing the employment practices and cultural attitudes at the company to eliminate gender discrimination. About $60 million of the settlement was earmarked to cover back pay. The verdict was also noteworthy because it marked the first time that a class action gender discrimination claim was tried to a verdict.

The Wal-Mart Case: The Largest Gender Discrimination Case to Date

The case of *Dukes v. Wal-Mart Stores, Inc.*, 603 F.3d 571 (2010), is the largest sex discrimination class action suit of all time. It began in 2000, when Betty Dukes, a 54-year-old Wal-Mart hourly worker in California, brought a sex discrimination claim against the company. She alleged that, after 6 years of favorable job performance, she was denied the training she needed to advance to a higher, salaried position. In June 2001, Ms. Dukes became the lead plaintiff in a lawsuit brought before the US District Court in San Francisco that sought to represent 1.6 million women, including all those who currently work or had previously worked in a Wal-Mart store since December 26, 1998. The suit claimed that Wal-Mart discriminated against women in promotions, pay, and job assignments, all of which violated Title VII of the Civil Rights Act of 1964.

After the Ninth Circuit Court had twice affirmed the (lower) federal district court's initial decision in favor of the plaintiff-workers, Wal-Mart appealed to the US Supreme Court. In June 2011, the Court held that the nationwide class of 1.6 million women who had worked for Wal-Mart and alleged gender discrimination against the retailer was unsustainable. Rather than assess the extent to which they were subjected to gender discrimination, in a 5–4 ruling, the Court rejected the claim based on the finding that the class action format was invalid on two major grounds. *See Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011).

First, whatever discrimination may have been committed was either *store and/or manager-specific* and therefore did not emanate from *specific direction* provided by the company's top management. In the Court's view, this disqualified the case from fitting within the requisite class action format.

Second, the Court found that, since the plaintiffs held widely varying positions requiring very different job duties (i.e., from cashiers to store managers), they did not suffer a *common injury* as is required under the rules for bringing class actions.

Procedural Hurdles to Future Employment Class Actions: The Wal-Mart Precedent

The effect of the Wal-Mart case, in terms of procedural hurdles inherent in class actions, has been so significant that the 2013 edition of the “Annual Workplace Class Action Report,” published by the law firm of Seyfarth Shaw, had the following to say about its consequences.

> ... *Wal-Mart* influenced settlement strategies in workplace class actions in a profound way. Employers settled fewer employment discrimination class actions than at any time over the past decade and at a fraction of the levels as in 2006 to 2011. This reflected the impact of *Wal-Mart*, and the notion that difficulties in certifying nationwide, massive class actions impaired the ability of the plaintiffs’ bar to convert their case filings into blockbuster settlements. It also manifested the ability of defendants to dismantle large class cases, or to devalue them for settlement purposes. Simply stated, *Wal-Mart* aided employers to defeat, fracture, and/or devalue employment discrimination class actions, and resulted in fewer settlements at lower amounts.

The Report went on to note that the monetary value of the top 10 private plaintiff discrimination settlements agreed to or paid in 2012 totaled $48.65 million. This represents a substantial drop from 2011—the year in which the *Wal-Mart* case was decided—during which the top 10 settlements totaled $123.3 million.

Expansion of Gender Discrimination Expanded to Include Sexual Orientation Discrimination

On March 1, 2016, the EEOC published a press release announcing the filing of its first two gender/sexual discrimination cases (under Title VII) based on sexual orientation. Although lesbian, gay, bisexual, and transgender issues had already been established as a priority in the EEOC’s Strategic Enforcement Plan for fiscal years 2013–2016, the filing of these two lawsuits represents a significant development and reinforces the EEOC’s stated agenda with concrete legal action.

These two lawsuits might also indicate that the EEOC could further extend the scope of its gender discrimination allegations to include discrimination on the basis of sexual orientation (although no cases of that nature have yet been filed).

Race Discrimination

Title VII protects employees against employment discrimination on the basis of race and color, as well as national origin, sex, or religion.

It is unlawful to discriminate against any employee—or applicant for employment—because of race or color in regard to hiring, termination, promotion, compensation, job training, or any other term, condition, or privilege of employment.

Title VII prohibits both intentional discrimination and neutral job policies that disproportionately exclude minorities and that are not job related.

Potential Damages

Successful Title VII claimants can receive reinstatement or front pay (i.e., future wages); back pay (i.e., past wages); attorneys' fees; an injunction against the prohibited discrimination; damages for pain, suffering, and mental anguish; and punitive damages.

Damages for pain, suffering, mental anguish, and punitive damages are available only to victims of intentional discrimination and are subject to the following caps, based on the size of the employer's workforce.

15 to 100 employees	$50,000
101 to 200 employees	$100,000
201 to 500 employees	$200,000
501 employees or more	$300,000

In cases involving multiple claimants, each successful claimant is subject to a separate cap. The above caps do not affect the amount of back pay, front pay, attorneys' fees, or interest on back pay that a successful claimant may collect.

Effect of the Civil Rights Act of 1991

This Act broadened claimants' rights under Title VII. While previously limited to a bench trial (i.e., a trial before a judge), as a result of this law, plaintiffs now have the right to have their case heard by a jury. Jury trials potentially increase an employer's exposure, because most juries tend to identify with and, thus, favor the employee and generally award larger verdicts than do judges.

ADEA of 1967

The ADEA of 1967 bars employers from discriminating against employees over the age of 40 on the basis of age with regard to hiring, discharge, compensation, and other terms, conditions, or privileges of employment. Under the ADEA, employers are prohibited from (1) failing or refusing to hire, discharging, or discriminating in the compensation of an individual because of age; (2) depriving an individual of employment opportunities or otherwise adversely affecting the employee's status because of age; or (3) reducing an individual's wages to eliminate a wage discrepancy that might violate the ADEA. Employers may not retaliate against an employee for asserting rights protected by the ADEA or publish any notice or advertisement that expresses any age preference or limitation. As with Title VII and the ADA, a majority of courts hold that there is no individual personal liability for supervisors under the ADEA.

ADEA Application

The ADEA protects workers employed in a business that has 20 or more employees for each working day for 20 or more calendar weeks in the year. One exception to the ADEA is the compulsory retirement of bona fide executives or "high policy makers" at age 65 or over. A "high policy making position" is limited to upper-level employees who are "individuals with little or no line authority but who play a significant role in developing corporate policy.

Potential Damages

Successful plaintiffs under the ADEA are entitled to back pay, benefits, interest, attorneys' fees and costs, and front pay if they are not reinstated. If the employer is found to have willfully violated the ADEA, the wronged employee is also entitled to liquidated damages in an amount equal to the award for back pay and benefits. In this instance, liquidated damages refers to the actual amount of wages lost from the time of the wrongful termination based on age discrimination until adjudication of the claim by a court or by a settlement.

"But for" Causation: The Required Standard of Proof under the ADEA

The key case establishing the all-important standard of proof in age discrimination cases was the US Supreme Court's decision in *Gross v. FBL Fin. Servs. Group, Inc.,* 200 U.S. 321, 129 S. Ct. 2343, 174 L. Ed. 2d 119 (2009).

The plaintiff in this case, Jack Gross, alleged that he was demoted on account of his age in violation of the ADEA. In a 5–4 decision, the US Supreme Court held that a plaintiff bringing an ADEA claim must prove that age was the "but-for" cause of the challenged adverse employment action—not merely one factor among many that motivated the adverse employment action. In other words, unless a plaintiff could prove that age was the overriding cause for an adverse employer action, the claim would not be actionable under the ADEA. For example, an employer would still have a valid defense to an ADEA claim if the employer could prove that the employee's poor performance—rather than his age—was the overriding cause of his termination—despite the fact that a plaintiff provided evidence that derogatory comments had been made about his age.

PDA of 1978

In a 1978 amendment to Title VII, the PDA brought "pregnancy, childbirth, or related medical conditions" within the purview of "sex" as a characteristic protected by Title VII. This legislation created a new "protected class"—pregnant women—and gave them the right to bring claims for discrimination under Title VII. The PDA allows a pregnant woman to recover equitable (i.e., job reinstatement following termination) and compensatory relief (and, at times, punitive damages) to remedy acts of discrimination on the part of her employer.

Protections Included Within the Act

The following are included within the Act's protections.

1. Hiring. An employer cannot refuse to hire a pregnant woman because of (1) her pregnancy; (2) a pregnancy-related condition; or (3) the prejudices of coworkers, clients, or customers.
2. Pregnancy and Maternity Leave. An employer may not single out pregnancy-related conditions for special procedures to determine an employee's ability to work.
3. Health Insurance. Any health insurance provided by an employer must cover expenses for pregnancy-related conditions on the same basis as costs for other medical conditions.
4. Fringe Benefits: **Pregnancy-Related Benefits Cannot Be Limited to Married Employees**. In an all-female workforce or job classification, benefits must be provided for pregnancy-related conditions if benefits are provided for other medical conditions.
5. Anti-Retaliation. It is also unlawful to retaliate against an individual for opposing employment practices that discriminate based on pregnancy or for filing a discrimination charge, testifying, or participating in any litigation under Title VII.

Accommodations for Pregnant Workers

The issue in *Young v. UPS*, 135 S. Ct. 1338 (U.S. 2015), involved the question of whether, under the PDA, employers must afford the same job accommodations to an employee with a pregnancy-related work limitation as they do to their employees with similar but non-pregnancy-related work limitations.

When plaintiff Peggy Young, a delivery driver employed by United Parcel Service, became pregnant in 2006, she was advised by her medical practitioner not to lift more than 20 pounds. Yet, because her job required her to lift up to 70 pounds, she sought a lighter-duty accommodation from her employer. The request was denied, and she was placed on unpaid leave.

By a vote of 6–3, the Court concluded that the PDA did intend to prohibit employers from treating pregnant workers less favorably than nonpregnant workers. Thus, when the pregnant workers have similar limitations in their ability to perform certain types of work (as nonpregnant workers), an employer is obligated under the PDA to provide accommodations at least as favorable as those ordinarily offered to other workers.

The Worker Adjustment and Retraining Notification (WARN) Act of 1988

The WARN Act requires certain employers (any private-sector or not-for-profit employer with 100 or more full-time employees) to provide their employees with written notice of a planned mass layoff or plant closing, so that workers may seek alternative employment prior to the layoff. In addition, a number of individual states have laws with a similar intent that supersede the WARN Act, typically in a more liberal fashion.

The law applies to both hourly and salaried employees, including those in managerial and supervisory positions. However, it does not apply to employees who have worked for less than 6 months and those who work less than 20 hours per week.

What Events Trigger a Requirement to Notify Employees?

Three events trigger the requirement to provide employees with a 60-day notice period prior to an “employment loss”: a plant closing, a mass layoff, or a cumulative layoff.

- **Plant Closing.** An employer is required to give 60 days’ notice if an employment site will be shut down, resulting in the loss of employment for 50 or more workers, during any 30-day period.
- **Mass Layoff.** An employer is required to give 60 days’ notice if there will be a mass layoff that does not involve a plant closing but will result in (1) the loss of jobs at an employment site during any 30-day period for 500 or more employees or (2) the loss of employment for 50 to 499 employees if they comprise at least 33 percent of the employer’s workforce.
- **Cumulative Layoff.** An employer is required to give workers 60 days’ notice if, during a 30-day period, the number of jobs lost for 2 or more groups of workers, each of which is less than the minimum number needed to trigger notice, would reach the minimum threshold if they were combined during any 90-day period. Job losses within any 90-day period will count together cumulatively.

What Are the Exceptions to the Law?

The three major exceptions to the 60-day notice requirement are as follows.

- **Faltering Company.** In situations where a company has sought new capital or new business in order to stay open and where giving notice of mass layoffs would prevent the firm from obtaining the new capital or business, the notice requirement is waived.
- **Unforeseen Circumstances.** This exception applies when there are business circumstances that were not reasonably foreseeable at the time notice would otherwise have been required. For example, if the firm’s largest customer from which it generates one-third of its annual sales suddenly transfers all of its business to a competitor, such a situation would fall under the unforeseen circumstances exception.
- **Natural Disaster.** This exception applies where a plant closing or mass layoff is the direct result of a natural disaster, such as a hurricane, flood, or earthquake.

The ADA

The ADA forbids employers from discriminating against a "qualified individual" with a "disability" when the discrimination is based on the individual's disability. A "qualified individual" is "an individual with a disability who, with or without reasonable accommodation, can perform the essential functions of the employment position that such individual holds or desires."

ADA Application

The ADA applies to employers with 15 or more employees who are employed for the current or preceding year for 20 or more calendar weeks. As with Title VII, the majority rule is that there is no individual liability under the ADA.

The ADA imposes two broad requirements: (1) equal opportunity and (2) reasonable accommodation.

Equal Opportunity

Equal opportunity compels an employer to hire a job applicant, regardless of any disability, provided he or she possesses the requisite skills, education, and experience to handle the duties of the position.

Definition of "Disability"

The ADA defines "disability" as (1) a physical or mental impairment that substantially limits one or more of the major life activities of an individual, (2) a record of such an impairment, or (3) the perception that an individual has an impairment. The ADA extends the term "disability" to diseases such as epilepsy, tuberculosis, and AIDS but does not protect individuals with addictions to controlled substances. Employers, however, may bar individuals with specified contagious diseases (not including AIDS) from handling or preparing food.

Reasonable Accommodation

An employer is obligated to provide "reasonable accommodation" that will allow disabled employees to perform essential job functions. An employer is required to make "reasonable accommodations" for a disabled employee or applicant if doing so imposes no "undue hardship" on the employer.

These accommodations must be provided in three areas: (1) to permit an employee to perform the essential functions of the job, (2) to create fairness in testing and applications procedures, and (3) to permit a disabled individual to enjoy the benefits and privileges of employment that are at least substantially equal to those benefits and privileges afforded to similarly situated nondisabled individuals.

Examples of "Reasonable Accommodation"

Examples of "reasonable accommodation" include making offices accessible to persons with disabilities, modifying job descriptions, providing flexible work schedules, reassignment, or other workplace adjustments that the employer can accomplish without undue hardship.

Potential Damages

A plaintiff filing suit under the ADA has the right to demand a jury trial. A successful claimant under the ADA may obtain reinstatement; back pay and benefits; attorneys' fees; expert witness fees; damages for pain, suffering, and mental anguish; and punitive damages. Compensatory and punitive damage awards are subject to the same caps as Title VII claims. However, if the employer, in good faith and in consultation with the disabled employee, attempts to identify and make a reasonable accommodation, the court may not award compensatory and punitive damages. In its discretion, the court may order an employer to afford an employee a reasonable accommodation.

The Americans with Disabilities Act Amendments Act of 2008 (ADAAA)

In an effort to clarify questions regarding what constitutes a "disability," effective January 1, 2009, a number of changes to the ADA were enacted by a law known as the ADAAA. Two of the more important changes involve mitigating measures and expansion of major life activities.

Mitigating Measures

The changes brought by the ADAAA reject recent Supreme Court precedent, which holds that "mitigating measures" (e.g., medications, prosthetics, corrective surgery, hearing aids) are to be considered in assessing whether an individual is covered under the ADA. Rather, the ADAAA holds that impairments are to be evaluated in their unmitigated state when determining whether the individual is substantially limited in a major life activity (except that ordinary eyeglasses and contact lenses may be considered).

Expansion of Major Life Activities

ADAAA also added several new activities to the list of major life activities covered by the statute, including: "sleeping, . . . concentrating, thinking, [and] communicating." Also included as major life activities are "the operation of major bodily functions" such as the "immune system, normal cell growth, digestive, bowel, bladder, neurological, brain, respiratory, circulatory, endocrine and reproductive functions." All of these new major life activities create additional factors that employers will have to consider when making employment decisions.

The FMLA of 1993

The FMLA of 1993 allows employees, in certain circumstances, to take unpaid leave from work to care for themselves or close family members (i.e., parent, child, but not first cousin).

Application of FMLA

The Act requires businesses with 50 or more employees to provide up to 12 weeks of unpaid, job-protected leave to eligible employees for qualified family and medical emergencies. An employee is eligible only if (1) the employer has at least 50 employees within a 75-mile radius of the employee's worksite; (2) he or she has worked for any covered employer for a minimum of 1 year; and (3) the employee has worked for his or her current employer for a minimum of 1,250 hours during the preceding year.

An employee seeking leave is required to provide 30 days' advance notice to his or her employer when the leave is foreseeable, such as for childbirth or adoption. The employer can ask that the employee comply with the company's standard procedure for obtaining leave, although medical leave may not be denied because the employee fails to follow the proper procedures.

The Problem of Intermittent Leave

Under the law, employees are allowed to take what is known as intermittent leave. According to Department of Labor regulations, an employee can potentially take leave in increments as brief as 15 minutes per day. HR professionals routinely cite this as one of the greatest challenges under the Act—first, because tracking intermittent leave is so tedious and, second, because it has the potential to disrupt scheduling and work flow within a business if employees take repeated leaves of such short durations.

Chronic Conditions

Another intermittent leave challenge is dealing with chronic conditions such as diabetes, migraine headaches, depression, and asthma, whereby an employee typically requests leave without prior notice and for only a brief period of time (e.g., a half hour to lie down during a migraine headache).

Many HR executives have purchased software programs that track FMLA leave time or have such programs built into their HR management systems.

Damages Recoverable under FMLA

Employees may enforce their rights under the FMLA in federal court or through the US Department of Labor and, if successful, may receive money damages and attorneys' fees and cash, as well as equitable relief, including reinstatement and promotion. Even an employee who has not suffered any lost wages because of a violation may recover monetary damages sustained as a direct result of the violation, such as child care or nursing care up to a sum equal to 12 weeks of pay. The court may double damages if it finds that the employer intentionally violated the FMLA.

USERRA of 1994

USERRA, which was signed into law on October 13, 1994, is intended to minimize the disadvantages to an individual that occur when that person needs to be absent from his or her civilian employment to serve in this country's uniformed services. Specifically, USERRA provides for a cumulative 5-year time period during which a person may be absent from work for uniformed services duty and retain reemployment rights.

USERRA Application

A key point associated with USERRA is that all employers are subject to it—regardless of their size.

What Is the Magnitude of the Exposure?

Admittedly, a low percentage of situations involving the assertion of USERRA rights ends up in court. Nevertheless, given the fact that, since 2001, roughly half a million people have served in Middle East military operations, and given the sheer number of potential plaintiffs such operations have created, the magnitude of the exposure cannot be ignored.

The Purpose of USERRA

The law attempts to encourage noncareer uniformed service (i.e., in the National Guard and Reserves), so that America can enjoy the protection of those services, staffed by qualified people, while balancing the needs of private and public employers that also depend on these same individuals.

Who Is Covered by USERRA?

USERRA potentially covers every individual in the country who serves or has served in the uniformed services. The Act applies to employers in the public and private sectors, including federal employers. The term "uniformed services" means the Armed Forces, the Army National Guard, and the Air National Guard when engaged in active duty for training, inactive duty training, or full-time National Guard duty; the commissioned corps of the Public Health Service; and any other category of persons designated by the president in time of war or emergency.

Employee Eligibility

To be eligible for USERRA rights, employees must

1. have held a civilian job prior to their service in the uniformed services,
2. have given notice to their employer that they were leaving the job for uniformed service,
3. have been in uniformed service for no longer than a cumulative total of 5 years during their employment,
4. not be released from uniformed service under dishonorable or other punitive conditions, and
5. apply for reemployment within specified time limits after return.

Advance Notice Requirements

The law requires all employees to provide their employers with advance notice of military service. This advance notice includes a reasonable time period with which to leave for home to prepare for service.

An Employee's Rights upon Returning to Work

The rights to which returning employees are entitled under the USERRA are subject to the "escalator principle." This principle requires returning employees to be treated as if they had been continuously employed. They must be reemployed in the job that they would have attained had they not been absent for uniformed service. This may require that the employer train the returning employee to enable him or her to function in a new position. Returning employees must also receive the seniority, status, pay, and other benefits to which they would have been entitled had they not gone on leave.

An employer is not required to reemploy a service man or woman when (1) the employer experiences "changed circumstances" that would make reemployment impossible or unreasonable (such as layoffs that would have included the employee, for example) and (2) when there is "undue hardship."

GINA of 2008

The GINA is designed to prohibit the improper use of genetic information in health insurance and employment. The Act, which became effective November 21, 2009, prohibits group health plans and health insurers from denying coverage to a healthy individual or charging that person higher premiums based solely on a genetic predisposition to developing a disease in the future. The legislation also bars employers from using individuals' genetic information when making hiring, firing, job placement, or promotion decisions. The law applies to all employers, regardless of size of the workforce.

GINA: A Claim Scenario

A company requires preemployment physicals as a condition of employment. The results of a prospective employee's physical indicate that she is healthy and fully capable of performing the job duties of the particular position for which she applied. However, during the course of the examination, it is also revealed that she has a genetic predisposition to developing breast cancer. As a result of the law, the employer would not be able to deny the person the job, despite such *a predisposition.*

Confidentiality of "Genetic Information"

Under GINA, it is also unlawful for a business to disclose genetic information about applicants, employees, or members. Businesses must keep genetic information confidential and in a separate medical file. There are six narrow exceptions to the confidentiality rule, as follows.

- **Inadvertent Acquisition of Genetic Information**. (E.g., a manager or supervisor overhears someone talking about a family member's illness.)

- **As Part of Health or Wellness Programs**. Genetic information may be acquired by the employer if it is offered by the employee on a voluntary basis.
- **Certification for FMLA Leave**. Family medical history may be obtained in the event an employee is asking for leave to care for a family member with a serious health condition.
- **Commercially and Publicly Available Documents**. Genetic information may be acquired through sources like newspapers, provided the employer is not actively searching those sources (e.g., websites and online discussion groups that focus on issues such as genetic testing of individuals and genetic discrimination).
- **Genetic Monitoring Programs.** Genetic information may be acquired if such information is used to monitor the biological effects of toxic substances in the workplace and where such monitoring is required by law.
- **Forensic Testing Programs**. Genetic information of employees may be obtained by employers that engage in DNA testing for law enforcement purposes (e.g., as a forensic lab) or for purposes of human remains identification. But the genetic information may only be used for analysis of DNA markers for quality control and detection of sample contamination.

Liability under State and Local Statutes

Aggrieved employees also can seek protection under state and local antidiscrimination statutes similar to the federal statutes discussed above, including fair employment practices laws and whistleblower statutes.

Fair Employment Practices Laws

Every state has enacted fair employment practices legislation, which bars discrimination by private employers against defined categories of individuals. The fair employment practices laws are broader than their federal counterparts but are not uniform in their protection. For example, several states protect marital status, and a small but growing number of states protect sexual orientation. Since local fair employment laws are typically broader than corresponding federal statutes, they have the effect of subjecting small businesses to local laws, even though federal statutes do not bind them. Therefore, aggrieved employees may be more inclined to bring claims under local laws.

Whistleblower Statutes

The federal government protects employees from retaliatory actions by their employers when the employees report violations of any law on the part of their employers. Many states also have passed laws prohibiting an employer from firing or otherwise retaliating against an employee for disclosing an unfair or illegal practice by the employer.

Public Policy Protection

Many state courts have created common law remedies that protect employees from termination or retaliation for exercising their legal rights. Employees discharged or retaliated against for exercising their rights may sue their employer for damages. Courts generally justify this exception to the at-will employment rule on the basis of "public policy," holding that an employee should not be discharged for exercising rights under other laws that were enacted to protect the employee.

Chapter 3 Review Questions

1. Victoria's employer never disclosed how much other employees were actually paid but implied that they were rewarded equitably based on their positions within the company. When Personnel accidentally sent Victoria the paycheck addressed to Victor, she noticed that he had been receiving higher wages for doing exactly the same work. Having discovered this secret, she learned that other male employees were also better compensated. Victoria then sued her employer under the Equal Pay Act of 1963. If the suit is successful, Victoria may recover all the following as damages, except

   A. 2 years' back pay.

   B. doubled damages if the court finds that the employer's conduct was willful.

   C. her boss's job.

   D. the difference in pay.

2. He-Man Corporation has 250 employees. Ten female employees convinced the court that He-Man had discriminated against them on the basis of their gender, but the courts agreed with He-Man that the discrimination was not intentional. Under Title VII of the Civil Rights Act, the total amount of damages that may be awarded for pain, suffering, mental anguish, and punitive damages

   A. is $0.

   B. may not exceed $200,000.

   C. may not exceed $300,000.

   D. may not exceed $2 million.

3. After 33 years as the librarian for a publishing company, during which he consistently received acceptable performance reviews, Holden arrives at work one day and is told his employment is immediately terminated because he lacks the necessary job competencies. His library assistant, a recent college graduate, becomes the company's sole librarian. As regards suits under the ADEA of 1967, legal precedents suggest that

   A. age discrimination against Holden can be inferred from the employer's false explanation for termination.

   B. Holden needs to provide specific evidence of derogatory comments about his age.

   C. age discrimination claims require direct evidence that may be lacking in this case.

   D. Holden needs to provide specific evidence of derogatory comments about his physical condition.

4. Which of the following individuals does not qualify for protection under the ADA?

   A. Brittany has a serious substance abuse problem.

   B. Deepak has been diagnosed with major depression.

   C. Eileen walks with a limp.

   D. Ferris is HIV positive.

5. Autumn's family seems to have many health problems. Although she is not paid during her absence, FMLA requires her employer to grant Autumn leave to care for any of the following except

   A. herself.

   B. Mrs. Fall, her mother.

   C. Twig, her infant son.

   D. Willow, her sister's daughter.

Answers to Chapter 3 Review Questions

1.

A. This answer is incorrect. Back pay awards are generally limited to 2 years.

B. This answer is incorrect. A court may double the damages award if it finds that the employer's conduct was willful.

C. That's correct! The Equal Pay Act provides only for the recovery of damages.

D. This answer is incorrect. The Equal Pay Act provides for the recovery of the difference in pay.

2.

A. That's correct! Damages for pain, suffering, mental anguish, and punitive damages are available only to victims of intentional discrimination.

B. This answer is incorrect. Each of the 10 successful claimants is subject to a separate cap.

C. This answer is incorrect. Damages for an employer with a 250-person workforce could not exceed $200,000 per person in the event of intentional discrimination.

D. This answer is incorrect. The discrimination was not intentional.

3.

A. That's correct! A 2000 US Supreme Court ruling indicates that age discrimination may be inferred from circumstantial evidence such as an employer's false explanation for termination.

B. This answer is incorrect. This form of specific proof is not required.

C. This answer is incorrect. After 33 years on the job, Holden was obviously older than the recent graduate who replaced him. He can rely on this circumstantial evidence to make his case.

D. This answer is incorrect. He does not need to provide such proof.

4.

A. That's correct! The ADA does not protect individuals with addictions to controlled substances.

B. This answer is incorrect. Mental and psychiatric impairments are defined as disabilities within the ADA.

C. This answer is incorrect. Eileen's physical impairment is considered a disability.

D. This answer is incorrect. The ADA extends the term "disability" to include diseases such as AIDS.

5.

A. This answer is incorrect. Autumn's leaves to take care of herself are permitted by FMLA.

B. This answer is incorrect. Unpaid leave is permitted to care for a close family member such as a parent.

C. This answer is incorrect. Twig is a close family member.

D. That's correct! FMLA does not allow employees to take unpaid leave from work to care for a niece.

Chapter 4
Rating and Underwriting EPL Coverage

Overview

Chapter 4 discusses the factors that are considered in developing rates for EPLI coverage.

Chapter Objectives

On completion of this chapter, you should be able to

- identify and prioritize the factors used in developing rates for EPLI policies,
- recognize the characteristics of an EPLI applicant that underwriters consider desirable and those that are considered undesirable, and
- identify the rationale behind EPLI underwriting evaluations.

The Rating Basis for EPLI Policies

EPLI policies are generally rated on a cost "per employee" basis. To develop a total premium, underwriters first determine a "per employee" rate and then multiply it by the number of covered employees under the policy.

The factors used in developing rates for EPLI policies are noted in Exhibit 4.1 and explained in the pages that follow. In addition, these factors are used as modifiers that are applied to such rates in determining a final premium.

Exhibit 4.1
EPL Rating and Modification Factors

- Jurisdiction
- Number and Dispersion of Locations
- Industry
- Number of employees
- Leased employees
- Union employees
- Profitability
- Mix of exempt/nonexempt employees
- Claim history
- Written HR procedures
- Termination and turnover rates
- Plans for staff reductions and layoffs
- Corporate culture

Jurisdiction

Location is the single most important factor affecting premiums, given the disparity in claim susceptibility and severity from state to state. (Accordingly, application forms almost always request a breakdown of the number of employees in each state of operation.) Substantial jury verdicts have been recorded in California (where more than one-third of all EPL claims are made), Illinois, Michigan, New Jersey, and Texas. In contrast, states such as West Virginia, Kansas, and New Hampshire exhibit relatively low EPL claim frequency and severity.

In addition to charging rates reflecting varying potential frequency and severity, underwriters also require differing minimum retentions/deductibles, depending on the specific jurisdiction involved. For example, one leading insurer applies a minimum $75,000 per claim retention/deductible to Southern California-based risks, a figure reflecting the higher severity of EPL claims in this jurisdiction.

Number and Dispersion of Locations

Underwriters also consider the number and dispersion of locations at which an insured operates. This is an important factor because the greater the geographical dispersion of its operations, the more difficult it is for a business to implement and monitor loss prevention and control policies. Therefore, geographically dispersed firms pose a greater risk of claim frequency and severity (than do single-location businesses) and are surcharged accordingly.

Industry

Industry is another important factor affecting EPL policy premiums. Firms in certain industries are more susceptible to being sued and subjected to substantial judgments. For example, restaurants pay a higher premium rate per employee, compared with most other industries, given the restaurant industry's higher-than-average rate of sexual harassment claims.

Number of Employees

Not only does the number of employees working at a business provide an indication of the number of potential plaintiffs, but the size of a company's workforce is also significant because larger organizations are more likely to be sued than smaller ones. There are three reasons for this.

Higher Standards of Claim Prevention

First, courts tend to hold larger firms to higher standards of claim prevention, compared to smaller organizations. The thinking is that such firms have greater financial ability to implement fair employment practices and should therefore be held to a higher standard, compared to smaller, less financially solid companies.

Deeper Pockets

Second, plaintiff's attorneys often target larger firms when they file lawsuits for two reasons: first, because they are more likely than smaller companies to be insured, thus providing a source of settlement proceeds, and, second, even if not insured (or insured with a high retention), larger companies have the kinds of deep pockets that encourage juries to award sizeable settlements or verdicts.

Similarly Situated Employees

Third, larger firms have greater numbers of similarly situated employees. For example, a Fortune 500 firm is more likely to employ 1,000 workers in a single plant, doing the same or similar job, than will a smaller firm. This makes larger firms more vulnerable to class-action (i.e., multiple plaintiff) claims, which have historically yielded a number of large settlements and judgments against major corporations.

Leased Employees

Underwriters are also interested in knowing the number of leased employees maintained by a company. Depending on the terms of the lease(s) under which leased employees work, an insured may or may not be responsible for maintaining EPLI on such personnel. In cases where the insured must purchase such coverage according to the terms of a leasing agreement, the underwriter will add leased employees to the "head count" used to develop a premium for the policy. (Typically, the rate per leased employee is one-third the rate per regular employee.)

Union Employees

The number of union employees working at a business is also an important underwriting consideration. This is because union workers are more likely to make a claim than nonunion workers are, since the former are more "sensitized" to possible causes of action, based upon input from union shop stewards. However, this factor is somewhat offset by the fact that most EPL forms exclude claims associated with grievances related to union contracts. In addition, agreements between union representatives (i.e., shop stewards) and the employer often resolve many minor disputes—without lawsuits.

Profitability

An employer's profitability is a key underwriting consideration. Since employees are frequently terminated for financial rather than performance reasons (as is the case during layoffs), firms in questionable financial condition are much more susceptible to wrongful termination claims compared to companies that have strong earnings. Thus, financially weaker companies often have to pay more for EPLI coverage than do those on firmer financial footing.

When evaluating a company's profitability, underwriters consider a number of specific factors.

- **Working Capital.** A firm with ample working capital is typically in a better position to avoid layoffs, compared to one with less available cash, particularly during economic downturns. Firms lacking such capital may be forced to lay off workers when earnings drop significantly, despite the fact that they intend to rehire them when conditions improve. In contrast, better capitalized companies are not necessarily forced into layoffs during slack periods.
- **Financial Ratios.** Underwriters also look at key financial ratios (e.g., return on equity ratio, current ratio, profit margin). Such data also enable an underwriter to assess a firm's likelihood of experiencing financial distress and consequent layoffs. This is especially true if the trends of such ratios are analyzed. (I.e., are the ratios improving or deteriorating?)
- **Age of Firm.** In situations where an insured or applicant for coverage does not show a profit for its most recent year, the underwriter often considers the number of years the company has been in business. In the case of a relatively "young" firm (i.e., less than 5 years of operating history), if losses have been decreasing, this is a positive sign, which enhances the firm's insurability. In fact, providing coverage for an established firm that is beginning to lose money is often more problematic than offering coverage to a newer company that has been experiencing losses for some time but is starting to stabilize financially and therefore does not anticipate future layoffs.

Mix of Exempt and Nonexempt Employees

A high percentage of exempt employees (i.e., those exempt from being eligible to receive overtime pay) increases the potential severity and frequency of claims and thus the rate per employee. Exempt employees are likely to earn higher salaries than are nonexempt employees (i.e., those eligible to receive overtime pay), thus producing larger income loss following termination. (Sometimes, underwriters apply a separate rate for exempt and nonexempt employees.) In addition, since exempt employees tend to be more educated and thus more aware of their rights, they are also more likely to bring claims than are nonexempt workers.

Exempt Employees and the "Reemployment" Factor

Exempt employees (especially those who are highly compensated) also have an increased likelihood of bringing a lawsuit, because it is generally more difficult for them to find jobs following termination, compared to nonexempt personnel (given the stigma associated with having been dismissed from a high-level position). Furthermore, such employees, given the condition of their finances, can often hold out longer than rank-and-file employees can and are therefore able to resist accepting initial (and even subsequent) settlement offers by their former employers. The state of their finances allows well-compensated former employees to continue the litigation process, which ultimately increases both eventual settlements and defense costs.

Claim History

Underwriters often surcharge (or even reject) firms with a history of employment-related litigation. However, prior claims are not necessarily grounds for rejection, especially if an organization has addressed the causes of such claims and has taken meaningful, effective action to prevent similar allegations in the future. On the other hand, an underwriter would, for example, be leery about a company applying for EPL coverage in which one of its officers was sued for sexual harassment and still remained with the organization following the settlement.

A frequency of prior claims is also a particular concern of most underwriters, compared with a single large claim. This is because multiple employment-related claims, incidents, and complaints often indicate management and/or employee morale problems. In contrast, a single, isolated catastrophic claim is generally perceived by insurers as a "one-off" occurrence that is not likely to happen again.

Written Procedures

Underwriters carefully evaluate a company's written procedures regarding employment practices.

Written HR Procedures Are Helpful in Defending Claims

Although written HR procedures may not necessarily prevent claims, they are nevertheless helpful in defending against claims (provided the organization has followed those procedures). Take the case of a company that has written procedures requiring both yearly, detailed performance reviews and warnings for poor performers. If a terminated employee brings a discrimination claim, but her file contains several negative performance write-ups and ample written warnings, the existence of such documents—as required by the company's HR procedures—will make it easier for the employer to defend the case.

Critical Policy Areas to Address

HR policies should address the following areas: salary administration, employee benefits, employment-at-will statements, performance appraisal, discipline, discharge, interviewing, hiring, work assignments, postemployment offers of medical coverage, providing references, grievance procedures, discrimination policies, and sexual harassment. Of course, the effective *enforcement* of these policies is a factor in which underwriters will also be interested.

Turnover and Termination Rates

Underwriters carefully assess turnover and termination rates since unfavorable trends could indicate employee morale and/or management problems. High turnover and termination rates also create a large potential plaintiff group that could bring claims against the insured in the future after coverage is bound.

Nevertheless, these rates must be evaluated in light of two mitigating factors: (1) the rate of voluntary versus involuntary turnover and termination and (2) the extent to which the "seasonal" nature (if any) of the business affects turnover and termination rates.

Management Stability

One important consideration as it relates to turnover and termination rates is the extent to which a company's senior management has changed in recent years. Management stability is usually a sign of a well-run and typically profitable company. Conversely, rapid turnover of company executives often signals profitability problems that sometimes manifest themselves in claims.

Plans for Staff Reductions and Layoffs

A firm's immediate plans for layoffs and staff reductions must be ascertained. If a company does plan layoffs within the near future, the underwriter may exclude claims from such layoffs within a policy or, alternatively, impose a surcharge, based on the clear increase in exposure caused by these plans.

Corporate Culture

Although impossible to quantify, a company's culture plays a crucial role in determining the likelihood of employee claims. For example, firms in which there is a high level of trust and communication are rarely sued. Despite its importance, an underwriter's assessment of an organization's culture remains a subjective exercise and is difficult to evaluate.

Renewal Underwriting: Assessing Change

When an EPL policy is up for renewal, the key factor that an underwriter considers is the extent to which the insured and its operations have changed since the inception of the soon-to-expire policy. Among the key items that an underwriter reviews include whether there are/is:

- New acquisitions
- Spin-offs of subsidiaries
- Higher-than-usual termination rate of employees
- Turnover in the company's HR management group
- Changes in financial statements
- Changes in written HR policies
- Any imminent or planned layoffs

Chapter 4 Review Questions

1. Madd Capp Company's EPLI premium will increase as its ____________ increases.
    A. claims count
    B. employee count
    C. payroll
    D. sales volume
2. Financially speaking, Joe's Pizza Factory is rolling in the dough, while Sonya's Spaghetti Factory is operating on a shoestring. From the viewpoint of an EPLI underwriter,
    A. all else being equal, the financial condition of these businesses has little if any impact on the cost of EPLI coverage.
    B. Joe is more susceptible to EPLI claims because he has hot pockets.
    C. Sonya is more susceptible to EPLI claims because of the greater possibility of layoffs.
    D. the financial condition of these businesses is not a significant underwriting factor.
3. Rich Stream, MBA, a vice president of Stutters' Mill, and his sister Brook, a Stutters' Mill mail room clerk with a high school education, suddenly found themselves both unemployed when Stutters' Mill downsized. The person more likely to bring an EPL lawsuit against Stutters' Mill is
    A. Brook, because she faces the stigma of being dismissed from a low-level position.
    B. Brook, because she is in a better position to hold out for a high settlement offer.
    C. Rich, because bringing a lawsuit reduces any stigma that might be associated with his sudden dismissal.
    D. Rich, because he will probably find it more difficult to find a comparable job.
4. Polly C. has been asked to review her employer's written corporate employment practices policies to ensure that they address critical areas. Critical policy areas include all of the following, except
    A. discrimination policies.
    B. performance appraisal policies.
    C. salary administration policies.
    D. workers compensation policies.
5. Which of the following characteristics of Ernie Company increases the likelihood of an employee suit?
    A. Employee turnover is low.
    B. Ernie's corporate culture involves a high level of trust and communication.
    C. Planned staff reductions will improve organizational efficiency.
    D. Senior management personnel usually stay with Ernie until they retire.

Answers to Chapter 4 Review Questions

1.

   A. This answer is incorrect. Policies are not rated on a per-claim basis.

   B. That's correct! EPLI insurance policies are generally rated on a cost "per employee."

   C. This answer is incorrect. Although the size of the payroll is generally proportionate to the employee count, EPLI premiums are not directly based on payroll dollars.

   D. This answer is incorrect. Premiums are not generally based on sales.

2.

   A. This answer is incorrect. Profitability is a key underwriting issue.

   B. This answer is incorrect. It would be more accurate to say that Joe has deep pockets.

   C. That's correct! Questionable financial condition often leads to layoffs, increasing a firm's susceptibility to wrongful termination claims.

   D. This answer is incorrect. Underwriters consider a firm's key financial ratios.

3.

   A. This answer is incorrect. Relatively little stigma is attached to the termination of a lower-level employee.

   B. This answer is incorrect. Given her more precarious financial condition, Brook will probably be eager to reach a prompt settlement of any claim against Stutters' Mill.

   C. This answer is incorrect. Bringing a lawsuit does nothing to reduce the stigma associated with being fired from a high-level position. Being branded as litigious might even add to the stigma.

   D. That's correct! It is generally more difficult for exempt employees to find satisfactory jobs following termination.

4.

   A. This answer is incorrect. Her employer should have a discrimination policy.

   B. This answer is incorrect. Key corporate policies should address performance appraisals.

   C. This answer is incorrect. Polly should be able to find a salary administration policy.

   D. That's correct! Workers compensation policies are insurance policies, not a firm's corporate policies.

5.

   A. This answer is incorrect. Low employee turnover suggests good employee morale, which makes claims unlikely.

   B. This answer is incorrect. Corporations in which there is a high level of trust and communication are rarely sued.

   C. That's correct! Planned layoffs within the near future clearly increase the exposure.

   D. This answer is incorrect. Management stability is usually a sign of a well-run company.

Chapter 5
EPL Loss Prevention

Overview

Chapter 5 explains how to control the exposures to employment litigation. In addition to preventing claims, these approaches will reduce the size of claims made against an insured. The chapter addresses the following topics.

- Effective hiring
- Using protective legal documents
- Reducing risks associated with terminations
- Preventing claims from providing references
- Preventing sexual harassment claims

Chapter Objectives

On completion of this chapter, you should be able to

- identify measures that can mitigate EPL loss exposures and,
- given case information, recognize deficiencies in an organization's current employment practices and identify steps the organization can take to reduce its loss exposures.

Effective Hiring

A significant percentage of all employee lawsuits are a direct result of hiring the wrong person for a particular job. Unfortunately, even companies with elaborate personnel policies and procedures hire the wrong people. However, if a company (1) tests for skills, (2) assesses the candidate's character/personality, and (3) does a thorough interview and background check, the risk of hiring the wrong person will be vastly reduced.

Test for Skills

Companies should not underestimate the value of skills testing. For example, an administrative assistant who types 60 words per minute, with mistakes, will be less effective than one who types 90 words per minute without mistakes. However, if a company fails to test for typing skills, it will never be aware of a prospective employee's level of ability to perform a specific task.

Avoiding Discrimination Allegations Associated with Skills Testing

A high percentage of jobs have a well-defined skill set that can be formally tested. To avoid allegations of discriminatory testing, the law only requires that skills tests be "objective," "reasonably related to the job," and "validated." Admittedly, there have been lawsuits claiming that preemployment tests were discriminatory because they had the effect of excluding a particular class of persons from a job (known as disparate impact discrimination, a concept discussed earlier). However, such cases are rarely filed, especially against private-sector employers and then typically against only large organizations.

Weighing the Risk of a Discrimination Lawsuit versus Hiring the Wrong Employee

Ultimately, a company must weigh the substantial risk of hiring a poorly qualified worker against the relatively low probability of a lawsuit alleging discriminatory testing procedures. Indeed, the damage an underqualified workforce can cause a company is much greater than the low probability of lawsuits the firm faces when it uses objective and validated tests that assess the skills and abilities required for a particular job.

Test for Personality/Character

A wide range of character assessment tools are available on the market today, a number of which have been specifically oriented to hiring. As is also the case with skills testing, there have been occasional lawsuits against firms that have used psychological tests. Again, such risks must be weighed against the potential costs associated with hiring the wrong person for a job—lost productivity, reduced morale, missed business opportunities—in addition to the person's salary.

Personality Assessments: How High Are the Stakes?

One indication of the high stakes associated with evaluating prospective management/professional employees is provided in *Hiring Smart*, by Dr. Pierre Mornell, in which he estimates that the cost of hiring the wrong employee is two-and-a-half times the person's annual salary—provided the person is replaced within 6 months.

In "Talk About Bad Company: The True Cost of a Bad Hire," (April 27, 2014; *Small Business Trends*), Curt Finch states the following.

- In a recent Career Builder survey, 42% of companies reported that a bad hire cost them at least $25,000 in the past year, and 25% reported a loss of at least $50,000
- For small companies, where every employee often juggles many important responsibilities, the cost of a bad hire was as high as $190,000, according to a report by the Association of Certified Fraud Examiners
- CFO's reported that supervisors waste 17% of their time managing under-performing employees

Do Not Use Personality Assessment Scores as the Sole Hiring Criterion

One means of reducing the risks associated with lawsuits is to not use a candidate's scores on personality assessments as the *sole source* of hiring decisions. Rather, such tests should be used as only one of *several sources* of information in evaluating a candidate but not as the only decision-making factor.

The one exception to this rule is where the company has established predictive validity for the particular position under consideration. For example, assume an auto dealership has used a certain personality assessment for the past decade. Based on such use, the dealership has found that every successful sales person received a specific minimum score on the segment of the test that measures extraversion (i.e., the extent to which a person enjoys interacting with others). If a candidate for a sales position failed to reach this minimum score, it would be both appropriate and nondiscriminatory to not offer this person the sales job.

Interviewing and Background Checking

Thorough preemployment interviews and background checks (including criminal, credit, and driving histories), performed in compliance with state and federal laws, should be conducted. The information obtained from such procedures will be valuable in assessing a prospective employee's track record of previous problems with management and history of job turnover during his or her career.

Powerful Interview Questions

Three powerful interview questions can spot problem employees before they are hired. Each can be an important “tell” in evaluating a job candidate. The questions are as follows.

- What was it in your last job that felt most unfair?
- What was it in your last job that excited you the most?
- What were the three biggest challenges in your last job, and how did you overcome them?

The first question provides insight into whether the applicant is a “self-created” victim who has problems accepting responsibility for his or her actions and their results. The answer to the second question indicates what the potential employer can hopefully recreate in the job for which the candidate is being considered. Finally, the last question provides insight into the person’s problem-solving style, yet another key factor in evaluating prospective employees.

Obtaining References on Prospective Employees: Secure Releases from Former Employers

Employers are often reluctant to provide detailed, subjective information about former employees. Therefore, when checking the background of a prospective employee, attempt to obtain a “post-employment release of employment information” request. When signed by the prospective employee, the release authorizes that person’s former employer to provide detailed information about that person’s tenure with the organization. Even more important, this form releases the former employer from liability claims associated with providing this information. Such a form, a standard feature found in HR software packages, will make it easier to obtain meaningful reference information from prospective job candidates.

Ask the Rehire Question

Many firms, when asked to provide information about former employees, refuse to release any more than “name, rank, and serial number” (despite receiving a release from a former employee). However, they will sometimes answer the following question, the response to which is very telling: “Was the employee eligible for rehire at the time he or she left your company?” Although a number of HR directors refuse to provide subjective information about an ex-employee’s tenure, they will occasionally provide an answer to this all-important but seemingly less-intrusive rehire question, the answer to which provides an interviewer with a significant piece of information.

Verify Academic Backgrounds

The potential for degree fraud is becoming ever more likely, given the proliferation of Internet-based diploma mills that not only print authentic-looking diplomas from reputable, nationally respected universities but also provide transcripts of supposed coursework completed at these institutions.

The problem of counterfeit diplomas and transcripts is easily solved. All colleges and universities routinely offer students “transcript request forms” that should be completed by the applicant and marked so that the requested transcript will be sent *directly to a company’s HR manager*—rather than to the former student who is requesting the transcript. This simple step will eliminate virtually all possibility of degree fraud. Accordingly, a company should never accept as verification of an academic credential or degree a diploma or even a transcript—no matter how official looking—if a job candidate furnishes them directly.

Online Searches of Job Candidates

Increasingly, employers are using the Internet to gather information about job applicants, using online social networking websites such as Facebook, LinkedIn, and others. There is no federal law expressly prohibiting online searches of job candidates, and only a few states do not allow it. There are both advantages and disadvantages associated with this practice, the nature of which are summarized in Exhibit 5.1.

Exhibit 5.1
Should You "Google" Job Applicants?

Why You Should

In-Depth Information. An employer can potentially obtain more detailed, candid information about the applicant's background, experience, articles the person has written, or professional reputation than it may learn during a "scripted" interview.

Uncovering Relevant Negative Information. The employer may obtain personal details that could indicate a lack of professionalism or maturity, such as drug use or use of inappropriate or discriminatory language on a Facebook page.

Why You Shouldn't

Information an Employer Would Rather *Not* Have. An employer could, for example, learn that an applicant is gay, is a member of a particular religious or political group, is disabled, has children, or has some other protected characteristic. If the applicant is not hired and is then able to show that such information was uncovered in an Internet search, the candidate could allege that the impermissible criterion was the reason he or she was not hired.

Possible Invasion of Privacy. An electronic search of an applicant may result in an invasion of privacy claim.

State Statutes. Some states, such as New York, have enacted statutes prohibiting discrimination based on lawful off-duty activities. Therefore, if, through an Internet search, an employer learns that an applicant is a member of a certain religious sect and ends up not hiring the candidate, the employer must be able to articulate a legitimate reason *not* related to his/her religious activities for rejecting the person.

Reliability Issues. A search may disclose information about someone else with the *same name* as the applicant. Moreover, information about an applicant could have been posted by a third party and may be untruthful or defamatory.

Possible Negligent Hiring/Retention Claims. An employer regularly Googles all of its job applicants yet fails to discover negative information about an applicant who is hired and subsequently assaults a customer. Here, it could be asserted that, despite its established practice of Googling applicants, the employer failed to discover readily obtainable information concerning the employee's prior conviction for assault.

Online Search Precautions

When conducting online searches, several basic steps can limit potential liability associated with this process.

- **Create and Follow a Written Online Search Policy.** If a business is going to Google applicants, it must have a written policy stating both the logic and the mechanics behind it. If *all* applicants will be Googled, the policy should so state. Or, if only certain positions within a company require candidates to undergo a search, the policy should note this accordingly.
- **Tell Applicants They Will Be Googled and Secure Their Permission.** If a company decides to conduct online candidate searches, applicants should be told that as a condition of potential employment, the company will do so. Then, if a candidate agrees to this practice, he or she can have no expectation of privacy.
- **Only Google "Finalists."** Given the potential legal liabilities and other assorted pitfalls associated with online searches, it is a good idea to use them selectively. Thus, companies should only conduct searches of people who are (1) "qualified" and are (2) being seriously considered for the job in question.
- **Document Rejections Based on Google Searches.** If a company rejects/does not make an offer to a candidate otherwise qualified for a job, based on information gleaned from an Internet search, the company should document the specific information found, as well as the reason why it disqualified the candidate.

Using Protective Legal Documents

Despite the publicity garnered by large employment-related verdicts, many firms still fail to use protective legal documents that might have prevented or mitigated these large damage awards. Some of the more important protective legal documents include "at-will" employment agreements, management rights statements, agreements in which employees assent to arbitrate (rather than litigate) employment-related claims, and agreements barring employees from bringing class action litigation. In addition, outside counsel with employment law expertise should be asked to review all employer-produced, HR-related material.

Have Employees Sign "At-Will" Employment Agreements

Both new and current employees should be required to sign a statement acknowledging that their employment is on an "at-will" basis, meaning that they can be terminated for cause or for no cause, at any time, and with no advance notice. The "at-will" doctrine is recognized in most jurisdictions.

Avoid Implied Promises of "Permanent" Employment

Businesses must avoid making statements at the time of hire or during an employee's tenure that could be construed as promises of permanent employment. In addition, the employer should make sure that employees clearly understand (through either signed statements or contract provisions) that no oral understandings or promises are incorporated into the employment relationship. Employee handbooks should also be audited to ensure that they contain no statements that could be interpreted to guarantee permanent employment.

Include a "Management Rights" Provision in Written Material

Any written material given to employees, both new and existing, should include language reserving the right of the organization to modify and interpret HR policies and practices without advance notice and at management's sole discretion. This is known as a "management rights" provision and will help to defeat claims alleging that the company promised to notify employees of any future changes to the employee handbook.

Require Employees to Sign Mandatory Arbitration Agreements

Employers should consider asking employees to sign binding arbitration agreements, which preclude an employee from suing an employer and instead require that employment disputes be settled by binding arbitration. There have, however, been numerous legal challenges brought against mandatory arbitration agreements, some of which have been successful. Accordingly, depending upon both the state in which a business is located or headquartered, along with other particulars, mandatory arbitration agreement may not be enforceable.

Advantages of Mandatory Arbitration Agreements

Observers agree that the advantages of arbitration to employers outweigh the potential disadvantages. These advantages are noted as follows.

- **Avoids the Unpredictability of Juries.** Employers and defense counsel prefer arbitration because it avoids the risk of a so-called runaway jury. Since the majority of jurors identify more with an individual employee than with an employer, juries sometimes have a tendency to dispense their own brand of justice in the form of an astronomical award. In contrast, arbitrators usually have a better ability than most jurors do to understand the reasoning behind legitimate business decisions made by an employer.
- **Has Lower Costs Than Litigation.** Compared to a trial, an arbitration proceeding involves less discovery and fewer motions than a typical lawsuit, producing considerable savings in legal fees.
- **Affords Earlier Resolution.** The time between the filing of an employment claim and the arbitration hearing is usually much shorter than the time from the filing of a lawsuit to the trial date. The benefit of achieving an early final resolution of employment cases, where emotions often run high and tension in the workplace lingers for some time, is extremely important to any company.
- **Removes the Dispute from Public Scrutiny.** Employers want to keep their workplace disputes out of the public fishbowl known as the courtroom. Private arbitration achieves that goal.

Have Employees Sign Agreements Barring Employment-Related Class Action Lawsuits

One variation of mandatory arbitration agreements includes agreements prohibiting employees from bringing employment-related class action litigation against their employers. Yet, as is also the case with mandatory arbitration agreements, agreements prohibiting class actions have been met with resistance by employees and again and may not be universally enforceable. On one hand, the 2nd, 8th, and 9th US Circuit courts of appeal have held such agreements enforceable. On the other hand, the National Labor Relations Board (NLRB) in Murphy Oil USA, Inc., 361 NLRB No. 72 (2014), reaffirmed an earlier decision in which the NLRB found that requiring employees to waive their right to bring class actions against employers violated the National Labor Relations Act (NLRA). As a consequence, considerable legal expense may be incurred if an employee brings an action disputing such a provision. Thus, employers should recognize the risks of including class action waivers within mandatory arbitration agreements.

Use Legal Counsel to Review Employer-Produced Material

Both internal and external counsel should review all employer-produced written material (e.g., employee handbooks, "at-will" statements, arbitration agreements, benefits descriptions, and HR policies) for possible misleading statements regarding the employer-employee relationship.

Preventing Wrongful Termination Claims

A number of steps can help to minimize both the incidence and severity of wrongful termination claims. These are noted in Exhibit 5.2 and discussed in the paragraphs that follow.

Exhibit 5.2
Preventing Wrongful Termination Claims

- Conduct periodic performance evaluations.
- Avoid knee-jerk terminations.
- Consider alternatives to termination.
- Be consistent in making termination decisions.
- Educate and assist managers in the termination process.
- Terminate at the right time and place.
- Use counseling, employee assistance, and outplacement programs.

Conduct Periodic Performance Evaluations

Conducting periodic performance evaluations that honestly note deficiencies but give the employee opportunity for remedial action is the initial step in preventing wrongful termination claims. Directly addressing performance deficiencies is critical because it is difficult to justify termination or demotion when a person has received ostensibly adequate ratings for an extended period of time. Performance evaluations should be conducted on a regular basis (at least once yearly, and quarterly for employees who are experiencing difficulties) and follow written procedures developed by management.

To the extent possible, it is advisable to evaluate employees using objective and quantifiable performance standards—for example, in the case of a customer service representative, on the basis of the number of customers with which he/she interacts per day or the number of customer complaints received. (However, a quantitative assessment is admittedly easier to accomplish for some positions than others.)

Record Derogatory Information Carefully

When performance has been unsatisfactory, managers and supervisors should be instructed on how to properly document personnel files so that especially embarrassing or disparaging remarks do not appear in writing, since these documents are fully discoverable in employment-related litigation.

Record the Need for Remedial Steps

After providing fair warning, coupled with a plan for performance improvement, if progress is not forthcoming, a manager must consider termination. However, by having documented the need for remedial action, the organization is in a position to have demonstrated its good faith. This will make it easier to defend against claims. Honest, timely evaluations, coupled with an opportunity for the employee to improve performance, will make it easier to assert that the company opted for justifiable termination only as a last resort.

Document, Document, Document

Judges and juries expect to see documentation of poor performance. Make sure the employee signs any performance evaluations or warnings. Thorough and objective documentation of poor performance guards against claims of ulterior motives such as harassment or discrimination.

Avoid Knee-Jerk Terminations

While most employers, as a general rule, fire "too slowly," sometimes there are circumstances where an owner or a manager engages in a "knee-jerk" termination. Not surprisingly, many of these terminations end up as lawsuits. Rather than firing an employee during a heated argument, employers should take 5 minutes and go for a walk to cool off.

Moreover, knee-jerk terminations often violate the terms of a company's disciplinary procedure, whereby the employee is first entitled to the opportunity to remedy unsatisfactory performance, making room for affirmative arguments by a savvy plaintiff's counsel. If there is a company procedure for terminations, it should be followed.

Consider Alternatives to Termination

Alternatives to termination include restructuring the person's job, moving that person to another department or location, or demoting the employee to a lower position on a temporary or permanent basis. But, as already discussed, many employees have filed lawsuits not just for wrongful termination but also for wrongful demotion. Alternatively, consider giving the employee leave without pay so that he or she can think over whether he or she wants to continue working for the company.

Be Consistent in Making Termination Decisions

If there is a company termination policy, employers must follow it consistently and make sure that any action taken is consistent with the manner in which the company has previously treated other employees under similar circumstances.

Educate and Assist Managers in the Termination Process

A firm's termination procedures should be established by management, committed to writing, reviewed by legal counsel, distributed and explained to supervisors, and implemented in the event that an employee must be terminated. By having such guidelines in place and then adhering to them, a company reduces the possibility that the employee will prevail in a wrongful termination claim.

Involve Additional Persons

Have more than one person review a termination decision. This person can be an HR executive or other company manager. The reviewer should inquire into the immediate supervisor's true motivations and check any other concerns. (I.e., does the employee have a contract that controls this decision?) In addition, it is highly recommended that the organization's director of HR approve all terminations.

Obtain an Independent Review of the Decision to Terminate

It may also be prudent to consider obtaining an independent, outside review by an employment attorney when confronted with a termination decision that appears problematic.

Terminate at the Right Time and Place

Being terminated is a highly emotional experience. Studies have found that employees who recover the most quickly are those who focus on pursuing new opportunities, as opposed to those who dwell on their past circumstances. As a result of these studies, the consensus is that employees should be terminated on Monday, Tuesday, or Wednesday so that they do not have the entire weekend to dwell on their misfortune. It is also suggested that the termination decision be done in the morning, when everyone is less tired and has the energy necessary to deal with the decision. Lastly, seek "neutral grounds" for communicating the termination decision, one not regularly used by any of the parties involved in the termination. A conference room that is private or even an off-site location is therefore preferable to the manager's or the employee's office.

Have the Appropriate Paperwork Ready

In most states, an employer is required to give an employee his or her final paycheck at the time of termination. This includes all accrued vacation pay, sick pay, commissions, and other benefits. Depending on the size of the company and the state in which it is located, an employer may also be required to give a Consolidated Omnibus Budget Reconciliation Act notice for continued medical coverage, an unemployment insurance benefits notice, information on transferring the employee's health insurance, and 401(k) plan details.

Addressing Severance Pay Issues

If the employer is considering offering any form of severance package, a release of all claims against the company should also be presented at the time of the termination meeting. It should be explained to the employee that he or she is not required to sign the agreement at that moment but that he or she has the opportunity to speak with an attorney of his or her choosing. However, a response to the release should be requested no later than 14 calendar days from the date of the document.

Handling the Exit Interview

A witness should be present when an employee is notified of termination. This requirement will assist in corroborating what was said during the exit interview so that someone will be able to refute a claim of defamation if one is made.

What to Say, How to Say It

The reason(s) for termination should be stated sensitively but candidly. Acknowledge the emotional and financial loss an employee will suffer as a result of being terminated. Managers should choose their words carefully, as if the exit interview were being taped, since claims are more likely to result when employees are treated in an unduly harsh manner.

Use Counseling, Employee Assistance, and Outplacement Programs

The separation of almost any relationship is accompanied by emotional upheaval. Recognize that the employee, even if he or she is "at fault" for the termination, will be facing uncertainty, fear, anger, resentment, and a host of other emotions. Anything that the employer can do to ease the transition will not only reduce the employer's liability exposure but also send a message of true caring to the remaining workforce.

Unless an employee was dishonest or deceitful, it is often a good idea to make an effort to help him or her find new employment. A willingness to expend funds for outplacement services shows a company's concern for and sincere efforts to help a terminated employee. These kinds of programs sometimes reduce an employee's incentive for making a claim and will assist in defending a claim if one is made.

Other techniques to avoid wrongful termination suits (or at least mitigate their effect if they do arise) include counseling and employee assistance programs (for employees with performance, personal, or substance abuse problems) and outplacement services.

Preventing Claims from Providing References

Providing references about former employees has the potential to produce two types of claims.

- **The Defamation Exposure.** First, they can result in claims by ex-employees alleging that their former employer provided untrue, defamatory references that prevented the ex-employee from obtaining a new position.

- **The "Wrongful Hiring" Exposure.** Second, references sometimes result in lawsuits against firms that provide favorable references concerning former employees when, in fact, such ex-employees were known to have been incompetent, dishonest, or dangerous. This is known as "wrongful hiring." For example, Employer "A" gives a positive reference to Employer "B" about a former employee who was fired for embezzling. Company "B" hires the ex-employee, who embezzles from Company "B." As a result, Company "B" sues Company "A" for providing a knowingly false reference.

Obtain Releases as a Condition of Providing References

Given these potential problems associated with references, companies should obtain signed agreements from ex-employees that will prevent the kinds of claims discussed above.

Specifically, companies should secure a signed "post-employment release of employment information" statement that absolves a former employer from liability when they give reference information to prospective employers. Such a form will provide legal protection when a former employer releases subjective information about a former employee that goes beyond "name, rank, and serial number."

Such agreements reduce the former employer's legal exposure for providing unduly negative references (i.e., the defamation exposure) and lowers the chance that it could be alleged by another employer that the former employer failed to provide candid but derogatory information about a potential employee (i.e., the wrongful hiring exposure).

Preventing Sexual Harassment Claims

A number of actions can help an organization reduce the frequency and severity of claims alleging sexual harassment. These steps are noted in Exhibit 5.3 and discussed in the paragraphs that follow.

Exhibit 5.3 Preventing Sexual Harassment Claims
• Develop a written policy against sexual harassment. • Communicate the policy. • Train supervisors, managers, and employees on how to implement the policy. • Develop a complaint procedure that protects the employee making the complaint. • Promptly, thoroughly, and confidentially investigate complaints. • Carefully document investigations. • Take timely, effective actions following investigations. • Continuously review the program.

Develop a Written Sexual Harassment Policy

The most important measure in preventing sexual harassment claims is for an organization to prepare, distribute, publicize, and enforce a written policy against sexual harassment.

Contents of an Effective Sexual Harassment Policy

An effective policy should include the following.

- A definition of sexual harassment, along with specific examples of sexual harassment
- Strong wording prohibiting sexual harassment and outlining disciplinary action
- A confidential complaint-reporting mechanism

- A statement that all complaints and investigations will be held confidential

Communicate the Policy

The policy must be communicated to all employees and supervisors, preferably in direct meetings. It should be placed on bulletin boards, in the HR office, and in employee manuals or handbooks. US Supreme Court decisions have held that the existence and communication of a corporate sexual harassment policy can sometimes provide an affirmative defense when confronted with such claims.

Train Supervisors in Implementing the Policy

Training of all supervisors can substantially reduce an employer's legal liability for sexual harassment. Persons who know the laws prohibiting sexual harassment should administer training. During training, managers and supervisors should be given guidance regarding the types of conduct that constitute sexual harassment.

Develop a Confidential Complaint Procedure

Developing a confidential complaint procedure is another key element of a corporate sexual harassment policy. However, unless a complaint can be made *outside* of the normal organizational chain of command, the complaining employee is exposed to the risk of retaliation. For example, assume that a female administrative assistant alleges harassment by her male supervisor. If, under her employer's complaint procedure, she must report such harassment to her supervisor, there will be obvious disincentive to make such a complaint, given the high probability of retaliation against her. Accordingly, sexual harassment complaint procedures should provide that employees must file grievances with appropriate individuals who work in different departments (e.g., HR) within the company.

Investigate Complaints

Once complaints are made, they must be promptly and thoroughly investigated. At least two employees should investigate complaints. Such persons should be well-regarded members of the company, and, preferably, one should be of the same gender as the complaining employee.

Consider Using Outside Investigators

Given the emotionally charged nature of sexual harassment allegations, it is sometimes appropriate to retain the services of an outside firm to investigate sexual harassment complaints. Using such a service can often assist in maintaining independence and objectivity during the investigation process, which might otherwise be impossible if a company employee is charged with this responsibility.

Document Investigations with Care

It is important to recognize that internal documents pertaining to sexual harassment investigations are discoverable in legal actions. For this reason, those responsible for investigating allegations must use caution when or if they make subjective or derogatory remarks, either verbally or in writing. Of course, such cautions apply whether they are evaluating the person making the complaint or the alleged harasser.

Take Prompt, Appropriate Actions Following Investigations

Following the investigation, all parties involved should be counseled. Appropriate discipline, including termination, if warranted, should follow. It is important to note that executives and managers who are harassers must not be treated any differently than nonmanagerial/nonexecutive personnel.

Continuously Review the Policy

By continuing to review the policy, modifications can be made that reflect the changing conditions of the company. Confidential exit interviews can ensure compliance with the policy, allow the company to assess its usefulness, and, ultimately, make improvements to ensure its continued effectiveness.

Chapter 5 Review Questions

1. Job candidates' scores on psychological tests
    A. are inherently discriminatory.
    B. can appropriately be used if experience has demonstrated their validity.
    C. should never be used along with other decision-making criteria.
    D. should preferably be used as the sole source of hiring decisions.
2. Hector, a single father, intends to do a thorough background check before hiring Billie as a nanny. To obtain meaningful references from her former employers, Hector should attempt to have Billie sign a(n)
    A. employee reference request.
    B. letter of record.
    C. reservation of rights.
    D. waiver of subrogation.
3. By requiring employees to sign binding arbitration agreements that preclude employees from suing their employer, Unified Airlines expects to
    A. avoid the risk of a runaway jury.
    B. delay the resolution of claims.
    C. improve transparency by increasing public scrutiny.
    D. incur higher costs than with litigation.
4. When Rory Canon admits that he failed to finish printing and collating the handouts in time for the president's board meeting, the president fires him on the spot, without even asking what the problem was. The president's reaction is
    A. an appropriate way to deal with this jerk.
    B. an example of firing too slowly.
    C. probably consistent with the company's disciplinary procedures.
    D. likely to lead to a lawsuit.
5. Linda's office is open from 9:00 a.m. to 5:00 p.m., Monday through Friday, but she usually arrives late and leaves early. Linda doesn't know it yet, but HR director Arnold, known not-too-affectionately as The Terminator, will soon fire her. The best way for Arnold to terminate Linda is on
    A. Monday morning, in a private conference room.
    B. Wednesday afternoon, in his office.
    C. Friday afternoon, in her office.
    D. Saturday morning, by email.

Answers to Chapter 5 Review Questions

1.

   A. This answer is incorrect. Charges of discrimination are more likely with skills tests, and, even then, disparate impact claims are rare.

   B. That's correct! It is appropriate and not discriminatory to use a test that experience has proven valid.

   C. This answer is incorrect. Other decision-making criteria should also be used.

   D. This answer is incorrect. The risk of a lawsuit is lower when psychological tests are not the sole basis for hiring decisions.

2.

   A. That's correct! An employee reference request signed by a former employee authorizes the former employer to provide detailed information about that person's tenure with the former employer and releases the former employer from liability claims associated with the information release.

   B. This answer is incorrect. The authorization to obtain information from a previous employer is referred to by a different name.

   C. This answer is incorrect. A reservation of rights letter concerns an insurance claim that might not be covered.

   D. This answer is incorrect. A waiver of subrogation agreement agrees to forgo one's rights to collect damages from the party responsible for a loss.

3.

   A. That's correct! Arbitration avoids the risk of a jury whose members identify more readily with the employee than with the employer.

   B. This answer is incorrect. Prompt resolution is the desired goal.

   C. This answer is incorrect. Private arbitration keeps workplace disputes out of the public fishbowl known as the courtroom.

   D. This answer is incorrect. Arbitration generally produces considerable savings in legal fees.

4.

   A. This answer is incorrect. This is the type of knee-jerk termination that creates problems.

   B. This answer is incorrect. It seems Canon was fired too rapidly.

   C. This answer is incorrect. If the company is using sound loss control, its procedures will describe a termination process that prevents snap termination decisions like this one.

   D. That's correct! Many knee-jerk terminations produce lawsuits.

5.

   A. That's correct! Consensus is that employees should be terminated in the morning on Monday, Tuesday, or Wednesday and that the decision be communicated on neutral grounds.

   B. This answer is incorrect. The Terminator's office, which probably seems threatening, is not a neutral location.

   C. This answer is incorrect. If the termination takes place well before 5:00 p.m., Linda should still be there, but it would be preferable to act earlier in the week and earlier in the day.

   D. This answer is incorrect. This impersonal approach is inappropriate, and the timing is also bad.

Chapter 6
EPL Coverage Options

Overview

This chapter begins by explaining why EPL coverage is not provided under commercial general liability (CGL) policy forms. It then discusses the various sources of EPL coverage.

Chapter Objectives

On completion of this chapter, you should be able to

- recognize the EPL coverage gap created by CGL forms;
- recognize the extent of coverage available under
    - stand-alone EPLI policies,
    - management liability policies, and
    - businessowners policies (BOPs); and,
- given relevant information, select an appropriate method of providing EPL coverage.

The Lack of EPL Coverage under CGL Policy Forms

Since the early 1990s, CGL policy forms are increasingly restrictive as respects the extent of EPL coverage they provide. As the frequency and severity of EPL claims began to rise in the late 1980s, CGL insurers became reluctant to cover such claims under their policies. In addition, the proliferation of stand-alone EPL forms beginning around this time made it apparent to CGL insurers that EPL-specific policies were better suited to covering employment-related claims.

The Employment-Related Practices Exclusion: CG 21 47 (12/07)

By 1998, CGL insurers had developed a standardized exclusionary endorsement that significantly restricted the scope of EPL coverage available under their policies. Accordingly, nearly all CGL policy forms are currently being written with endorsement CG 21 47 (12/07), known as the "Employment-Related Practices Exclusion," which bars coverage of employment-related claims.

As a result of this exclusion, stand-alone EPLI policies that fill this significant coverage gap have become increasingly available, as has EPL coverage under management liability package policies and BOPs.

Stand-Alone EPLI Policies

Buying a stand-alone EPLI policy has become a popular option because approximately 50 insurers, as well as Insurance Services Office, Inc. (ISO), offer such forms. The following discussion addresses the pros and cons of this option.

Pros

The two advantages of this approach include (1) added coverage breadth and (2) availability of risk management and claim prevention advice.

Added Coverage Breadth

EPL exposures are "specialty" risks, much like directors and officers (D&O), intellectual property infringement, media liability, and other exposures that typically are addressed with coverage-specific insurance products. Stand-alone EPLI policy underwriters better understand these risks and continuously update their policies to address evolving claim causes in favorable ways, as they vie for a greater or more profitable share of the EPLI market. For this reason, stand-alone EPLI policies tend to offer somewhat broader coverage than do management liability package policies or BOPs (discussed later in this chapter). However, the difference in coverage breadth between stand-alone forms and the scope of EPLI coverage available under management liability package policies has been narrowing substantially in recent years.

Risk Management and Claim Prevention Advice

The availability of risk management advice and practical loss prevention tools (often at no cost or low cost) are also significant advantages offered by a stand-alone EPL policy. Examples include providing a hotline for labor and employment lawyers, assisting in writing employee manuals, making online loss control assessments available, and giving advice on potentially volatile situations.

Cons

Although stand-alone EPLI policies are a viable coverage option, there are nevertheless some cons, including higher premium cost and added risk management program complexity.

Higher Premium Cost

The cost of a stand-alone policy is higher than the premium charged for EPL coverage made available under a management liability package policy or (especially) a BOP.

Added Risk Management Program Complexity

Stand-alone EPLI policies add complexity to the process of administering an insurance program. More specifically, with the exclusion of EPL exposures by CGL insurers and, thus, the need to buy separate EPL coverage, insureds must now maintain yet another "tower" of insurance (i.e., a primary EPL policy and perhaps an excess EPL policy) for a risk that CGL forms once covered.

Management Liability Package Policies

Management liability package policies afford another alternative for obtaining EPL coverage.

Basic Structure

As the name indicates, such policies "bundle" EPL coverage along with several other lines of insurance, including D&O, fiduciary liability, special crime coverage (also known as kidnap/ransom insurance), and cyber and privacy coverages. More specifically, management liability package policies consist of (1) a set of common policy provisions applicable to *all* of the coverage lines addressed by the policy (pertaining to matters such as cancellation, subrogation, and cooperation with the insurer in the event of a claim) and (2) individual policy forms that apply *only* to one of these individual coverages.

Flexibility

Usually, an insured must only select two of these five types of coverage to be eligible to purchase EPL coverage under a management liability package policy. In other words, an insured seeking EPL coverage need only buy *one other* of the following coverages in order to obtain EPL coverage within a management liability policy: D&O, fiduciary, special crime, or cyber and privacy coverage.

Cost Advantage

Management liability policies afford meaningful premium discounts compared to what would be charged if an insured were to purchase the aforementioned coverages separately. This is because an insurer uses much of the same data to underwrite EPL coverage as it does for D&O, fiduciary, special crime, and cyber and privacy insurance. Although the exact discount will vary, the premium for EPLI coverage purchased within a management liability package policy will be roughly 10–20 percent lower than if equivalent coverage were obtained under a stand-alone EPLI policy.

Somewhat More Limited Eligibility

At one time, management liability package policies were made available only to privately held firms, not-for-profit organizations, and relatively small publicly traded companies (i.e., those with annual sales of under $25 million).

Since that time, though, even insurers writing coverage for large, publicly traded businesses (i.e., those with annual sales exceeding $1 billion) have been increasingly offering management liability package policies.

Coverage Breadth Nearly Equivalent to Stand-Alone Forms

Management liability policies typically offer a scope of coverage for EPL exposures that is nearly equivalent to what is available under stand-alone forms. The major difference is that stand-alone policies tend to provide a somewhat more extensive list of covered perils under the "inappropriate workplace conduct" category. Another difference is that stand-alone forms frequently offer more favorable extended reporting period (ERP) options, such as ERPs of more than 1 year. A final difference is that a handful of stand-alone forms offer defense-only coverage (in amounts ranging from $100,000 to $250,000) of wage and hour claims.

Separate Limits (Per Coverage) versus Combined Single Limits

Most management liability package policies are written with separate limits for each of the coverages selected. However, a minority of policies, and especially those for small firms, are written with a combined single limit. This approach is almost always less costly than one in which separate limits are provided and may be adequate for small insureds that have very low claim frequency. For such companies, the probability of sustaining *both* an EPL *and* either a D&O, fiduciary, special crime, or cyber and privacy claim in a single year is unlikely. Thus, for such organizations, a policy containing a separate EPL limit may not justify the additional cost.

EPLI Coverage under BOPs

BOP policies provide yet another source of EPL insurance. Coverage is provided by attaching the "Employment-Related Practices Liability Endorsement," form BP 05 89 (01 10), to a BOP. This endorsement is part of the portfolio of coverage forms offered by ISO, an organization that develops standard policy forms and files information with state regulators on behalf of insurance companies that purchase its services.

What Are BOPs?

BOPs are "package policies" for small businesses. ISO BOPs combine several different coverages under a single form, most often general liability insurance and property insurance. As already explained, a key feature of package policies—and one that significantly impacts the pricing structure of the employment-related practices liability endorsement—is that package policies usually afford meaningful premium discounts. This is because, as is also the case with management liability package policies, there are cost efficiencies inherent in the underwriting process when more than one coverage line is provided under a single policy.

Eligibility

Eligibility for a BOP policy is based on the *type* and *size* of a business.

Specifically, there are two basic requirements that a business must meet to be eligible.

- None of its locations can exceed 35,000 in square footage (excluding basements not open to the public).
- Its gross annual sales must not exceed $6 million.

The following types of businesses, among others, are ineligible, regardless of whether they meet the requirements noted above.

- Manufacturers
- Auto repair or service stations; auto, motor home, mobile home, and motorcycle dealers; parking lots or garages
- Bars and pubs
- Places of amusement
- Banks and other financial institutions
- Self-storage facilities that provide outdoor storage of motorized vehicles of any type

How EPL Is Covered under BOPs

BOPs do not automatically cover EPL exposures. Rather, the policies cover EPLI exposures by means of an employment-related practices liability endorsement, form BP 05 89 (01 10). This endorsement is a seven-page coverage form, written on a claims-made basis.

No EPL Coverage Endorsement Available under ISO, Non-BOP Policies

Interestingly, there is no similar EPLI coverage endorsement found within the ISO CGL or property insurance endorsement portfolios. In other words, if an insured is covered by a “standard” ISO property or ISO CGL policy (i.e., the business is not eligible for a BOP), ISO offers no comparable endorsement that can be attached to *either* the CGL policy *or* property policy to also afford EPLI coverage. Therefore, if a company is ineligible for a BOP form, it must obtain EPLI coverage by means of either a stand-alone EPLI policy or a management liability package policy. (ISO does offer a stand-alone EPLI policy of its own, although an analysis of the form is beyond the scope of this course.)

Premium Determination

The premium for an EPL endorsement to a BOP policy is determined by applying a state-specific rate for the $10,000 basic limit of coverage provided by the endorsement. The premium for coverage is determined by multiplying the rate per employee (based on the type of business being covered) by the number of covered employees. Although the basic limit available under the ISO EPLI coverage endorsement is $10,000, a limit of up to $100,000 is available.

The basic deductible available under the ISO EPLI coverage endorsement is $500. However, a deductible of up to $25,000 is available, for which commensurate premium credit is granted.

Coverage Aspects

The coverage afforded by the endorsement contains similar provisions found within stand-alone and management liability package policy EPLI forms.

Positive Features

In some respects, the endorsement actually offers an even broader scope of coverage than do standard EPLI forms (e.g., a more liberal counsel selection provision and an ERP limit reinstatement, coverage areas that will be discussed later in this course).

Negative Features

Conversely, there are a few areas in which the coverage falls below the breadth found within customary stand-alone policies, including the following: (1) constructive discharge and breach of confidentiality/privacy are not covered perils; (2) a lack of coverage for certain special categories of employees including leased, temporary, part-time employees, and for other persons, such as independent contractors, applicants, and volunteers; (3) no coverage for third-party liability; and (4) the absence of a discovery provision. (Such provisions are discussed in Chapter 11 of this course.)

Need for Higher Limits

In addition to the coverage deficiencies noted, the largest possible limit that can be purchased under ISO's BOP program is $100,000. This is insufficient to address the kinds of EPL exposures faced by even the small employers for which the program is designed. (At times, however, insurers do file state exceptions to these maximum limits, and regulators typically approve them.)

Chapter 6 Review Questions

1. RMI Hardware Store is concerned about its employment-related claims exposures. Tom Cox, RMI's broker, advises RMI that there are several sources of EPL coverage. Which of the following is not a source of coverage?
   A. A management liability package policy
   B. A stand-alone EPL policy
   C. RMI's BOP
   D. RMI's CGL policy
2. Globule Warning Company (GWC) is an international corporation. After evaluating the alternatives, GWC decided not to purchase a stand-alone EPLI policy because it would make GWC's risk management program more complicated than including the coverage under another type of policy. How would a separate policy make GWC's risk management program more complicated?
   A. GWC would have more restrictive coverage.
   B. GWC would need to maintain an additional "tower" of insurance (a primary EPL policy and possibly also an excess EPL policy) for a risk that could be covered under another form.
   C. The insurer providing EPL coverage would impose stringent loss control recommendations.
   D. The reduced cost of a stand-alone policy is accompanied by onerous restrictions.
3. R&I Company is evaluating the possible purchase of Fiddle-Deedee Insurance Company's management liability policy form containing (1) EPL, (2) D&O, (3) fiduciary liability, and (4) special crime coverages. Assuming R&I decides to purchase this policy, it is probably required to select
   A. only one of these four coverages.
   B. at least two of the four coverages.
   C. any three of the four coverages.
   D. all four coverages.
4. As compared with the EPL coverage available in management liability policies, stand-alone EPL policies may offer all the following benefits, except
   A. a longer list of covered perils.
   B. defense-only coverage for wage and hour claims.
   C. lower costs.
   D. more favorable ERP options.

5. Bee Insurance Company offers an ISO BOP, which is
    A. a new dance step.
    B. an obsolete dance step.
    C. a package policy form for small businesses promulgated by Insurance Services Office, Inc.
    D. excluded under most EPL insurance policies.

Answers to Chapter 6 Review Questions

1.

   A. This answer is incorrect. Management liability package policies provide an alternative for obtaining EPL coverage.

   B. This answer is incorrect. Buying a stand-alone EPLI policy has become a popular option because approximately 50 insurers, as well as ISO, offer such forms.

   C. This answer is incorrect. EPL insurance can be provided by attaching the “Employment-Related Practices Liability Endorsement” to a BOP.

   D. That’s correct! Nearly all CGL policy forms currently written have the “Employment-Related Practices Exclusion” endorsement, which bars coverage of employment-related claims.

2.

   A. This answer is incorrect. A stand-alone policy provides broader coverage.

   B. That’s correct! An additional insurance “tower” would add to the complexity of GWC’s risk management program.

   C. This answer is incorrect. The insurer’s advice and practical loss-prevention tools, often available at little or no cost, are generally viewed as a significant advantage.

   D. This answer is incorrect. The cost of a stand-alone policy is higher than the premium charged for EPL coverage under a management liability package policy or a BOP.

3.

   A. This answer is incorrect. More than one coverage in this “package policy” must be purchased.

   B. That’s correct! Usually, an insured must select at least two of these four types of coverage to be eligible to purchase EPL coverage under a management liability policy form.

   C. This answer is incorrect. Although it is permissible to purchase three coverages, this is not a requirement.

   D. This answer is incorrect. It is not necessary to purchase all four available coverages.

4.

   A. This answer is incorrect. Stand-alone policies tend to provide a somewhat more extensive list of covered perils under the “inappropriate workplace conduct” category.

   B. This answer is incorrect. A few stand-alone forms offer defense-only coverage (in amounts ranging from $100,000 to $250,000) of wage and hour claims.

   C. That’s correct! Management liability policies afford meaningful premium discounts compared to what would be charged if an insured were to purchase the same coverages separately.

   D. This answer is incorrect. Stand-alone forms frequently offer more favorable ERP options, such as ERPs of more than 1 year.

5.

   A. This answer is incorrect. Although insurers are sometimes accused of dancing around difficult claims, the ISO BOP is not a dance step.

   B. This answer is incorrect. The ISO BOP is still in common use.

   C. That’s correct! An ISO BOP is a businessowners policy. Insurance Services Office, Inc. (ISO), as well as many individual insurers, has promulgated the policy language used in BOP forms. Bee Insurance Company apparently uses the ISO form.

   D. This answer is incorrect. It’s the other way around. The ISO BOP excludes EPL coverage unless an endorsement is added.

Chapter 7
Covered Organizations, Covered Persons, and Covered Acts Provisions in Stand-Alone EPL and Management Liability Package Policies

Overview

Chapter 7 discusses the (1) covered organizations, (2) covered persons, and (3) covered acts provisions contained in stand-alone EPLI and management liability package policy forms.

Chapter Objectives

On completion of this chapter, you should be able to

- recognize the coverage available to the corporate entity in stand-alone EPL policies and management liability package policies;
- given relevant information, determine whether a particular person or group of people is covered by a stand-alone EPL policy or a management liability package policy; and
- recognize the types of acts that are covered and not covered by a typical stand-alone EPL policy or a management liability package policy.

Covered Organizations

EPL policies provide explicit coverage for the corporate entity. This is critical because virtually all EPL lawsuits name *both* the corporate entity *and* specific individuals as defendants. Accordingly, if a lawsuit were filed naming an employee such as a manager or supervisor as well as “XYZ Corporation” as defendants, the policy would also cover XYZ Corporation.

Coverage of Subsidiaries

The policies also cover subsidiaries of the named insured organization. Typically, a subsidiary is defined as a company in which the named insured organization holds a majority interest.

Most underwriters are also amenable to providing coverage for entities in which the named insured holds a minority interest. This is done by way of an endorsement for additional premium.

Coverage for Newly Acquired/Newly Formed Organizations

Most, but not all, EPLI policies provide what is known as “automatic coverage” (coverage that is immediately applicable) for newly acquired and newly formed entities as long as (1) the covered organization holds a majority interest in the new organization and (2) the size of the newly acquired or newly created organization is at or below a specific threshold, typically based on its number of employees relative to the covered organization.

Size Thresholds

Usually, this threshold states that automatic coverage applies, provided the new organization has less than 10 percent to 35 percent (depending upon the individual policy) of the number of the covered organization's employees. This is appropriate, since automatic coverage is provided for no additional premium.

Applicable Period of Coverage

The period of time during which automatic coverage applies varies from 30 to 90 days, depending on the individual policy form. For coverage to apply *after* this period, the insurer requires (1) submission of information about the new entity and (2) additional premium.

Coverage Only Applies Post-Acquisition/Creation Acts

It is important to note that automatic coverage only applies to wrongful employment acts that take place *after,* rather than prior to, acquisition/creation of the new entity. Coverage of preacquisition events needs to be addressed by the acquired entity's own EPLI policy, usually by means of an ERP endorsement (a topic that will be discussed later in this course).

Covered Persons

Under nearly all of the policies, officers, directors, partners, managers, and employees are "covered persons." In addition, the forms typically cover (1) personal representatives of insureds such as heirs, administrators, and executors and (2) spouses but only for their "status" as spouses. Thus, if an insured's spouse is also named in a lawsuit but did not commit any actual wrongful act, coverage would nevertheless apply to this individual. Specifically, coverage would apply only to the spouse's interest in assets held jointly (to which claimants' attorneys frequently seek access). In contrast, the employee's spouse would not have coverage if, for example, the spouse was accused of committing sexual harassment at the insured company's Christmas party.

Definition of "Employee"

While all of the policies cover "employees," there is some variation between the exact definitions of the term "employee." The following categories of "employee" are usually covered.

- Full-time employees (including management/supervisory employees and former employees)
- Part-time employees
- Leased employees
- Temporary employees
- Seasonal employees
- Interns
- Volunteers
- Students
- Independent Contractors

Firms employing personnel *not* falling within any of these categories should review their policies' definitions of "employee" and request modifications to secure coverage for such persons.

Coverage for Former Employees

Most but not all of the leading forms provide coverage for "former employees." The rationale for this extension is that, by virtue of being granted coverage, it ensures that the former employee will cooperate with the insurer and thereby assist in defending a claim in which the former employee is named as a defendant.

Coverage of Leased Employees

For coverage to apply to leased workers, all three of the following requirements need to be met: (1) The insured must agree to provide legal indemnification to the leased worker as if the worker were an actual employee of the insured corporation. (Absent an agreement to indemnify leased workers, the insured company would not be legally obligated to indemnify the leased worker for his or her conduct. This is because, legally, such workers are the employees of the leasing firm.) (2) The firm that leases the worker to the insured must be scheduled as an insured under the policy. (3) The insured must pay an additional premium to cover the leased workers. Typically, the per-leased-worker premium is one-third of the usual per-employee premium.

Coverage of Independent Contractors (ICs)

About half of all EPLI policy forms provide coverage for ICs. There are three qualifications that must be met for coverage to apply under the insurers' policies that cover ICs. First, the insured company must agree, in writing, to indemnify the IC for employment-related liability claims incurred while working for the insured company. Second, the insured's policy must be endorsed to provide IC coverage. Third, additional premium is required.

Cover Small ICs under Your Policy

In an ideal world, ICs with which a business engages should be required to purchase and provide evidence of their own EPLI coverage. However, when dealing with small ICs, it may not be realistic or even possible to actually enforce such a requirement. Thus, when engaging small ICs, it is best if your business simply purchases coverage under its own EPLI policy, using the process noted in the preceding paragraph. Most often, insurers do not object to covering ICs, provided they (a) are made aware of the exposure and (b) receive an appropriate premium.

On the other hand, when dealing with a large IC—especially one of comparable size or larger, a business is in a better position to mandate that the IC provide evidence of or purchase EPLI coverage.

Covered Acts

Most standard EPL policy forms cover five major categories of employment-related perils: (1) discrimination, (2) wrongful termination, (3) harassment, (4) retaliation, and (5) a number of other specifically enumerated workplace torts, collectively referred to as "inappropriate employment conduct" or "miscellaneous workplace torts."

Discrimination

Typically, the forms indicate that coverage "... applies to any violation of any applicable (i.e., federal, state, or local) discrimination law...." Thus, virtually all EPL forms cover discrimination on the basis of race, gender, national origin, religion, age, disability, and genetic conditions. This is because all of these types of discrimination are barred by federal statutes. On the other hand, given such language, while EPL policies will, for example, cover claims alleging employment-related discrimination on the basis of sexual orientation in New York, California, and Illinois (because such discrimination violates state law in these states), comparable coverage (neither defense nor indemnity) would not apply for sexual orientation discrimination in Mississippi, Alabama, or Georgia, where discrimination on this basis does not violate state statutes.

Wrongful Termination

Most but not all of the policies define the term “wrongful termination.” However, it is actually to the insured’s advantage when an EPLI policy does not define “wrongful termination.” This is because a definition of the term only serves to restrict—rather than expand—the scope of coverage available.

Those forms that do define “wrongful termination” normally define it as “... actual or constructive termination of the employment relationship in a manner that is wrongful and against the law or which breaches an implied agreement to continue employment.”

No Coverage for Breach of an Express Employment Contract

One key point to note is that nearly all of the policies, either in their definitions of “wrongful termination” or in the exclusions section of the policies, preclude coverage for both indemnity and defense coverage resulting from wrongful termination alleging breach of an express employment contract (i.e., an employment contract for a stated number of years, containing clearly delineated compensation amounts but barring termination, except for gross misconduct). As will be explained later, in the exclusions portion of this course, the rationale for excluding coverage for employment contracts is that they are within the insured organization’s control (i.e., such contracts are drafted by and agreed to by the insured organization) and are therefore considered by insurers to be a business risk for which coverage is not intended. However, a handful of insurers have begun to offer coverage, via endorsement and for additional premium, to defend claims alleging breach of an express employment contract.

Coverage for Breach of “Implied” Employment Contract Breaches

Most policies do, however, offer both defense and indemnity coverage in situations where an employee plaintiff alleges that a termination breached an “implied” contract of employment. More specifically, plaintiffs often assert that wording in (1) an offer letter, (2) an employee handbook, or (3) an oral statement made, for example, by a manager to a subordinate (e.g., “You have a great future with this company”) created an “implied” contract of employment.

Harassment

When insurers first began writing EPLI policies in the early 1990s, virtually all policy forms covered “sexual harassment” rather than “harassment,” as is now the case under most but not all insurers’ policy wording. This change occurred because it became apparent that workplace harassment is usually, but not always, of a sexual nature. For example, an employee could be harassed by means of name-calling and taunting, although not in a sexual manner, or could even be given the “silent treatment” when supervisors ignore them.

Accordingly, an EPLI policy form should define “harassment” so it covers both sexual harassment and nonsexual harassment.

Definition of Harassment

The policies usually define harassment as involving unwelcome *sexual* or *nonsexual* advances, verbal or physical conduct, or requests for sexual or nonsexual favors that

- are either explicitly or implicitly made a condition of employment;
- are used to make decisions that affect a person’s employment;
- create an intimidating, hostile, or offensive working environment; or

- interfere with job performance.

Retaliation

The typical scenario involving a retaliation claim is one in which an employee first alleges discrimination based on a protected status (e.g., race, gender, disability). The second portion of the claim will then assert that, *in retaliation for* making such a claim, the employee was treated adversely. An example: after alleging race discrimination, an employee is demoted in retaliation for making the race discrimination claim.

In addition, retaliation is frequently alleged (1) in conjunction with a claim of sexual harassment or wrongful termination, (2) in response to an employee's making a claim under a state workers compensation law, or (3) for whistleblowing.

Whistleblower Retaliation Claims

Retaliation claims can also be brought by people who are not in a protected category, based on an assertion that the person was penalized or treated adversely for (1) complaining about or opposing certain employer actions (e.g., billing practices on a government contract), (2) refusing to engage in illegal or unethical conduct, or (3) exposing such conduct via testimony at a trial or administrative hearing. Accordingly, an EPL policy definition of "retaliation" should also include coverage for "whistleblower claims."

"Inappropriate Employment Conduct" or "Miscellaneous Workplace Torts"

As already noted, nearly every insurer's policy form provides coverage for claims alleging discrimination, harassment, wrongful termination, and retaliation. In addition to these categories of claims, most EPLI policies also contain a section titled "inappropriate employment conduct" or "workplace torts" that enumerates a variety of other employment-related perils *not* falling within any of the preceding four categories. Importantly, the actual scope of coverage provided by the policies varies most significantly in this area. Clearly, the broader the scope of perils falling within a policy's definition of "inappropriate employment conduct"/"workplace torts," the more favorable the policy is for the insured.

Exhibit 7.1 lists a number of the more common acts falling within the definitions of "inappropriate workplace conduct"/"workplace torts." This list is not all-inclusive. Given the creativity of plaintiffs' attorneys, new wrongful employment causes of action are continuously emerging.

Exhibit 7.1
Representative Workplace Torts Covered by EPLI Policy Forms

- Constructive discharge
- Defamation, libel, slander
- Infliction of emotional distress, mental anguish
- False arrest, false imprisonment
- Failure to enforce company policies and procedures
- Invasion/breach of privacy
- Breach of confidentiality
- Wrongful discipline
- Internet-related wrongful acts
- Humiliation
- Wrongful demotion
- Negligent/wrongful evaluation
- Negligent supervision
- Negligent hiring
- Negligent retention
- Negligent training
- Coercion
- Failure to grant tenure
- Failure to grant partnership
- Failure to grant shareholder status
- Failure to provide or enforce consistent employment-related corporate policies and procedures
- Failure to provide training
- Wrongful deprivation of a career opportunity
- Bullying
- Employment-related misrepresentation
- Wrongful failure to employ or promote
- Defamatory statements in connection with an employee reference
- Social media-related claims
- NLRA violations

Chapter 7 Review Questions

1. As an aspiring apprentice for the Grump Company, Abby was not happy when Donald, the director of HR, called her into his office and announced, "You're fired!" In fact, she was so unhappy that she retained an attorney who sued both Donald and Grump Company for wrongful termination. If Grump Company has a stand-alone EPL insurance policy, it will provide coverage in this situation for

   A. both Donald and Grump Corporation.

   B. neither Donald nor Grump Corporation.

   C. only Donald.

   D. only Grump Corporation.

2. Max Knife Corporation recently acquired a 40 percent interest in Mini Blade Company, a much smaller cutting-edge firm in the same industry. Max has a stand-alone EPL policy. What is probably the best way to expand coverage to include EPL claims against Mini?

   A. Add an endorsement for an additional premium

   B. Do nothing now; the insurer's premium auditor will recognize and charge for the additional exposure.

   C. Purchase a separate EPL policy to cover Mini's exposures

   D. Rely on the EPL policy's automatic coverage

3. Spears Corporation, which has approximately 100,000 employees, is acquiring Sword Company, which currently has 75,000 employees. Spears' current EPL policy will not expire for another 9 months. How, if at all, will the automatic coverage of Spears's EPL policy cover claims against Sword?

   A. Automatic coverage will apply for the remainder of the policy term.

   B. Automatic coverage will apply only to acts taking place after the acquisition date.

   C. Automatic coverage will be provided for no additional premium.

   D. Automatic coverage will not apply.

4. North Pole Corporation's unendorsed stand-alone EPL policy provides coverage under some circumstances for all the following, except

   A. Minnie Elf, employee—a factory worker.

   B. Olive, an independent contractor.

   C. Rudolph, husband of employee Minnie Elf.

   D. Sandy Claws, CEO.

5. In comparing several insurers' EPLI forms that Dingbat Corp. might purchase, Edith notices significant differences in their coverage of wrongful termination. The approach that provides the most desirable protection for Dingbat covers

    A. wrongful termination with no further elaboration.

    B. actual termination of the employment relationship in a manner that is wrongful and against the law.

    C. actual or constructive termination of the employment relationship in a manner that is wrongful and against the law.

    D. actual or constructive termination of the employment relationship in a manner that is wrongful and against the law or that breaches an implied agreement to continue employment.

Answers to Chapter 7 Review Questions

1.

   A. That's correct! Nearly all EPL policies provide coverage for the corporate entity as well as officers, directors, partners, managers, and employees.

   B. This answer is incorrect. Wrongful termination is a covered peril, specifically defined in most policies.

   C. This answer is incorrect. Grump Corporation has coverage.

   D. This answer is incorrect. As an employee of Grump Corporation, Donald has coverage.

2.

   A. That's correct! Most underwriters are also amenable to providing coverage for entities in which the named insured holds a minority interest; this is done by way of an endorsement for additional premium.

   B. This answer is incorrect. The additional exposure should be addressed now.

   C. This answer is incorrect. It should be possible for the existing policy to cover the added exposure.

   D. This answer is incorrect. The automatic coverage would not apply in this case because Max does not own a majority interest in Mini.

3.

   A. This answer is incorrect. The period of time during which automatic coverage applies varies from 30 to 90 days, depending on the policy form.

   B. This answer is incorrect. When automatic coverage applies, acts prior to the acquisition date are not covered.

   C. This answer is incorrect. When automatic coverage is provided, an additional premium is required.

   D. That's correct! Automatic coverage applies only when the size of the newly acquired organization is at or below a specific threshold, typically based on the number of employees. Usually, automatic coverage applies when the new organization has less than 10 to 35 percent of the number of the covered organization's employees. Sword's employee count is roughly 75 percent of Spears's.

4.

   A. This answer is incorrect. All policies cover employees.

   B. That's correct! Independent contractors are not included within standard EPL insurance definitions of "employee," although coverage might be available by endorsement.

   C. This answer is incorrect. Spouses of insureds are covered—not for wrongful acts but only for their status as spouses who may have an interest in assets held jointly.

   D. This answer is incorrect. Corporate officers are covered persons.

5.

   A. That's correct! Any definition of "wrongful termination" restricts rather than expands the scope of coverage available.

   B. This answer is incorrect. Questions can be raised whether a given termination was illegal.

   C. This answer is incorrect. This definition does not cover breach of an implied agreement to continue employment.

   D. This answer is incorrect. Although this definition is commonly used, it limits coverage to terminations that meet the definition.

Chapter 8
Third-Party Liability, Wage and Hour Coverage, and Definitions of "Damages" and "Claims" Provisions in EPL Policies

Overview

Chapter 8 discusses the third-party liability, wage and hour and coverage, and definitions of "damages" and "claims" provisions in EPL policies.

Chapter Objectives

On completion of this chapter, you should be able to

- distinguish third-party liability coverage from other coverage available in a stand-alone EPL policy;
- recognize the breadth and limitations of third-party liability coverage in a stand-alone EPL policy; and
- identify the losses and expenses that qualify as damages and claims under EPLI policy forms.

Third-Party Liability Coverage

The original purpose of EPLI policies was to provide coverage for claims made by employees. More specifically, such policies were designed to cover claims in which employees alleged that employers or fellow employees committed wrongful acts against them in conjunction with their employment. However, in recent years, nonemployees (most often customers, clients, and vendors) have also made claims alleging harassment and discrimination committed by employers and their employees in a number of incidents. These claims have been termed "third-party liability claims."

Third-Party Liability Claims: High-Profile Examples

High-profile examples of third-party liability claims were those made by African American customers of two national chains: Denny's (restaurants) and Adam's Mark (hotels). Both actions alleged discrimination against customers belonging to this minority group and produced multimillion dollar settlements. More recently, in April of 2016, two black women filed claims against Victoria's Secret, seeking $4 million (each) in damages. The women alleged that they were ordered to leave the company's Beverly Center, California, store, and were "… shocked and humiliated to be accused of wrongdoing and … thrown out of the store as if they were criminals."

The Need for Third-Party Liability Coverage

Coverage for third-party liability claims is required because CGL policies exclude coverage for harassment and discrimination—the two causes of action most likely to be alleged in claims brought by third parties.

Public Contact: The Key Driver of Third-Party Liability Claims

A firm's exposure to third-party liability claims is largely a function of the extent to which its operations involve *contact with the public*. For example, an airline, which engages in considerable customer contact, would have a much greater exposure to third-party claims, compared to a firm that manufactures aircraft engines for sale to a handful of large industrial customers.

How Third-Party Liability Coverage Is Provided within EPL Forms

At one time, third-party EPL coverage was available only by a separate endorsement. Currently, however, under the vast majority of forms, third-party EPL coverage is automatically included within the policies as a covered "wrongful employment act" and is provided as a separate insuring agreement (with a separate limit), most often designated as "Insuring Agreement B. Third-Party Liability."

Wage and Hour Coverage

At one time, virtually every EPL insurer routinely excluded coverage for wage and hour claims. Such claims typically allege (1) failure to pay overtime and (2) various "pay practices" claims (such as failure to grant meal and rest breaks). Importantly, based on the policies' definitions of "loss," standard wording of the exclusion not only precludes coverage for settlements and judgments, but, in addition, it eliminates coverage for the *defense costs* associated with wage and hour claims.

Wage and Hour Defense Coverage

However, around 2008, a handful of insurers began providing defense-only coverage for wage and hour claims. Following are the key features of such coverage.

- **Availability of the Endorsement.** The endorsement is offered as an "automatic" part of an EPLI policy, rather than as an add-on. In other words, insurers that provide the wage and hour endorsement include it in *all* of the policies they issue, rather than add it based on the insured's request. Conversely, as respects those insurers that are not offering the endorsement, when approached about adding it, they all routinely decline to provide wage and hour coverage at *any* price.
- **$100,000 or $150,000 Sublimit.** Depending on the particular insurer, in the current market, the endorsement affords defense coverage of wage and hour claims with a sublimit of $100,000 or $150,000.
- **No Additional Limit of Insurance Created.** Significantly, the aforementioned available sublimits apply within, not in addition to, the policy's regular aggregate limit. For example, assume that the full $250,000 sublimit is paid out under a wage and hour coverage endorsement to an EPLI policy in conjunction with the defense of a claim. Also assume that the policy contained a $1 million per claim/aggregate limit. In this situation, $750,000 ($1 million less $250,000) would remain to cover other types of claims under the policy.

Wage and Hour Indemnity Coverage

Beginning in January 2013, Aon created a program to cover both the defense *and* indemnity costs of wage and hour claims. However, the program requires a minimum $1 million per claim retention. And since only a small percentage of employers can realistically assume losses of this magnitude, the program covered just a handful of large companies. Since the Aon program was introduced, one insurer, Beazley, began offering a wage and hour indemnity policy with a $250,000 minimum per claim retention (although with lower available limits than other insurers writing this line of coverage), a figure that is likely to attract a larger field of potential insureds. In short, the market for wage and hour indemnity coverage is in a fluid state and is likely to evolve considerably over the next 5 to 10 years.

“Covered Damages” Definition

EPLI policy forms contain “covered damages”/”covered loss” provisions that specify what the policies do and do not cover.

The most expansive policies include the following within these definitions.

- Compensatory damages (i.e., settlements and judgments)
- Defense costs
- Punitive damages
- Liquidated damages under ADEA, FMLA, or the Equal Pay Act
- Back pay
- Front pay
- Claimant’s attorneys’ fees
- Pre- and post-judgment interest

Excluded Losses/Excluded Damages

On the other hand, nearly all policies’ definitions of “covered damages/covered loss” do not include the following items.

- **Fines, Penalties, Sanctions.** Virtually all of the forms’ definitions of “loss” or “damages” preclude coverage for fines, penalties, and sanctions. To provide coverage for such items, which accrue as a result of wrongful conduct, would violate public policy.
- **Taxes.** The policies almost universally exclude coverage for taxes, because taxes are obligations that accrue from state, local, and federal tax laws—not as a consequence of legal liability for certain employment practices.
- **Damages Associated with Employment Contracts/Severance Payments.** Coverage for damages involving contracts of employment, such as obligations to make severance payments in the event an employee is terminated with or without cause, are not within EPLI policies’ definitions of “loss” or “damages.” This is because the drafting of such contracts and agreements is within the control of the insured organization at the time these contracts were developed and is thus considered a business risk.
- **Nonpecuniary Relief.** Coverage for relief not associated with monetary damages (e.g., reinstating a wrongfully terminated employee) is not within the policies’ definitions of “loss” or “damages.” This is because insurance contracts provide promises to pay money under certain circumstances rather than providing performance guarantees.
- **Loss of Use or Destruction of Property.** EPLI policies exclude coverage involving liability for damage to and/or loss of use of business or personal property, because this exposure is covered under CGL policy forms.
- **Medical Expenses for Physical Injury.** Liability for medical expenses incurred as a consequence of bodily injury is excluded by EPLI policies because this exposure is addressed under workers compensation policies.
- **Insurance Plan Benefits.** Some, although not all, of the forms, either by their definitions of “loss” or “damages” or within the exclusions sections, preclude coverage for benefits owed to employees as part of judgments or settlements. The rationale underlying this approach is that obligations to provide employee benefits are business risks and therefore do not fall within the

scope of coverage intended by the policies. Another rationale for excluding these items within the policies' definitions of loss is that the policy does not intend to cover items that could be addressed by a fiduciary/employee benefits liability policy.

Still another reason for excluding insurance plan benefits is that their actual cost on a long-term, "going-forward" basis is highly speculative. For example, if a claimant is awarded 10 years of benefits (that she would have received had she not been wrongfully terminated), it would be very difficult to predict the actual cost of such benefits that many years into the future. Case in point: during some years, the cost of health insurance coverage rises by 3 to 5 percent, whereas in others, it has increased by as much as 20 percent.

- **Costs Relating to Labor Disputes.** Such costs are precluded either by the policies' "loss" or "damages" definitions or by separate exclusions because these costs are business risks to which firms in particular industries, especially those subject to collective bargaining agreements, are exposed.

Punitive Damages

Nearly all insurers' forms grant coverage for punitive damages, provided punitive damages are insurable in the jurisdiction within which a claim for such damages has been brought. Since EPL claim judgments frequently include punitive damages, the value of such coverage is considerable.

The Unpredictability of Punitive Damages Awards

In addition to their sheer magnitude, another reason punitive damages coverage is important is that, by their very nature, punitive damages awards are highly unpredictable. For example, in *Kolstad v. American Dental Ass'n*, 527 U.S. 526, 119 S. Ct. 2118, 144 L. Ed. 2d. 494 (1999), a case involving sexual harassment, the $50,000 compensatory award represented less than 1 percent of the $7 million in punitive damages that were awarded. In another instance, a lawsuit against the Ralph's supermarket chain in California produced an award of $5 million each to 6 women who alleged sexual harassment, for a total of $30 million, in addition to an earlier judgment of $550,000 for emotional damages. Surprisingly, there were no compensatory damages awarded.

Most Favorable Jurisdiction Provisions

Since the early 2000s, EPL insurers have attempted to circumvent state-specific prohibitions *against* insurer payment of punitive damages (i.e., about 40 percent of the states bar such coverage) by means of what are known as "most favorable jurisdiction" provisions. Such wording states that, with respect to determining the insurability of punitive damages, the law of the jurisdiction most favorable to the insurability of punitive damages will apply, provided one of the following four criteria is met: (1) the act giving rise to the punitive damages award occurred in a jurisdiction allowing punitive damages coverage; (2) the claim giving rise to the punitive damages is made in such a jurisdiction; (3) the insured is incorporated or maintains its principal place of business in a jurisdiction allowing punitive damages coverage; or (4) the insurer is incorporated or maintains its principal place of business in such a jurisdiction. Accordingly, most favorable venue wording is imperative (1) when purchasing an EPL policy in a state where punitive damages are not insurable and (2) for insured companies having multistate operations and that therefore cannot predict where the claims seeking punitive damages will arise.

Two Limitations of Most Favorable Jurisdiction Provisions

Most favorable jurisdiction provisions contain two key limitations. First, they merely modify the existing level of coverage for punitive damages already provided by an EPL policy; they do not provide coverage if the policy excludes punitive damages (although the vast majority of EPL forms do not). Second, the enforceability of most favorable jurisdiction wording has never been tested in court. As a result, insureds should request such wording but not be required to pay additional premium for it, because an insurer's liability for payment, as a result of this endorsement, remains uncertain.

Definition of "Claim"

The manner in which the policies define the term "claim" has an important bearing upon the scope of coverage the forms provide. In addition to the fact that standard wording in an EPLI policy covers both *oral* and *written* demands for damages in conjunction with claims, the policies also cover legal expenses incurred that involve (1) administrative hearings and (2) criminal indictments associated with employment claims.

Coverage for Written and Oral Demands

Coverage is triggered under the policies not only by a written demand (i.e., a summons and complaint) but also by an oral demand. Occasionally, an employee-claimant's attorney will make claims orally (e.g., when he or she calls the insured company, notifying it of the intention to sue). In other instances, employees make oral claims themselves. For instance, after being terminated at the end of an exit interview, many an employee has said something to the effect of "I'm going to sue this place for everything it's worth." Oral notification of a claim accelerates the trigger of coverage; because it eliminates the need to wait for a written lawsuit before reporting the claim to an insurer, this approach is advantageous for an insured.

Coverage for Administrative Hearings

A policy's definition of "claim" should also include coverage for administrative proceedings before the EEOC, as well as proceedings and hearings before applicable state and federal agencies.

Such a definition is essential for an insured because, frequently, a claim is triggered due to hearings and proceedings *even before* litigation has been filed against the corporate organization. In these situations, insured organizations immediately begin to incur legal costs, even prior to being served with a lawsuit, given the necessity of retaining legal representation at such investigatory proceedings.

The Cracker Barrel Case: Why the Definition of "Claim" Must Include EEOC Hearings

The case of *Cracker Barrel v. Cincinnati Ins. Co.*, No. 11–6306, 2012 U.S. App. LEXIS 19161 (6th Cir. Sept. 10, 2012), heard by the Sixth Circuit of the US Court of Appeals, illustrates the importance of an EPLI policy definition of "claim" that encompasses EEOC hearings. In this situation, 10 employees filed race and sexual discrimination charges with the EEOC against Cracker Barrel. The EEOC, in turn, sued Cracker Barrel on behalf of the employees. After Cracker Barrel reported the claim to Cincinnati Insurance Company, the insurer denied coverage because the policy stated that, for a matter to qualify as a "claim," it had to be brought "by the employee." Cincinnati asserted that, rather than being brought by the employees, it was filed by the EEOC and thus did not qualify as a "claim." Unfortunately for Cracker Barrel, the court agreed with Cincinnati's argument and upheld the insurer's coverage denial. Given this situation, it is imperative that an EPLI policy's definition of "claim" includes within this term "claims brought by the EEOC."

Coverage for Criminal Proceedings

Also important is the fact that nearly all of the policies' definitions of "claim" encompass coverage for criminal proceedings associated with employment litigation. Such coverage is advantageous for insureds because civil employment litigation *also* frequently has a criminal component. Case in point: The CEO of a corporation is sued civilly for sexual harassment. In addition, he is charged with assault in connection with the sexual harassment and will require defense coverage for the criminal indictment.

Chapter 8 Review Questions

1. In the context of EPL, “third-party liability claims” refers to claims brought by
   A. employees.
   B. employers.
   C. fellow employees.
   D. nonemployees.
2. Superb Market employs a number of high school and college students to stock shelves and work the cash register. During peak periods, these employees—especially those at the cash register—often work nonstop for hours on end. Which one of the following practices at this store is least likely to result in a wage and hour claim against Superb Market?
   A. Cash register employees are not permitted to take rest breaks unless there are no customers are in a checkout line.
   B. Employees who work on a Sunday are paid overtime, but those who work on a Saturday are not.
   C. Stocking clerks are not permitted to take a meal break until all work is completed.
   D. Students less than 16 years old are paid less than the legal minimum wage.
3. Briarwood Corporation has an EPLI policy that includes wage and hour defense coverage. As is typical of such policies, Briarwood’s insurance includes all the following features except
   A. a sublimit somewhere between $100,000 and $150,000.
   B. coverage that is an automatic part of the policy, not an add-on.
   C. defense coverage within policy limits.
   D. indemnity coverage with a $1 million limit.
4. When Yossarian Co.’s EPLI claim was closed, risk manager John Joseph was surprised to learn that Yossarian’s claims-related costs were not all covered in full. “What’s the catch?” he asked his insurance broker, who replied that most EPLI policies provide coverage for all the following, except
   A. damages payable in a judgment.
   B. damages payable in a settlement.
   C. defense costs.
   D. fines and penalties.
5. Which of the following would not be covered by most EPLI policies’ claim definition?
   A. An oral demand to pay damages
   B. An Occupational Safety and Health Administration (OSHA) inspection
   C. Administrative proceedings before the EEOC
   D. Criminal proceedings associated with employment litigation

Answers to Chapter 8 Review Questions

1.

   A. This answer is incorrect. The original purpose of EPLI policies was to provide coverage for claims by employees, but these are not third-party claims.

   B. This answer is incorrect. The employer is the first party in an EPLI claim.

   C. This answer is incorrect. Fellow employees may bring claims, but they are not considered third parties.

   D. That's correct! Third-party claims are brought by nonemployees such as customers, clients, and vendors.

2.

   A. This answer is incorrect. Pay practices such as failure to grant rest breaks are a common source of wage and hour claims.

   B. That's correct! Employers are not required to pay overtime for weekend work.

   C. This answer is incorrect. Pay practices such as failure to grant meal breaks are a common source of wage and hour claims.

   D. This answer is incorrect. Pay practices such as failure to pay minimum wage are a common source of wage and hour claims.

3.

   A. This answer is incorrect. The endorsement usually affords defense coverage of wage and hour claims with a sublimit of $100,000 or $150,000.

   B. This answer is incorrect. The endorsement is offered as an "automatic" part of an EPLI policy, rather than as an add-on; insurers that provide this endorsement include it in all policies they issue.

   C. This answer is incorrect. The available sublimits apply within, not in addition to, the policy's regular aggregate limit.

   D. That's correct! Most policies provide defense coverage only.

4.

   A. This answer is incorrect. Subject to policy terms, the insurer will pay court-awarded damages.

   B. This answer is incorrect. EPLI policy forms cover settlements.

   C. This answer is incorrect. Defense costs are covered.

   D. That's correct! Virtually all EPLI forms' definitions of "loss" or "damages" preclude coverage for fines, penalties, and similar items.

5.

   A. This answer is incorrect. An oral demand (for example, a phone call from the claimant's attorney expressing an intent to sue) triggers coverage.

   B. That's correct! OSHA is concerned with employee safety, not employment practices issues.

   C. This answer is incorrect. Virtually all "claim" definitions encompass administrative proceedings before the EEOC.

   D. This answer is incorrect. Nearly all policies' definitions of "claim" encompass coverage for criminal proceedings associated with employment litigation.

Chapter 9
Claims Management, Defense Cost, and Special Conditions in EPL Policies

Overview

Given the nature of employment-related litigation, the claims management and defense cost provisions are among the most important sections in the policy. In addition, EPL policies are written with a number of conditions that are particular to such policies. Chapter 9 examines these provisions in detail.

Chapter Objectives

On completion of this chapter, you should be able to

- identify the types of conditions typically found in an EPL policy that relate to claims management and defense costs,
- recognize the effect of various EPL policy conditions relating to claims management and defense costs,
- recognize the effect of special conditions that reduce deductible amounts or deal with other insurance, and
- identify the types of loss control services that some insurers offer to their EPLI insureds.

Claims Management Provisions

The manner in which a policy addresses the claims management process has a significant bearing on the actual scope of coverage provided by an EPLI policy. The key claim handling areas include (1) claims settlement procedures, (2) duty to defend versus non-duty to defend language, and (3) defense cost provisions.

Claims Settlement Procedures

Only a small percentage of EPLI forms contain the traditional “hammer clause” provision. A hammer clause becomes operative when the insured and insurer cannot agree on a settlement figure proposed by the insurer. Under such circumstances, if the insured prefers to defend a claim rather than settle it, the insured must pay any additional amount for which the claim is eventually settled *plus* defense costs incurred from that point forward.

Coinsurance Hammer Clauses—A Favorable Variation

A favorable variation of the hammer clause—and one that is used by the majority of EPL insurers—is the so-called coinsurance hammer clause. Such provisions provide for (1) a sharing of defense costs incurred after the insured refuses to consent to settlement and (2) a sharing of any settlement amount or judgment amount that is larger than the settlement amount that the insurer wanted the insured to accept. The most common sharing percentage is 70 percent insurer/30 percent insured. Coinsurance hammer clauses benefit insureds because they continue the coverage on a partial basis if the insured decides to litigate rather than settle a claim based on an insurer’s recommendation.

How "Traditional" Hammer Clauses Operate: An Example

An insurer recommends that an insured agree to settle an EPL claim for $200,000. The insured withholds consent and instead opts to litigate the claim. A judgment of $500,000 is eventually awarded against the insured, and, in the process, the insured incurs an additional $125,000 in defense costs. Under a "traditional" hammer clause, the insured must self-insure the difference between the $500,000 judgment and the insurer's original $200,000 settlement recommendation ($300,000). The insured must also absorb the $125,000 in defense costs that were incurred following the insured's refusal to settle for the amount recommended by the insurer. In effect, the insured will be out of pocket an additional $425,000 ($300,000 settlement amount above that recommended by the insurer, plus the $125,000 in defense costs incurred following the insured's refusal to settle based on the insurer's recommendation).

How Coinsurance Hammer Clauses Operate: An Example

Assume the identical scenario noted above. Again, the insurer recommended that the insured settle the claim for $200,000, but the insured withheld consent. A verdict is eventually rendered for $500,000, and $125,000 in additional defense costs are incurred following the insured's refusal to settle for the amount recommended by the insurer. Under a policy with a 70 percent coinsurance hammer clause, the insurer would pay 70 percent of the additional settlement amount (i.e., 70 percent of $300,000 or $210,000) plus 70 percent of the additional $125,000 in defense costs ($87,500), for a total of $297,500. As a result, the insured's share would be the substantially lower amount of $127,500, compared to its $425,000 share that it was required to pay a policy with a standard hammer clause (in the previous example).

Duty to Defend Language versus Non-Duty to Defend Language

When EPLI policies emerged in the early 1990s, most of the forms were written on a "duty to defend" basis. Today, however, the EPLI market has evolved to the point where the policyholder also has the option to purchase what is known as a non-duty to defend form. This is especially true if an insured has purchased a stand-alone EPLI policy.

- The phrase *"duty to defend"* in an EPLI policy expressly states that the insurer has the duty to defend any claim alleging a covered act under the policy.
- The phrase *"non-duty to defend"* in an EPLI policy states that the insurer does not have the duty to defend claims, rather that it is the duty of the insured to defend claims. Such forms only compel the insurer to pay the defense costs in connection with the insured's executing the defense of the claims.

Three of the important differences between a "non-duty to defend" and "duty to defend" policy are (1) the right to choose defense counsel, (2) the right to control the defense of the claim, and (3) the insurer's obligation to defend when one or more allegations associated with a given claim are not covered by the policy.

Defense Counsel Selection Issues

In most circumstances, under a "duty to defend" policy, unless specifically negotiated otherwise in the policy, the insurer has the right to choose defense counsel. (The attorney is selected from the insurer's list of law firms, known as "panel counsel."). Conversely, under a "non-duty to defend" policy, the policyholder is able to use any lawyer of its choosing.

Claim Handling Issues

Another key difference between a "non-duty to defend" EPLI policy and a "duty to defend" EPLI form is in the area of claim handling and control of the defense process. Specifically, "non-duty to defend" programs allow the policyholder—not the insurer—to create the "reputation" that the policyholder seeks to project because they permit the policyholder to handle and settle claims. In contrast, under a "duty to defend" policy, the insurer typically has the absolute right to control the defense of the claim—by means of invoking the policy's "consent to settlement" or "hammer" clause (discussed earlier), if the insured wants the coverage afforded by the policy.

In contrast to the benefits of being able to make autonomous claim settlement decisions afforded by a non-duty to defend policy, a duty to defend provision may benefit an insured if the insured is inexperienced in managing the complexities of employment litigation. Under such circumstances, an insured is generally better off if it delegates strategic claims management decisions to an insurer rather than trying to make them internally. For this reason, the EPL sections of management liability package policies are usually written with duty to defend provisions. This is because smaller, privately held companies (as opposed to large public companies) are generally covered by "packages."

However, for firms that are more familiar with the details of the EPL claim handling process (typically larger companies that are more routinely faced with such claims), an EPLI policy containing a non-duty to defend provision may be preferable.

"All Allegations" Defense Coverage

Another difference between duty to defend and non-duty to defend policies is that under the former, the insurer is obligated to defend all of the allegations in a lawsuit, as long as at least one such allegation is covered by the policy. The following scenario illustrates the importance of this point. A former employee with 20 years of service is terminated by an insured. In addition to her claim for wrongful termination, she also alleges damages from the fact that the company failed to pay her overtime during her last 5 years of service (i.e., a wage and hour claim).

Although damages arising from the wrongful termination allegation are covered by a standard EPL policy form, the wage and hour claim is excluded. However, since coverage exists for the first allegation (i.e., wrongful termination), an insurer, under a duty to defend policy, must also defend the wage and hour claim; although it would not be liable for any potential damages. In contrast, under a non-duty to defend policy, the insurer would only be obligated to pay the costs of defending the wrongful termination claim.

Related Claims Provisions

Related claims provisions in EPLI policies, also sometimes referred to as "interrelated claims provisions," apply to situations (1) in which *more than one claim* results from a *single* wrongful act and (2) when claims from a *single* wrongful act are made *during more than one* policy period.

According to such provisions, the insured is entitled to the limit applicable when the *first* claim was made, rather than the sum of the limits that were applicable to the policy periods during which all claims were made.

In addition, related claims provisions also state that a single deductible applies to each claim.

Related Claims Provisions: An Example

The following scenario offers a practical example of how a related claims provision functions. An insured company purchased EPL policies with the following terms and limits.

- January 1, 2017, to January 1, 2018, $1 million;
- January 1, 2018, to January 1, 2019, $2 million; and
- January 1, 2019, to January 1, 2020, $3 million.

During 2016, a male supervisor sexually harassed three different female employees at the company. Each of these individuals made claims against both the supervisor and the company on July 1, 2017, July 1, 2018, and July 1, 2019, respectively. All three claims resulted from a single related wrongful act (i.e., the same supervisor's harassment), yet the claims in this instance were made during three different policy periods. Under these circumstances, only one policy limit (i.e., the $1 million limit applicable during the January 1, 2017, to January 1, 2018, policy period) would apply to all three claims, because that was the year in which the first claim arising from the original wrongful act was made.

Since, as noted above, related claims provisions indicate that a single deductible applies to each claim, in this example, only one deductible/retention would apply to all three individual claims, since the claims arose from essentially the same set of circumstances.

Defense Cost Provisions

In addition to covering claim settlements and judgments, EPLI policies pay the costs required to settle or defend claims. Such items typically involve (1) attorneys' and adjusters' fees and expenses; (2) the cost of legal proceedings, including mediation and arbitration; and (3) the cost of appeal bonds. (Insurers are not, however, obligated to furnish such bonds.) Under some, but not all, insurers' forms, defense costs also include monies that the insured must pay while assisting the insurer during the defense and investigation of claims (subject to a per-day limit of $250 to $500, depending on the insurer), such as attending trials or depositions.

Expenditure of Defense Costs Reduces Policy Limits

Almost without exception, the expenditure of defense costs reduces the limits available to pay claims under EPL policies. This is in contrast to the approach used in CGL policies, in which defense costs are paid in addition to policy limits. Given the high costs of defending EPL claims, insureds should bear this "shrinking limits" factor in mind when deciding on how much coverage to purchase. Often, defense costs can far exceed the actual settlement figure or judgment rendered against an insured in employment-related claims.

Additional Defense Coverage Limits

Given the fact that the expenditure of defense costs reduces policy limits, a handful of insurers include provisions within their forms that afford *additional* coverage limits for defense costs. When an insured purchases additional limits under these provisions, it is important to note that (1) such limits are *in addition to* the regular limits provided by the policy, (2) those limits can *only* be applied to defense costs, and (3) the additional defense coverage limits apply *before* the regular policy limits are used.

Insurer Internal Claims Handling Expenses Are Not Considered Defense Costs

Importantly—and although they are covered by EPLI policies—internal insurer claim handling staff costs, such as in-house attorneys and independent adjusters, are not considered defense costs. This approach benefits insureds because it means that such monies do not deplete the coverage limit available under the policy, since, as was explained above, payment of defense expenditures is within—not in addition to—an EPLI policy's limits.

"Value Added" Loss Control Services

Depending on the insurance company, EPLI policies often contain a provision for loss control services. Such services are provided at no cost or significantly reduced cost to the EPLI policyholders. Their purpose is to reduce the insured's exposure to employment-related claims being made against them. When selecting among competing insurers, the nature, availability, and quality of value-added provisions and services should be carefully considered.

Just as the different insurers' forms vary with respect to the scope of coverage, a correspondingly wide range of possible "value-added" services is available. These services may include the following.

- An HR law compliance audit conducted by an attorney or HR professional

- An online self-audit that takes the insured through a series of detailed questions and, based on the answers to the questions, provides an assessment of the areas in which the organization could be vulnerable to claims
- Personnel forms, software for creating employee handbooks, and other policies and procedures that the insured can adapt for its own use
- "Hotline" services manned by employment law attorneys or HR specialists, which assist in managing "on-the-spot" compliance issues, problems, and disputes
- Training materials in print or online format
- Continuing education workshops aimed at presenting approaches that reduce and control claims

Chapter 9 Review Questions

1. Armand Tool Company has an EPLI policy with a $1 million limit. A complainant-employee is willing to settle an employment practices claim for $10,000, and the insurer recommends this offer be accepted. However, Armand believes it has done nothing wrong and chooses to pursue a defense. If Armand's defense is unsuccessful, the EPL policy includes a provision that will require Armand to pay any difference in damages between $10,000 and any higher amount for which the claim is ultimately settled. This provision is commonly referred to as a

    A. circuit breaker.

    B. claw hammer.

    C. deal breaker.

    D. hammer clause.

2. Columbian Casualty recommends that its insured agree to settle an EPL claim for $300,000. The insured withholds consent and instead opts to litigate the claim. A judgment of $500,000 is eventually awarded against the insured, and, in the process, the insured incurs an additional $75,000 in defense costs. If the insured's EPL policy has a traditional hammer clause, the insured will be out of pocket for

    A. $75,000.

    B. $192,500.

    C. $200,000.

    D. $275,000.

3. Colossal Casualty recommends that its insured agree to settle an EPL claim for $300,000. The insured withholds consent and instead opts to litigate the claim. A judgment of $500,000 is eventually awarded against the insured, and, in the process, the insured incurs an additional $75,000 in defense costs. If the insured's EPL policy has a 70 percent coinsurance hammer clause, the insured will be out of pocket for

    A. $75,000.

    B. $82,500.

    C. $192,500.

    D. $275,000.

4. Blue Suede Shoe Company has a "duty to defend" EPLI policy. Sue, a Blue Suede employee, sued Blue Suede, claiming that a coworker who worked alongside Sue continually harassed her by stepping on her toes, and complaints to her supervisor provided no relief. She also seeks reimbursement for her podiatrist's medical fees resulting from this repeated on-the-job trauma. The harassment claim is within the scope of the EPLI, but workers compensation covers the medical fees. Blue Suede's insurer will

    A. defend Blue Suede against the harassment claim only.

    B. defend Blue Suede against the medical expense claim only.

    C. defend Blue Suede against both the harassment claim and the medical expense claim.

    D. expect Blue Suede to provide its own defense against Sue's claims.

5. Burger Flipper Restaurant purchased EPL policies with the following terms and limits: (A) January 1, 2014, to January 1, 2015, $1 million; (B) January 1, 2015, to January 1, 2016, $2 million; (C) January 1, 2016, to January 1, 2017, $3 million. None of these three policies contained a retroactive date. During 2013, a female supervisor at Burger Flipper Restaurant sexually harassed three different male employees at the company. Each of these individuals made claims against both the supervisor and the company on July 1, 2014, July 1, 2015, and July 1, 2016, respectively. All three claims resulted from a single related wrongful act (i.e., the same supervisor's harassment). Ignoring any deductible that might apply, what total amount of coverage, if any, is available to Burger Flipper for these three claims?

    A. No coverage is available because the harassment occurred before the first policy went into effect.

    B. $1 million.

    C. $3 million

    D. $6 million

Answers to Chapter 9 Review Questions

1.

A. This answer is incorrect. The term circuit breaker does not apply when the insured "re-fuses" to settle.

B. This answer is incorrect. This term refers to an Armand hammer product.

C. This answer is incorrect. It's not a deal breaker, but it does change the picture.

D. That's correct! A "hammer clause" becomes operative when the insured and insurer cannot agree on a settlement figure proposed by the insurer. If the insured prefers to defend a claim rather than settle it, the insured must pay any additional amount for which the claim is eventually settled.

2.

A. This answer is incorrect. The insured must also absorb the additional settlement costs.

B. This answer is incorrect. No coinsurance is involved in this example.

C. This answer is incorrect. The insured must also absorb additional defense costs.

D. That's correct! The insured must absorb the $200,000 additional settlement amount plus the additional $75,000 in defense costs.

3.

A. This answer is incorrect. The insured must absorb only a portion of the additional defense costs.

B. That's correct! The insured must absorb 30 percent of the additional defense and settlement costs.

C. This answer is incorrect. The insurer must pay an additional $192,500.

D. This answer is incorrect. The insurer pays a portion of the additional settlement and defense costs.

4.

A. This answer is incorrect. The policy covers more than the harassment claim.

B. This answer is incorrect. The harassment claim is covered.

C. That's correct! Under a duty to defend policy, the insurer is obligated to defend all allegations in a lawsuit, as long as the policy covers at least one such allegation.

D. This answer is incorrect. The insurer will provide the defense.

5.

A. This answer is incorrect. Coverage is available under one or more of these policies.

B. That's correct! Because of the policy's related claims provision, only the $1 million policy limit would apply to all three claims, because that was the year in which the first claim arising from the original wrongful act was made.

C. This answer is incorrect. The highest of these three limits does not apply in this case.

D. This answer is incorrect. The related claims provision does not permit the insured to stack the limits that apply to claims made from a single wrongful act, even if the claims are made in different years.

Chapter 10
Exclusions in EPL Policy Forms

Overview

EPL forms differ significantly with respect to the actual wording of the exclusions they contain, and these differences have a substantial impact on the actual scope of coverage a given policy provides. Often, a policy will exclude a particular exposure, but the policy's exclusionary wording will also be written with "exception" wording that has the effect of "adding back" and thus covering certain aspects of the otherwise excluded exposure. Chapter 10 analyzes wording of the most common EPL policy exclusions.

Chapter Objectives

On completion of this chapter, you should be able to

- identify the important characteristics of EPLI exclusions that pertain to
    - criminal, fraudulent, or intentional acts;
    - bodily injury;
    - WARN Act liability;
    - liability under workers compensation and similar laws;
    - contractual liability;
    - liability under the ADA;
    - wage and hour claims;
    - claims about which an insured had prior knowledge;
    - claims reported to prior insurers;
    - claims for nonpecuniary relief;
    - labor-related claims;
    - claims for breach of employment contracts; and
    - claims for insurance benefits and
- recognize problematic wording in EPLI exclusions and identify more acceptable alternatives.

Criminal, Fraudulent, or Intentional Acts

Virtually all of the policies preclude coverage for fraudulent, criminal, and intentional acts.

Final Adjudication Wording

However, nearly all insurers' forms promise to *defend* allegations of such acts until "final adjudication," whereby it is judicially determined that an insured caused or is indeed responsible for intentionally causing an injury.

Non-imputation Wording

The intent of such wording is to cover the insured organization (and in some instances, other individual insureds), despite the fact that the insured organization may be vicariously liable for the wrongful acts of another culpable individual.

For example, if a supervisor commits sexual harassment, the insured organization, which is vicariously liable for the supervisor's acts, will have coverage despite this exclusion (although the supervisor will not).

Accordingly, this exclusion indicates that wrongful acts of a criminal, malicious, or intentional nature committed by one insured will *not* be imputed to any other insured. This has the effect of preserving coverage for insureds who were not culpable in causing a claim, while barring coverage as to those who acted intentionally. So in this example, the supervisor's wrongful act will not be imputed to his employer (the insured organization), and, as a result, the insurer will defend the employer and pay any judgment or settlement on the employer's behalf if it is found to be vicariously liable for the employee's wrongful act.

Bodily Injury

Liability for claims involving bodily injury is excluded by EPL policies because such coverage is typically afforded under CGL policy forms.

Key Exception Language

However, most, but not all, versions of this exclusion "except," and therefore cover, damages for (1) emotional distress, (2) loss of reputation, (3) mental anguish, or (4) humiliation. This type of coverage is important because employment-related claims frequently allege damages associated with such perils, which, if caused by employment-related acts, would not be covered under CGL policies.

WARN Act Liability

Under the federal WARN Act, employers of 100 or more persons are required to give their workers specific notice periods prior to various types of mass layoffs or plant closings. The majority of EPL policies preclude coverage for claims alleging failure to provide such notice as required by this law, with the rationale that a failure of this type is within the control of the insured.

Key Exception Language

However, a favorable variation of this exclusion is one in which there is an exception, and therefore coverage, for claims alleging WARN Act violations if the insured organization consulted with attorneys prior to the claim being made and the insured attempted, in good faith, to comply with the law.

Liability under Workers Compensation and Similar Laws

Nearly all of the forms exclude coverage for the insured's obligations under workers compensation and similar laws, such as disability, unemployment compensation, the Employee Retirement Income Security Act (ERISA), the Occupational Safety and Health Act, the Racketeer Influenced and Corrupt Organizations (RICO) Act, and others.

One rationale for this exclusion is that separate coverage is available for obligations associated with some of these laws, such as workers compensation and ERISA. In addition, insurers will not, on a public policy basis, provide coverage for liabilities associated with laws such as RICO (which involve clearly culpable conduct).

Key Exception Language for Retaliation

Favorable versions of this exclusion do, however, contain important exception language. Specifically, such language affords coverage for retaliation that takes place as a result of an employee exercising his or her rights under any of these laws.

Contractual Liability

The vast majority of EPLI forms exclude coverage for contractually assumed liability (i.e., an agreement to indemnify or hold a third party harmless).

Exception for Liability in the Absence of a Contract

Nearly all policies contain an exception that provides coverage for liability that would have attached in the absence of a contract. For example, assume an insured organization periodically leases employees from an employment agency. The insured organization agrees to indemnify the employment agency for any wrongful, employment-related acts committed by the insured organization against the employment agency's employees. Yet, under these circumstances, the insured organization would have been liable, *even in the absence of the contract*, to indemnify the employment agency. Consequently, the contractual liability exclusion will not apply, and coverage will be available under the insured organization's EPLI policy.

ADA

Loss arising from an insured's failure to comply with any accommodations or building modifications for the disabled, as required by the ADA, is excluded by most EPLI forms. The effect of this exclusion is to preclude coverage, for example, for the costs an insured incurs to install wheelchair access ramps within its building. Insurers consider this exposure a business risk and therefore exclude it.

Coverage Is Not Excluded for Discrimination Based upon Disability

However, it should be recognized that this exclusion would not apply if, for example, a disabled person were to allege discrimination because he or she was denied employment (because of his/her disability) with an insured company. In effect, the purpose of the ADA exclusion is to preclude coverage for the cost of making physical modifications, rather than to eliminate coverage if it is alleged that an insured discriminated on the basis of a plaintiff's disability.

Exception Wording Covers Defense Costs in Response to Injunctive Relief

Some versions of this exclusion contain exception wording that affirmatively provides coverage for the costs of *defending* claims alleging violation of the ADA, which is, of course, favorable for the insured.

Wage and Hour Claims

Virtually all EPLI policies exclude coverage for "wage and hour claims." As explained earlier in this course, such claims fall within one of two broad categories: (1) misclassification claims, which are claims alleging that an employer misclassified an employer as an "exempt" employee (i.e., one who is exempt from receiving overtime) and then failed to pay overtime to the employee and (2) pay practices claims, which comprise "all other" types of compensation-related claims (e.g., not allowing employees to take rest and meal breaks, miscalculating the amount of wages owed, failing to pay employees on a timely basis).

Exception for Coverage of Claims under the Equal Pay Act of 1963

Most EPLI policies contain wording that modifies the exclusion so it does not apply to claims associated with the federal Equal Pay Act of 1963. This law, which prohibits discrimination in determining the wages of male and female employees, mandates equal pay for both sexes when work involves equal levels of skill, effort, and responsibility.

Exception for Retaliation Claims

Another advantageous (for the insured) version of this exclusion excepts and thus covers claims alleging retaliation that are caused by an employee's filing a wage and hour claim (e.g., after filing a wage and hour claim, an employee received a negative performance review and, in response, brought a retaliation claim against the company).

Prior Knowledge of Potential Claims

Nearly all EPLI policies exclude coverage for claims produced by circumstances or incidents that the insured knew, prior to policy inception, had the potential to result in claims. The purpose of EPLI policies is to cover only fortuitous circumstances about which the insured had no knowledge prior to the inception of the policy, as opposed to incidents for which claim potential was recognized, despite the fact that a formal claim had not yet been made at the time of policy application.

Only Knowledge by Managers or Executives Should Be Considered "Prior Knowledge"

Nearly all versions of this exclusion state that only knowledge of a potential claim by a manager, supervisor, director, or officer can bar coverage.

Claims Reported to Prior Insurers

Most policies exclude coverage for claims reported under prior insurers' policies. The rationale for this exclusion is that a subsequent policy may contain broader coverage and/or higher/additional limits. Accordingly, if a claim reported to a prior insurer was excluded and/or had its limits exhausted by payment of the claim, an insured might attempt to make the same claim under a subsequent policy.

Nonpecuniary Relief

Most EPLI policies exclude coverage for nonmonetary damages. Coverage of such damages, also known as "injunctive relief" or "nonpecuniary relief" (e.g., reinstatement of a terminated employee), is beyond the intended scope of EPLI forms because insurance policies are contracts to pay money rather than to perform or enforce the performance of services.

Exception for Defense Costs

Favorable versions of this exclusion "except," and therefore cover, the costs required to defend claims seeking nonpecuniary relief, which can be considerable.

Labor-Related Claims

Most of the leading EPLI forms exclude coverage for claims made by employees who are striking, locked out, or temporarily or permanently replaced. The rationale for this exclusion is that it addresses what is essentially a business risk faced by the employer and, for that reason, is considered uninsurable.

Breach of Employment Contracts

Nearly all EPL forms exclude coverage for damages accruing when the insured organization breaches an explicit employment contract. Such damages are typically in the form of severance payments called for under the contract.

The rationale for the exclusion is that the insured was in control of this exposure when it entered into the employment contract, as well as when it terminated the contract. The exposure is therefore viewed as an uninsurable business risk.

Defense Coverage for Breach of Employment Contracts

Although no insurers' forms cover the indemnity costs associated with the breach of employment contracts, most insurers' policies affirmatively cover defense costs associated with claims alleging breach of an employment contract.

Defense Coverage for Loss for Which the Insured Would Be Liable in the Absence of a Contract

In addition, EPLI forms generally cover loss for which the insured would be liable in the absence of a written contract. Such loss is typically in the form of defense costs. The following example illustrates how such coverage applies.

After he is terminated, there is a dispute as to the amount of wages that a former employee had earned and was therefore owed by the insured organization. In this situation, even in the absence of an employment contract, the insured organization would still be liable for earned wages prior to termination. Although the policy would not cover a settlement that encompassed actual wages earned (because EPLI policies' definitions of "loss" or "damages" exclude earned wages), it would pay the cost of defending against the claim.

Insurance Benefits

Nearly all EPLI forms contain exclusions precluding coverage for the payment of both compensation and insurance benefits to an employee once he or she is no longer working at the insured company. The rationale underlying this approach is that obligations to provide both future compensation and benefits are business risks and therefore do not fall within the scope of coverage intended by EPL policies.

Exception for Coverage of Benefits as a Part of Claim Settlements

Frequently, however, as part of a wrongful termination lawsuit, a former employee claims a loss of both compensation and insurance benefits, resulting from his or her termination. If a settlement of the claim were to provide for a certain lump sum of money that, presumably, was intended to replace some or all of the lost compensation/benefits, this exclusion would not preclude coverage for a judgment or a lump sum settlement in conjunction with the claim.

No Coverage for Earned Wages

On the other hand, this exclusion *does* preclude coverage for wages that a claimant had earned prior to termination. Again, this is a business risk that the policies do not intend to cover.

Chapter 10 Review Questions

1. Otto Mann, a supervisor at Leather Company, has been accused of harassing a junior employee who worked in his department. Before receiving notice of a claim, the company claims it was unaware of the alleged harassment. Leather's EPL policy contains the usual exclusion for criminal, fraudulent, or intentional acts. How, if at all, will the harassment claim be covered?
   A. The insurer will defend both Otto Mann and Leather and pay any judgment against Leather.
   B. The insurer will defend Leather and pay any judgment against Leather. Otto Mann is not entitled to any protection.
   C. The insurer will defend Otto Mann and pay any judgment against him.
   D. The insurer will not defend either Otto Mann or Leather because harassment is illegal.
2. Most EPLI policies exclude coverage for damages for
   A. bodily injury.
   B. emotional distress.
   C. humiliation.
   D. loss of reputation.
3. Before proceeding with a tentative plan to lay off 25 of its 140 employees, Critical Mass Company consulted an attorney for guidance in complying with any laws that might apply to a mass layoff of this type, and the company then followed the attorney's advice. Nevertheless, a group of terminated employees filed a claim alleging that the Critical Mass layoff violated the federal WARN Act. How would most EPL policies respond to this claim?
   A. The claim would be covered through an exception to the WARN Act exclusion.
   B. The claim would be covered through an exception to the workers compensation exclusion.
   C. The WARN Act claim would be excluded.
   D. The workers compensation exclusion would preclude coverage for this claim.
4. Goldie, a Locks Company employee, told a coworker that continuing sexual harassment by another coworker was making her job unbearable, but she had not filed a complaint because she needed the job. Locks' EPLI policy excludes coverage for incidents or circumstances that have the potential to produce claims if an insured had knowledge of it prior to policy inception. This exclusion
   A. can lead to a denied harassment claim since an employee knew of Goldie's alleged harassment.
   B. ensures that any claim Goldie makes will be covered.
   C. ensures that management personnel will report such incidents in the new or renewal application so the underwriter can determine how best to handle it.
   D. would preclude coverage if Goldie's manager or supervisor was aware of the harassment.
5. Ivanna Verk's wrongful termination claim against Jerk Enterprises was partially successful; and the court ordered Jerk to give Ivanna her job back but did not award any back pay to Ivanna. How, if it all, will Jerk's EPLI respond to the related EPL claim?

A. Ivanna is entitled to compensatory damages, which the insurer will pay.
B. The insurer will pay the costs of reinstating Ivanna’s position.
C. The labor-related claims exclusion will preclude coverage.
D. The nonpecuniary relief exclusion will preclude coverage.

Answers to Chapter 10 Review Questions

1.

   A. That's correct! Due to the policy's final adjudication wording, the insurer will defend allegations against Otto until his liability is judicially determined. Thanks to the policy's non-imputation wording, the insurer will defend Leather and pay any judgment against Leather even if another insured (Otto) was liable for wrongful acts.

   B. This answer is incorrect. Otto is entitled to a defense against these allegations.

   C. This answer is incorrect. The insurer will not pay a judgment for Otto's intentional acts.

   D. This answer is incorrect. The insurer will defend both Otto and Leather until it is judicially determined that an insured caused or was responsible for the intentional injury.

2.

   A. That's correct! Liability for claims involving bodily injury is excluded by EPL policies because such coverage is typically afforded under CGL policy forms.

   B. This answer is incorrect. Most policies cover emotional distress through an exception to the bodily injury exclusion.

   C. This answer is incorrect. Most policies cover humiliation through an exception to the bodily injury exclusion.

   D. This answer is incorrect. Most policies cover humiliation through an exception to the bodily injury exclusion.

3.

   A. This answer is incorrect. Most policies do not include this exception.

   B. This answer is incorrect. Workers compensation does not apply to a layoff.

   C. That's correct! The majority of EPL policies preclude coverage for claims alleging to provide notice of a layoff as required by the WARN law with the rationale that a failure of this type is within the control of the insured.

   D. This answer is incorrect. Workers compensation does not provide layoff benefits.

4.

   A. This answer is incorrect. Nearly all versions of the prior knowledge exclusion state that only knowledge of a potential claim by a manager, supervisor, director, or officer can bar coverage.

   B. This answer is incorrect. It excludes coverage, in effect, for some claims.

   C. This answer is incorrect. The exclusion does nothing to ensure that incidents are reported.

   D. That's correct! Nearly all EPLI policies exclude coverage for claims produced by circumstances or incidents that the insured knew, prior to policy inception, had the potential to result in claims. However, nearly all versions of this exclusion state that only knowledge of a potential claim by a manager, supervisor, director, or officer can bar coverage.

5.

A. This answer is incorrect. The settlement did not require Jerk to pay back pay to compensate Ivanna for a period of unemployment, so no pecuniary damages are involved.

B. This answer is incorrect. Damages for injunctive relief are not covered.

C. This answer is incorrect. The labor-related claims exclusion does not apply.

D. That's correct! Most EPLI policies exclude coverage for nonmonetary damages. Coverage of such damages, also known as "injunctive relief" or "nonpecuniary relief" (e.g., reinstatement of a terminated employee), is beyond the intended scope of EPLI forms because insurance policies are contracts to pay money rather than to perform or enforce the performance of services.

Chapter 11
Coverage Triggers in EPL Policies

Overview

Chapter 11 examines the coverage trigger provisions found within EPL policies, all of which are written on a claims-made basis.

Chapter Objectives

On completion of this chapter, you should be able to

- identify the distinctive features of claims-made coverage triggers and
- recognize how claims-made coverage triggers function in an EPL policy.

Operation of Claims-Made Coverage Triggers

EPLI policies are written on what is known as a "claims-made" basis, which requires that two conditions be met for coverage to apply.

- First, the claim must be "first made" against the insured during the policy term. This means that, for coverage to apply, the claim must not have previously been made against the insured during a policy with an earlier term of coverage.
- Second, coverage applies only if the act giving rise to a claim takes place on or after the policy's "retroactive date."

Retroactive Dates

Retroactive dates in EPLI policies state that, for coverage to apply, the wrongful act giving rise to a claim must have taken place *on* or *after* the retroactive date specified by the policy's declarations page.

Purposes of Retroactive Dates

Retroactive dates have two purposes.

- First, retroactive dates exclude coverage for possible wrongful acts committed in conjunction with some known event (i.e., known to the insured) that took place prior to policy inception.
- Second, they also eliminate coverage for wrongful acts that took place far in the past—even if unknown to the insured.

Retroactive Dates in Policies for First-Time EPL Buyers

Retroactive dates are sometimes included in EPLI policies for firms that are buying coverage for the first time. This is because underwriters are reluctant to offer "full prior acts coverage" (i.e., policies without retroactive dates) under such circumstances. Their concern is that the insured's sudden desire to obtain a policy may have been prompted by the need to obtain coverage for circumstances they suspect could produce a claim in the future.

However, even if additional premium is required, the first-time buyer of EPL coverage should purchase a policy that does not contain a retroactive date if coverage on this basis is available. Otherwise, no coverage will be available for any claim that is made against the insured during the policy period if the insurer can demonstrate that the claim was caused by that acts took place prior to the inception of the policy. This could have the effect of excluding coverage for a significant portion of the insured's exposure to employment-related claims.

Retroactive Dates in Policies for Companies Currently Insured

On the other hand, for a company that already has an EPLI policy in place with another insurer, inclusion of a retroactive date that is the same as the new policy's inception date should be strongly resisted unless there is a specific underwriting reason, such as a recent, total overhaul of a company's operations. In other words, attempts should be made to have a policy written without a retroactive date (or one coinciding with the first EPLI policy purchased by the insured).

An Example

A company's current policy has a term of 1/1/16–17 and a retroactive date of 1/1/06, the date on which the company began doing business. In this situation, if the company decides to purchase coverage from a new insurer, the new insurer should not (except under unusual circumstances) offer the company a policy with a retroactive date earlier than 1/1/06.

Discovery Provisions

Circumstances often arise under which it is probable that an act will eventually cause a claim to be made against a company, despite the fact that litigation may not be initiated for some time. To address this problem, virtually all EPL policies are written with what are called discovery provisions (also known as *awareness provisions* or *notice of claim provisions*). These allow the insured to advise the insurer—during the policy period—of situations that could later produce a claim against the insured. In the event such situations do result in a claim, the claim will be considered to have been "made" during the policy period in which the insured originally notified the insurer. At that point, despite the fact that the actual claim is made against the insured long after the policy period has terminated, coverage applies nonetheless.

An Example

An insured has an EPL policy written with a 1/1/18–19 term of coverage. On 3/1/18, a female employee at the company complains to the HR department that her supervisor has been harassing her for the past month. Given the possibility that this situation could eventually result in an actual lawsuit against the company, later that day, its risk manager, under the EPL policy's discovery provision, reports this "incident" to the insurer. On 3/1/19, a year after receiving notification of the "incident" and reporting it to the insurer, the company receives a lawsuit from the employee.

In view of the fact that the risk manager reported the "incident" to the insurer, coverage will apply under the 1/1/18–19 policy *despite the fact* that the policy is no longer in force. Once an incident is reported during the term of a claims-made policy, coverage is "locked in," regardless of how far in the future a formal claim is made.

ERPs

If an insured cancels or non-renews an EPL policy, unless a replacement policy is purchased, there will be a gap in coverage for claims made after cancellation or nonrenewal. To prevent such a gap, an insured can purchase an "extended reporting period endorsement" (ERP). An ERP covers wrongful acts committed during the expired or canceled policy if they later result in claims against the insured.

An Example

An insured has an EPL policy written for a term of 1/1/20–21. When the policy expires, the insured does not renew it. As a result, the insured will have no coverage for any claim made against it after 1/1/21 (the date on which the policy expires) unless it either (a) renews the 1/1/20–21 policy or (b) buys an ERP.

No Coverage for Claims Caused by Wrongful Acts During the ERP

The ERP does not, however, cover claims caused by wrongful acts that took place *during* the ERP itself. Rather it only covers claims (1) made against the insured *and* (2) reported to the insurer during the ERP—provided the wrongful act that gave rise to the claim took place prior to the inception of the ERP.

Availability

Nearly all EPL policy forms permit the insured to purchase an ERP even if cancellation/nonrenewal is at the insured's election. This is known as a two-way ERP tail.

Automatic ERPs

The majority of insurers' forms offer what is termed an "automatic ERP," which allows the insured to report claims for either a 30- or 60-day period (depending upon the insurer) following policy expiration/cancellation. There is no additional premium charge for an automatic ERP.

No Reinstatement of Limits

When an insured purchases an ERP, no additional limits are created or reinstated. Thus, any claims reported during the ERP are subject to the original policy limit, even if other claims have been made under the policy.

An Example

Following expiration of an insured's $1 million EPL policy, with a January 1, 2020, to January 1, 2021, term, the insured buys a 1-year ERP with a term of January 1, 2021, to January 1, 2022. Assume that, during the now-expired January 1, 2020, to January 1, 2021, policy term, the insured reported two claims. Any monies paid in conjunction with the two claims will reduce the limit available under the ERP. Thus, if $500,000 is paid out for indemnity and defense of these two claims, the insured will have a limit of $500,000 available for any other claims reported during the ERP.

Duration

About half of all EPL policies offer ERP choices of several different durations. Such policies usually give the insured the option of up to four different time periods, normally ranging from 1 to 5 years. The remaining insurers' forms offer only a single-duration option, with 1 year being the most common option.

Premium Charge

The policies specify the premium charge for the ERP option as a fixed percentage of the expiring policy's premium, most often 100 percent for a 1-year ERP.

Time in Which to Elect

The majority of EPL policies allow the insured 30 days following nonrenewal, expiration, or cancellation to purchase the ERP. The remainder of the leading insurers allow the insured to make this decision within 60 days after that date.

Coverage for “Notice of Circumstances” during ERP

A key variation between the ERPs in EPL policy forms is whether a report of an “incident” or “notice of circumstances” that has the potential to but has not yet resulted in a formal claim against the insured will be covered by an ERP. In effect, under some insurers’ ERP wording, the policy’s discovery provision is operative, whereas, in others, it is not.

Given these circumstances, it is apparent that an ERP provision that covers “incidents” is far superior to that which requires the report of an actual “claim” to trigger coverage.

Chapter 11 Review Questions

1. To trigger coverage under a claims-made policy, the claim must be made
    A. after the retroactive date for an act occurring during the policy period.
    B. before the retroactive date for an act occurring during the policy period.
    C. during the policy period for an act that occurred on or after the retroactive date.
    D. during the policy period for an act that occurred before the retroactive date.
2. Ace Company's current EPL policy has a term of 1/1/17–18 and a retroactive date of 1/1/10, the date on which the company began doing business. Ace's only EPL claim involved a wrongful act during 2015. If Ace decides to purchase coverage from a new insurer, the new insurer should not normally offer the company a policy with a retroactive date earlier than
    A. 1/1/2010.
    B. 1/1/2015.
    C. 1/1/2016.
    D. 1/1/2017.
3. Deuce Corporation management just learned that one division of the company has been systematically violating wage and hour laws; this raises the possibility that workers in that division might make a wage-and-hour claim against Deuce. To date, however, no claim has been made. Deuce has an EPL policy with a discovery provision that allows Deuce to advise its current EPL insurer of the situation that could later produce a claim. According to the discovery provision, what will happen if Deuce gives notice to the insurer?
    A. If the situation results in a claim, the claim will be considered to have been made during the policy period in which the insurer was originally notified.
    B. The insurer will add an exclusion for this situation when the policy renews, thereby eliminating coverage for claims related to this incident that are made during future policy periods.
    C. The insurer will not renew Deuce's EPL policy.
    D. The insurer will substantially increase the premium when Deuce's EPL policy renews.
4. Claims would be covered under an EPL policy with an ERP for an alleged wrongful act that was committed
    A. after the policy's termination date but during the ERP.
    B. after the retroactive date and before the policy's termination date.
    C. after the retroactive date and during the ERP.
    D. before the retroactive date.

5. As regards the decision whether to purchase coverage for an optional ERP, a typical EPL policy

   A. permits the insured to activate ERP coverage during a 1-year period following the policy's termination.

   B. stipulates the premium that will be charged and requires the insured to declare during the policy period its intention to purchase or forgo ERP coverage.

   C. stipulates the premium that will be charged and the time period following nonrenewal, expiration, or cancellation during which the ERP may be elected.

   D. stipulates that the insured must select ERP coverage at policy inception.

Answers to Chapter 11 Review Questions

1.

   A. This answer is incorrect. The act need not occur during the policy period.

   B. This answer is incorrect. It is not possible to make a claim for something that hasn't happened yet.

   C. That's correct! For claims-made coverage to apply, (1) the claim must be first made during the policy term, and (2) the act giving rise to the claim must take place on or after the policy's retroactive date.

   D. This answer is incorrect. The act must have occurred on or after the retroactive date.

2.

   A. That's correct! If there is a retroactive date, it should coincide with the inception date of the insured's first EPLI policy.

   B. This answer is incorrect. The insured would then have no coverage for claims arising out of wrongful acts prior to 1/1/2015.

   C. This answer is incorrect. This retroactive date would preclude coverage for any additional claims resulting from the 2015 incident, but the insured would be better served by an earlier retro date.

   D. This answer is incorrect. For a company that already has an EPLI policy in place with another insurer, inclusion of a retroactive date that is the same as the new policy's inception date should be strongly resisted unless there is a specific underwriting reason, such as a recent, total overhaul of a company's operations.

3.

   A. That's correct! Even if an actual claim is made against the insured long after the policy period has terminated, coverage applies nonetheless.

   B. This answer is incorrect. The policy's discovery provisions would make such an exclusion irrelevant.

   C. This answer is incorrect. The discovery provision does not specify that the policy will not be renewed.

   D. This answer is incorrect. An underwriter might take Deuce's loss experience into account when renewing the policy, but that is not a function of the discovery provision.

4.

   A. This answer is incorrect. There is no coverage for wrongful acts during the ERP.

   B. That's correct! Coverage applies to wrongful acts that took place on or after the policy's retroactive date and before the policy's termination date.

   C. This answer is incorrect. Only part of this statement is correct.

   D. This answer is incorrect. Wrongful acts occurring before the retro date are never covered.

5.

   A. This answer is incorrect. A 30- to 60-day time period is typical.

   B. This answer is incorrect. The stipulation may be made after the policy terminates.

   C. That's correct! Nearly all policies indicate the specific ERP option's premium charge as a fixed percentage of the expiring policy's premium and allow the insured 30 (sometimes 60) days to elect coverage.

   D. This answer is incorrect. The stipulation may be made on or after policy termination.

Glossary

ADA—See Americans with Disabilities Act.

ADEA—See Age Discrimination in Employment Act.

adverse action—One of the elements of a retaliation claim. Examples include denial of a promotion, refusal to hire, demotion, suspension, discharge, threats, reprimands, negative evaluations, harassment, and change in hours.

Age Discrimination in Employment Act (ADEA) of 1967—A law that prohibits the making of employment decisions (e.g., hiring, promotion) based on age. It applies to employees or applicants who are 40 years or older and to companies with 20 or more employees. The ADEA specifies various remedies if a firm is found to have violated the law. Some of these include hiring an applicant who was discriminated against, reinstating a terminated employee, and paying of back wages, liquidated damages, "front" pay until an employee reaches the age of 70, court costs, and attorneys' fees.

Americans with Disabilities Act (ADA) of 1990—A federal statute passed in 1990, primarily aimed at preventing discrimination in hiring persons having a "disability" as defined by the Act. Under the ADA, employers must afford job applicants equal opportunity (i.e., evaluating an applicant solely on his/her ability to perform the essential functions of a job, regardless of disability) and make reasonable accommodations to allow disabled employees to perform job functions. However, employers are relieved from the reasonable accommodation requirement if it creates an "undue hardship," such as excessive costs or considerable work disruption. Alleged violations of the ADA are one of the leading perils covered by employment practices liability insurance (EPLI) policies.

Title III of the ADA is concerned with making public and commercial buildings physically accessible for disabled persons. It imposes remodeling and reconstruction requirements on some organizations that vary, depending on the primary use of each building. Some of the requirements apply regardless of whether the building in question must be remodeled or rebuilt for reasons other than ADA compliance. Accordingly, the ordinance or law exclusions in 1995 and later edition Insurance Services Office, Inc. (ISO), commercial property forms contain language intended to make it clear that there is no coverage for the cost of compliance with the ADA.

assault—An intentional act by one person that causes a second person to legitimately fear harm or unwanted contact by the first, although there is no need for actual physical contact between the two.

at-will employment—Employment can be terminated for cause or for no cause, at any time, and with no advance notice. The "at-will" employment doctrine is recognized in most jurisdictions.

battery—The intentional act of touching another person in a harmful or offensive manner.

BOP—See businessowners policy.

bullying—A type of conduct in which one person harasses another person over a time period in a workplace environment. Bullying is characterized by a pattern of deliberate, hurtful, and menacing behaviors. Bullying can have two aspects: physical—such as making intimidating physical threats, pushing, shoving, and invading an individual's personal space—or psychological—such as emotional intimidation that is mostly covert, including joking or initiation rites that may mask sadistic behavior. Employees who claim to have been bullied by other employees are increasingly suing employers. Bullying has become so common that more than 30 of states have passed anti-bullying legislation.

businessowners policy (BOP)—A package policy that provides both property and liability coverage for eligible small businesses. BOPs are written on special coverage forms that are generally very similar to their monoline property and liability form counterparts, but they typically have some unique features that make them especially advantageous for businesses that qualify. Both the American Association of Insurance Services (AAIS) and the Insurance Services Office, Inc. (ISO), offer BOP programs for use by their member insurers. Also, many insurers have their own BOP programs.

CGL—See commercial general liability.

Civil Rights Act of 1991—A federal act that broadened the scope of Title VII of the Civil Rights Act of 1964. The Civil Rights Act of 1991 gives employees who sue their employers the right to a jury trial and the right to recover compensatory and punitive damages. Prior to passage of the Civil Rights Act of 1991, successful claimants were entitled only to awards of back pay and lost benefits and were not afforded the right to a jury trial.

claims-made policy—A policy providing coverage that is triggered when a claim is made against the insured during the policy period, regardless of when the wrongful act that gave rise to the claim took place. (The one exception is when a retroactive date is applicable to a claims-made policy. In such instances, the wrongful act that gave rise to the claim must have taken place on or after the retroactive date.) Most professional, errors and omissions (E&O), directors and officers (D&O), and employment practices liability insurance (EPLI) is written as claims-made policies.

coinsurance hammer clause—An alternative to the standard hammer clause found within professional, directors and officers (D&O), and errors and omissions (E&O) policy forms. Such a provision provides for a sharing of defense and indemnity costs (between the insured and the insurer) incurred after the insured refuses to consent to a settlement proposed by an insurer. The most common sharing percentage is 50/50 but can sometimes go higher (e.g., 70 insurer/30 insured). The effect of such clauses is to reduce the amount of indemnity and defense costs that an insured could potentially incur if it refuses to consent to a settlement amount recommended by an insurer.

common law—Unwritten law derived from court case decisions based on custom and precedent. It is contrasted to statutory law.

constructive discharge—An attempt by an employer to force an employee to resign (rather than terminate the employee) by making the employee's working conditions highly disagreeable. Constructive discharge claims are considered a "workplace tort" and are covered under employment practices liability insurance (EPLI) policies. To sustain a claim for constructive discharge, employees must establish either that employment conditions are personally directed at the employee or that the conditions violate fundamental constitutional rights. (Merely unfair conditions of employment, such as unequal pay scales between men and women, may not necessarily establish a claim.) Thus, where a former police chief of detectives was stripped of all duties and forced to sit all day at a desk in a windowless storage closet without a telephone, the court found that the employee stated a valid claim of constructive discharge.

D&O insurance—See directors and officers liability insurance.

defamation—Any written or oral communication about a person or thing that is both untrue and unfavorable. Media liability and general liability policies typically provide coverage for claims alleging defamation (although general liability policies exclude such coverage for insureds engaged in media businesses).

directors and officers (D&O) liability insurance—A type of liability insurance covering directors and officers for claims made against them while serving on a board of directors and/or as an officer. D&O liability insurance can be written to cover the directors and officers of for-profit businesses, privately held firms, not-for-profit organizations, and educational institutions. In effect, the policies function as "management errors and omissions liability insurance," covering claims resulting from managerial decisions that have adverse financial consequences. The policies contain “shrinking limits” provisions, meaning that defense costs—which are often a substantial part of a claim—reduce the policy’s limits. This approach contrasts with commercial general liability (CGL) policies, in which defense is covered in addition to policy limits. Other distinctive features of D&O policies are that they (a) are written on a claims-made basis, (b) usually contain no explicit duty to defend the insureds (when covering for-profit businesses), and (c) cover monetary damages but exclude bodily injury (BI) and property damage (PD).

disability—A condition that incapacitates a person in some way so that he or she cannot carry on normal pursuits. The definition of “disability” in disability income policies varies substantially and should be carefully examined. Disability may be total, partial, permanent, or temporary or a combination of these. In the context of the Americans with Disabilities Act (ADA), “disability” is defined as a recorded or perceived physical or mental impairment that substantially limits one or more major life activities of an individual.

discovery provisions—Provisions that permit insureds to report incidents or circumstances that may result in claims in the future, found mainly in professional liability insurance policies written with claims-made coverage triggers. Discovery provisions, which are also known as “awareness” or “notice of potential claim” provisions, allow an insured to lock in coverage for such events so that coverage will apply under the current claims-made policy, regardless of how far in the future a claim is eventually made in conjunction with the incident that has been reported.

discrimination—(1) The act or process of evaluating insurable risks and determining premiums on the basis of likelihood of loss. Insurance laws prohibit “unfair discrimination”—that is, the formulation of rates on the basis of criteria that do not fairly measure the actual risk involved. (2) Unfair or illegal treatment of or denial of rights to persons on the basis of certain arbitrarily chosen attributes or characteristics, including race, gender, religion, creed, age, medical condition, pregnancy, sexual orientation/preference, physical appearance, marital status, physical or mental disability, or national origin. Discrimination does not usually fall within the coverage terms of the commercial general liability (CGL) policy (and may even be specifically excluded by endorsement) but may be covered as a form of personal injury (PI) under some umbrella policies. However, employment practices liability insurance (EPLI) covers a variety of employment-related claims, including discrimination.

disparate impact discrimination—Discrimination claims involving apparently neutral policies that have the effect of discriminating against a certain class of persons, even though such discrimination may not be intentional. For example, if a city required all police officers to be at least 5’10” tall, a female applicant would be likely to allege disparate impact discrimination because the vast majority of women are considerably shorter. Claims alleging disparate impact discrimination are covered under employment practices liability insurance (EPLI) policies.

disparate treatment discrimination—Discrimination that involves illegal, deliberate discrimination against an individual, such as failing to promote an otherwise qualified employee based upon race, age, sex, or national origin. Claims alleging disparate treatment discrimination are covered under employment practices liability insurance (EPLI) policies.

duty to defend—A term used to describe an insurer’s obligation to provide an insured with defense to claims made under a liability insurance policy. As a general rule, an insured need only establish that there is potential for coverage under a policy to give rise to the insurer’s duty to defend. Therefore, the duty to defend may exist even where coverage is in doubt and ultimately does not apply. Implicit in this rule is the principle that an insurer’s duty to defend an insured is broader than its duty to indemnify. Moreover, an insurer may owe a duty to defend its insured against a claim in which ultimately no damages are awarded, and any doubt as to whether the facts support a duty to defend is usually resolved in the insured’s favor.

With respect to directors and officers (D&O) and employment practices liability insurance (EPLI) policies, policies containing explicit "duty to defend" wording obligate an insurer to assume control of the claim defense process, including selecting counsel and paying legal bills. In contrast, non-duty to defend (or duty to pay) policies require only that the insurer reimburse the insured for funds expended by the insured in defending a claim.

employment-at-will doctrine—A legal doctrine holding that, absent a contract for a specified duration, both employers and employees are free to terminate the employment relationship at any time, with or without cause, and with or without notice. In recent years, however, both courts and legislatures have developed a number of exceptions to this doctrine, a factor largely responsible for a marked increase in claims alleging wrongful termination.

employment practices liability insurance (EPLI)—A type of liability insurance covering wrongful acts arising from the employment process. The most frequent types of claims covered under such policies include wrongful termination, discrimination, sexual harassment, and retaliation. In addition, the policies cover claims from a variety of other types of inappropriate workplace conduct, including (but not limited to) employment-related defamation, invasion of privacy, failure to promote, deprivation of a career opportunity, and negligent evaluation. The policies cover directors and officers, management personnel, and employees as insureds. The most common exclusions are for bodily injury (BI), property damage (PD), and intentional/dishonest acts. EPLI policies are written on a claims-made basis. The forms contain "shrinking limits" provisions, meaning that insurer payment of defense costs—which are often a substantial part of a claim—reduce the policy's limits. This approach contrasts with commercial general liability (CGL) policies, in which defense is covered in addition to policy limits. Although EPLI is available as a stand-alone coverage, it is also frequently sold as part of a management liability package policy. In addition to providing directors and officers (D&O) and fiduciary liability insurance, management liability package policies afford the option to cover employment practices liability (EPL).

EPL—Acronym for employment practices liability.

EPLI—See employment practices liability insurance.

Equal Pay Act of 1963—A federal law prohibiting pay discrimination against employees because of their gender. The Act compels businesses to pay equal wages to employees performing substantially equal work, regardless of the sex of the individual employees. Pay differentials may be based on merit, seniority, or any lawful factor other than sex. The Equal Pay Act applies to all businesses regardless of the number of employees. Inequalities in pay between men and women for performance of "substantially equal jobs" are prohibited, unless the differences are due to a factor other than sex, such as a seniority system or merit system. Claims alleging violation of the Equal Pay Act are covered by employment practices liability insurance (EPLI) policies.

ERP—See extended reporting period.

exempt employee—An employee who is exempt from eligibility for receiving overtime pay.

extended reporting periods (ERP)—A designated time period after a claims-made policy has expired during which a claim may be made and coverage triggered as if the claim had been made during the policy period.

fair employment practices laws—Legislation enacted in every state that bars discrimination by private employers against defined categories of individuals. Fair employment practices laws are generally broader than their federal counterparts, but they are not uniform in their protection.

Fair Labor Standards Act (FLSA) of 1938—A law that established a national, hourly minimum wage and promulgated eligibility rules for overtime pay. The Wage and Hour Division of the US Department of Labor administers the law, and virtually all wage and hour claims cite a violation of the FLSA. Wage and hour claims allege that workers classified by employers as "exempt" (and therefore ineligible for overtime pay) are, in fact, entitled to overtime pay. Wage and hour claims are a serious exposure for employers; a number of class action wage and hour claims have settled for more than $10 million.

Family and Medical Leave Act (FMLA) of 1993—A law allowing employees to take up to 12 weeks annually of job-protected unpaid leave. Such leaves are permitted in the event of a serious illness of the employee or family member or the birth or placement (through adoption or foster care) of a child. The law applies to employers having 50 or more employees and to employees who have worked for the employer for a minimum of 1,250 hours during the prior year. Charges of discrimination against those taking leave under the Act (or by those prevented from taking leave under the Act) can be filed with the Department of Labor, which investigates and enforces claims. In addition, an employee can sue his or her employer individually. Such claims are covered by employment practices liability (EPL) policies.

FLSA—See Fair Labor Standards Act.

FMLA—See Family and Medical Leave Act.

fraud—Deception or artifice used to cheat or intentionally mislead. This is closely related to misrepresentation and concealment. Proof of fraudulent acts by an insured in procuring insurance may lead to a denial of coverage and voiding of the policy by the insurer. As a loss exposure, certain types of fraud can be insured by a commercial crime insurance policy.

Genetic Information Nondiscrimination Act (GINA) of 2008—A law that prohibits the improper use of genetic information in both health insurance underwriting and pricing and in employment decisions. The Act prohibits health insurers from denying coverage to a healthy individual or charging that person higher premiums based solely on a genetic predisposition to developing a disease in the future. The legislation also bars employers from using individuals' genetic information when making hiring, firing, job placement, or promotion decisions. Here is an example of how the law might apply in an employment scenario. A company requires preemployment physicals as a condition of employment. The results of a prospective employee's physical examination indicate that she is healthy and fully capable of performing the job duties for the particular position for which she had been hired. However, the examination also revealed that she has a genetic predisposition for developing breast cancer. Under GINA, the employer would not be able to deny the person the job, despite such a predisposition.

GINA—See Genetic Information Nondiscrimination Act.

hammer clause—A provision (also known as the "blackmail settlement clause") found in professional liability insurance policies that requires an insurer to seek an insured's approval prior to settling a claim for a specific amount. However, if the insured does not approve the recommended figure, the consent to settlement clause states that the insurer will not be liable for any additional monies required to settle the claim or for the defense costs that accrue from the point after the insurer makes the settlement recommendation.

hostile work environment sexual harassment—A form of sexual harassment occurring when such conduct has the purpose or effect of unreasonably interfering with an individual's work performance or creating an intimidating, hostile, or offensive working environment. Coverage for such claims is covered under employment practices liability (EPL) policies.

independent contractor—An individual or company that has signed an agreement with another party to perform some job or function on behalf of that party without the direction or oversight of the party. As respects workers compensation, many states have established criteria that determine whether an individual is functioning as an independent contractor or employee. A worker classified as an independent contractor and not an employee is ineligible to receive benefits under the workers compensation policy of the other party. Despite the rules established, the delineation of an independent contractor remains in many jurisdictions a legal ambiguity.

Insurance Services Office, Inc. (ISO)—An organization that collects statistical data, promulgates rating information, develops standard policy forms, and files information with state regulators on behalf of insurance companies that purchase its services.

insured versus insured exclusion—An exclusion found in directors and officers (D&O) liability policies (and to a lesser extent in other types of professional liability coverage). The exclusion precludes coverage for claims by one director or officer against another. The purpose of this exclusion is to eliminate coverage for four types of situations: (1) employment practices claims, (2) internal disputes/infighting, (3) claims involving collusion, and (4) claims by organizations against their directors and officers for imprudent business practices.

invasion of privacy—Violation of a person's right to be left alone. Invasion of privacy is considered a "traditional" personal injury (PI) tort. Coverage for PI is excluded in some umbrella and professional liability coverage forms, although it is covered under commercial general liability (CGL) policies, in police liability policies, within liability policies designed for media firms, in employment practices liability (EPL) policies, and in a number of lawyers professional liability policy forms.

ISO—See Insurance Services Office, Inc.

misrepresentation—A false or misleading statement that, if intentional and material, can allow the insurer to void the insurance contract. Some insurance policies and state laws that govern insurance contract provisions vary on the exact details of the conditions under which coverage may be voided; these variations are usually denoted in state amendatory endorsements.

most favored venue wording—A provision found within some directors and officers (D&O), professional, and employment practices liability (EPL) policies stating 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 the jurisdiction meets one of the following criteria. It is the jurisdiction where (a) the punitive damages were awarded; (b) the act giving rise to the punitive damages award occurred; (c) the insured is incorporated or maintains its principal place of business; or (d) the insurer is incorporated or maintains its principal place of business. When this provision is included within a policy that affirmatively covers (or does not exclude) punitive damages, it provides assurance that such damages will be covered by the insurer, despite the fact that covering punitive damages is contrary to law in certain jurisdictions (e.g., California). Most favored venue wording merely modifies the existing level of coverage for punitive damages already provided by a policy. Such wording does not provide coverage if the policy otherwise excludes punitive damages. It is also important to recognize that the validity of this provision has not been tested in court.

negligence—A tort involving failure to use a degree of care considered reasonable under a given set of circumstances. Acts of either omission or commission or both may constitute negligence. The four elements of negligence are a duty owed to a plaintiff, a breach of that duty by the defendant, proximate cause, and an injury or damage suffered by the plaintiff. Liability policies are designed to cover claims of negligence.

negligent retention—A type of employment-related claim in which a plaintiff asserts that an employer failed to discharge an employee who management knew or should have known had a propensity toward violence, sexual harassment, or dishonesty. For example, negligent retention claims are often made after an employee commits a mass shooting at a plant or office. Injured workers then sue the employer, alleging that the company was negligent in not terminating the employee sooner. The basis of the claimants' argument is that, on prior occasions, the employee had provided clear evidence of a propensity for such violence (e.g., he had issued threats or brought a weapon onto the company's premises). Coverage for such claims is available under employment practices liability insurance (EPLI) policies.

non-duty to defend language—See duty to defend.

nonexempt employee—An employee who is eligible for overtime pay.

nonpecuniary relief—Relief not involving money damages, such as reinstating a wrongfully terminated employee.

post-judgment interest—Interest accrued between the time of the judgment and the time of payment.

prejudgment interest—Interest accruing on the amount of a legal award from the time of the injury or damage to the time the judgment is entered by the court. Prejudgment interest, when awarded as part of a judgment against the insured, is covered by the supplementary payments provision of standard general liability policies.

public policy exception—A common law remedy to the employment-at-will doctrine that has been created by the judicial system. Courts in various jurisdictions have recognized that an employee should not be terminated for exercising rights under other laws that were enacted to protect the employee. An example of a wrongful termination suit that has been allowed involved the firing of an employee for missing a week of work to serve on jury duty.

punitive damages—Damages in excess of those required to compensate the plaintiff for the wrong done, which are imposed in order to punish the defendant because of the particularly wanton or willful nature of his or her wrongdoing. Also called "exemplary damages." Although the standard commercial general liability (CGL) policy and business auto policy (BAP) contain no punitive damage exclusion, many umbrella and excess liability policies contain such an exclusion.

quid pro quo sexual harassment—A form of sexual harassment, such as unwelcome sexual advances or requests for sexual favors when (1) submission to such conduct is made a condition of an individual's employment, and (2) submission to or rejection of such conduct is used as a basis for employment decisions affecting the individual who is receiving such advances or requests. Claims alleging quid pro quo sexual harassment are afforded coverage under employment practices liability (EPL) policies.

reasonable accommodation—As defined in the Americans with Disabilities Act (ADA) of 1990, either modifications or adjustments to a job application process or a job performance process that enable a qualified applicant with a disability to be considered for or perform the position or modifications or adjustments that allow the disabled worker the same benefits and privileges afforded other similarly situated employees without disabilities. This modification or job adjustment must be achieved without imposing an undue hardship on the employer's operations.

retaliation claims—Such claims result when an employee alleges discrimination based on protected status (e.g., race, gender, disability), and, in retaliation for making such a claim, the employee is treated adversely (e.g., the employee receives a demotion). A successful retaliation claim must prove three elements: (1) that the employee engaged in a "protected activity" (filing a discrimination claim, alleging corporate misconduct), (2) that the employee suffered an "adverse action" (termination), and (3) that there was a causal connection between the adverse action and the protected activity. Employment practices liability insurance (EPLI) policies cover retaliation claims. In recent years, retaliation claims have also been made in conjunction with workers compensation claims. That is, employees have sued their employers when, in response to filing a workers compensation claim, an employer took some form of adverse action against the worker (e.g., imposing a change in work hours, giving the employee a demotion or a reprimand).

retroactive date—A provision found in many (although not all) claims-made policies that eliminates coverage for claims produced by wrongful acts that took place prior to a specified date, even if the claim is first made during the policy period.

For example, a January 1, 2010, retroactive date in a policy written with a January 1, 2010–2011, term, would bar coverage for claims resulting from wrongful acts that took place prior to January 1, 2010, even if claims (resulting from such acts) are made against the insured during the January 1, 2010–2011, policy period.

There are two purposes of retroactive dates: (1) to eliminate coverage for situations or incidents known to insureds that have the potential to give rise to claims in the future and (2) to preclude coverage for "stale" claims that arise from events far in the past, even if such events are unknown to the insured. In the former case, the retroactive date preserves the principle of "fortuity"—that is, the insurer should not be called upon to cover the so-called burning building. In the latter instance, the retroactive date makes policies more affordable by precluding coverage for events that, while insurable, are remote in time.

sexual harassment—Conduct involving unwelcome sexual advances, requests for sexual favors, and verbal, visual, or physical conduct of a sexual nature. There are two types of sexual harassment: quid pro quo sexual harassment, in which sexual contact is made a condition of employment, and hostile environment sexual harassment, in which such conduct creates an intimidating, hostile, or offensive working environment. Lawsuits against businesses that allege sexual harassment have increased significantly during the past decade. Accordingly, around 1990, the insurance market began offering employment practices liability (EPL) policies, a specialized form of insurance covering claims of sexual harassment as well as other employment-related torts.

third-party claims—Liability claims brought by persons allegedly injured or harmed by the insured. The insured is the first party, the insurer is the second party, and the claimant is the third party.

third-party liability coverage—In general, any type of insurance covering the legal liability of one party to another party. For example, commercial general, business auto, and errors and omissions (E&O) liability policies all provide third-party liability coverage. In the context of employment practices liability (EPL) insurance, a so-called third-party liability coverage option is sometimes available to address claims made by nonemployees (e.g., customers, vendors, clients) against the insured company that arise from acts committed by employees. Most often, third-party claims allege some form of either discrimination or harassment. The majority of EPL policies do not explicitly cover third-party claims, although most insurers will provide such coverage by endorsement.

Title VII of the Civil Rights Act of 1964—A law prohibiting discrimination by private sector employers. Title VII bars an employer from discriminating on the basis of race, color, religion, sex, or national origin in hiring, discharge, or compensation and with regard to any terms, conditions, or privileges of employment. An "employer" is defined under Title VII as any person "engaged in an industry affecting commerce who has 15 or more employees for each working day in each of 20 or more calendar weeks in the current or preceding calendar year." An "employer" can be a sole proprietor, partnership, or corporation. A partner is not considered an employee under Title VII. The majority of employment-related lawsuits alleging discrimination are brought under Title VII.

unconscious bias—A type of employment-related claim alleging that, with respect to promotions, raises, and job offers, Caucasian men inevitably slight women and minorities, because they use preconceived stereotypes in evaluating such persons, despite their conscious efforts to do otherwise. The leading proponent of this theory is sociologist William Bielby, who regularly testifies on behalf of employee plaintiffs in major employment discrimination cases (including those against Wal-Mart, FedEx, and Johnson & Johnson). As an example of unconscious bias, Bielby's research found that, in identifying candidates for management positions requiring relocation, hiring managers systematically excluded women from consideration because they reflexively assumed that women weren't interested in jobs requiring them to move long distances. Critics of unconscious bias claims assert that, while stereotypes are admittedly involved in interactions between strangers, when a Caucasian manager has known an employee for a significant time period, he will apply what is referred to as "individuating information," thereby allowing him to make objective decisions on the basis of the employee's individual skills and abilities, rather than on gender or racial stereotypes.

Uniformed Services Employment and Reemployment Rights Act (USERRA) of 1994—A federal law intended to ensure that persons who serve in the Armed Forces, Reserves, National Guard, or other "uniformed services" (1) are not disadvantaged in their civilian careers because of their service; (2) are promptly reemployed in their civilian jobs upon their return from duty; and (3) are not discriminated against in employment based on past, present, or future military service. Essentially, the Act requires employers to allow those who have served on active duty to go back to the same job and at the same pay after they return from such active duty service. The Act does, however, contain two important exceptions for employers under which employers are not required to reemploy a service man or woman, specifically when (1) the employer experiences "changed circumstances" (e.g., during a company-wide layoff) and (2) when there is "undue hardship" (e.g., the employer is facing severe financial difficulties).

USERRA—See Uniformed Services Employment and Reemployment Rights Act.

wage and hour claims—An assertion by an employee-plaintiff that his or her employer has failed to pay overtime wages owed to the employee. Within the past several years, a number of high-profile, high-dollar wage and hour claims have been filed on a class action basis, a fact that has vastly increased the dollar amount payable under such lawsuits. Given the magnitude of this exposure, most employment practices liability insurance (EPLI) policies specifically exclude coverage for wage and hour claims.

WARN Act exclusion—An exclusion found in employment practices liability insurance (EPLI) policies. Under the federal Workers' Adjustment Retraining Notification (WARN) Act, employers of 100 or more persons are required to give their workers specific notice periods prior to various types of mass layoffs or plant closings. The majority of employment practices liability (EPL) policies preclude coverage for claims alleging failure to provide such notice as required by the WARN Act. The rationale for this exclusion is that such claims are within the insured's control and therefore are preventable.

whistleblower claim—An assertion that an employee was penalized (e.g., terminated, demoted, disciplined) for complaining of or opposing certain employer actions (e.g., fraudulent billing practices on a government contract), refusing to engage in illegal or unethical conduct, or exposing such conduct via testimony at a trial or administrative hearing. Whistleblower claims are a type of retaliation claim and are covered by employment practices liability insurance (EPLI) policies.

whistleblower statutes—Laws that protect employees from retaliatory actions by their employer when the employees report violations of law by their employer. In addition to federal statutes, many states also have passed laws prohibiting an employer from firing or otherwise retaliating against an employee for disclosing an unfair or illegal practice by the employer. Employment practices liability (EPL) policies cover so-called whistleblower claims, whereby an employee asserts that he or she was retaliated against for whistleblowing.

wrongful hiring claims—Claims resulting when a former employer knowingly gives favorable references concerning a former problematic employee to a company that hires that former employee. The hiring company then sues the former employer for providing a knowingly false reference.

wrongful termination—The act of terminating an employee in a manner that is against the law. In recent years, erosion of the employment-at-will doctrine has been the factor most responsible for the increase in claims alleging wrongful termination. Coverage for this exposure is provided under employment practices liability (EPL) policies.