EMPLOYMENT PRACTICES LIABILITY EXPOSURES AND INSURANCE COVERAGE

IRMI®

PRINTED IN THE UNITED STATES OF AMERICA

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Employment Practices Liability Exposures and Insurance Coverage

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Chapter 1
Introduction and Course Overview

IRMI has teamed up with WebCE to bring you this quality continuing education course.

This Web CE 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 coverage.

The second part of the course takes a detailed look at the specific coverage terms within employment practices liability insurance (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 2 discusses three of the five most important common law exposures to employment practices liability claims: discrimination, wrongful termination, and sexual harassment.
- Chapter 3 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 4 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 5 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 6 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 7 enumerates the various sources of employment practices liability coverage, such as stand-alone EPL forms, coverage under directors and officers (D&O) liability policies, EPL endorsements to D&O policies, management liability forms, and businessowners policies.
- Chapter 8 begins the course's detailed discussion of employment practices liability policies, examining the covered organizations, covered persons, and covered acts provisions in the policies.
- Chapter 9 analyzes the third-party liability, covered damages, and covered claim definition found in employment practices liability policies.
- Chapter 10 discusses the claims management, defense cost, and special conditions provisions within employment practices liability policies.
- Chapter 11 lists the exclusions contained in employment practices liability policy forms and explains the significance of exception language within these exclusions
- Chapter 12 analyzes the manner in which an employment practices liability policy's coverage triggers apply. Concepts such as: claims first-made, retroactive dates, discovery provisions, and extended reporting provisions, are discussed.

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

1. Identify and discuss the five key common law exposures to employment practices liability claims.
2. Explain the significance of the various kinds of "inappropriate employment conduct" and describe how such conduct produces employment-related claims.
3. List the most important federal statutes relating to workplace discrimination and analyze the employment-related exposures such statutes create.
4. State the key factors used to price employment practices liability insurance coverage and explain the importance of such factors within the underwriting process.
5. Analyze the most effective methods of reducing exposures to employment liability claims and demonstrate how such methods can also lower claim settlement amounts.
6. Discuss the various methods of obtaining employment practices liability insurance coverage.
7. Explain how the covered persons/covered organizations/covered acts provisions function within employment practices liability policies.
8. Evaluate the scope of coverage provided by: (a) third-party liability provisions, along with the (b) "claim" and (c) "damages" definitions included within the policies.
9. Describe the functioning of the (a) claims management, (b) defense cost, and (c) special conditions provisions within employment practice liability policies.
10. List the most important exclusions found within employment practices liability policies and explain the operation and significance of the key "exception" wording commonly found within these exclusions.
11. Identify and describe the major components of the claims-made coverage triggers used to write employment practices liability coverage.

Chapter 2
Common Law EPL Exposures (Part 1)

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, a "catchall" term that includes, but is not limited to such perils as invasion of privacy, failure to promote, and defamation.

Chapter 2 will discuss the first three of these common law claim sources: discrimination, wrongful termination, and sexual harassment. Chapter 3 will discuss the latter two common law exposures (retaliation and inappropriate employment conduct).

Discrimination

Lawsuits alleging employment-related discrimination can be grouped into one of two broad categories: disparate treatment discrimination claims and 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. The seven types of discrimination handled by the Equal Employment Opportunity Commission (EEOC) include discrimination based on race, sex, national origin, religion, age, disability, and Equal Pay Act claims. In addition, the EEOC handles claims alleging retaliation based on the making of a claim of discrimination.

Unconscious Bias

Within the past 5years, one important, emerging type of disparate treatment claims is that alleging unconscious bias. The core contention underlying unconscious bias is that white men will inevitably slight women and minorities, regardless of their conscious efforts to do otherwise.

The leading proponent of this theory is sociologist William Bielby, who regularly testifies on behalf of plaintiffs in major employment discrimination cases, including those against Wal-Mart, FedEx, and Johnson & Johnson. It is Bielby's belief that not just white male managers, but *all* managers, unconsciously apply stereotypes in the employment decision-making process. For example, Bielby found that in identifying candidates for management positions that often require relocation, hiring managers systematically excluded women from consideration because they reflexively assumed that they weren't interested in jobs that required them to move long distances.

Criticism of the Unconscious Bias Hypothesis

Critics of unconscious bias claims assert that while stereotypes are admittedly involved in interactions between strangers, when a manager has known an employee for a significant period of time, the manager will apply what is referred to as “individuating information,” thereby allowing him/her to make decisions on the basis of the employee’s individual skills and abilities, rather than on stereotypes.

Disparate Impact Discrimination

These claims entail seemingly neutral company policies that have the actual effect of discriminating against a certain class of persons—rather than against an individual. 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 most women are shorter than 5 feet 10 inches tall. In this example, the discrimination is against women, rather than against a particular woman (which would constitute disparate treatment discrimination) because women will be disproportionally affected by such a requirement. However, a successful claimant 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.

A Key Example: The Policy Must Bear Upon the Ability To Perform the Job

A notable example of disparate impact discrimination was involved in the U.S. Supreme Court case of *Griggs v. Duke Power Co.* 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 disproportionate impact on minorities and, importantly, was unrelated to actual job performance for the positions to which the requirement pertained.

Wrongful Termination

Wrongful termination describes claims brought by a discharged employee against a former employer. Wrongful termination is the act of terminating an employee in a manner that is against the law. (The three most common legal grounds—(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—along with examples, are noted below.) Two key factors have triggered a marked increase in claims alleging wrongful termination during the past three decades: (1) the restructuring of corporate America 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, outsourcing, mergers and acquisitions, plant closings, and the transfer of manufacturing to non-U.S. locations. In the aggregate, such activities have resulted in substantial elimination of jobs, which, in turn has produced allegations that employees were wrongfully terminated.

The Employment-at-Will Doctrine

Historically, in the absence of a written employment contract, employment relationships in the United States were “at will”—that is, both the employer or employee were 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.

Legal Grounds for Wrongful Termination

There are three legal grounds upon which wrongful discharge claims can be made: (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., "whistle-blowing"), 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, 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.

Non-Written Employment Contracts

Even in the absence of a written contract of employment, non-written employment contracts have been found to exist by courts 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*, 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.

Constructive Discharge

Wrongful termination also encompasses so-called constructive discharge. In these situations, the employee retains his/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).

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 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 as 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. This could occur, for example, when a superior who has the power to confer or withhold a specific penalty or benefit, uses this power to coerce an employee into engaging in unwelcome sexual activity. 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 common 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, and pictures are frequently the basis on which such claims are made. For example, a person could make a claim of hostile environment sexual harassment if he or she were regularly subjected to jokes of a sexual nature by coworkers.

Factors in Assessing Whether an Environment is Hostile

The EEOC examines the following six factors in assessing whether an 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.

Single Event Can Constitute Hostile Environment Sexual Harassment

Some courts have held that a single incident is sufficient to create a hostile environment. For example, in *Radtke v. Everett*, the Michigan Supreme Court held that a single incident, if severe enough (e.g., a sexual assault), can create a hostile environment, if perpetrated by an employer in a close-knit environment.

Failure To Protect an Employee from Sexual Harassment by a Non-Employee

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, claims are sometimes made by employees, charging harassment by non-employee third parties such as customers, clients, vendors, or independent contractors.

For example, in *Powell v. Las Vegas Hilton Corp*., 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 if her employer knew of the harassment and failed to promptly take necessary steps to stop it.

No Need To Prove Psychological Harm

The U.S. Supreme Court held in *Harris v. Forklift Systems, Inc.*, 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. Prior to this case, some federal appellate courts were requiring a plaintiff to prove psychological harm arising from sexual harassment. 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. The earlier Act only permitted such recoveries in quid pro quo sexual harassment cases and did not allow either jury trials or punitive damages awards in any type of sexual harassment claim.

Affirmative Defenses to Hostile Environment Sexual Harassment Claims

The case of *Madray v. Publix Supermarkets* 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. In that case, the court rejected two employees' claims for hostile work environment sexual harassment because the employees failed to take advantage of opportunities provided by the employer to correct (i.e., report) the alleged harassment.

Sexual Harassment Policy—by Itself—Not a Defense

The 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 must not only create, communicate, and enforce sexual harassment policies and procedures, but must also act promptly and appropriately to investigate all harassment claims. The extent to which each of these actions is taken, will add to an employer's defense in any sexual harassment claim.

The number of sexual harassment claims increased significantly during the 1990s. The greatest rise in frequency occurred between 1991 and 1992, immediately after the Clarence Thomas hearings were held in the fall of 1991. (These hearings occurred when Thomas was being confirmed as a justice of the United States Supreme Court.)

According to Jury Verdict Research Institute, the median jury verdict in sex discrimination claims filed between 2000 and 2006 (which included sexual harassment), was $200,000. When any given case goes to trial, the probability of a verdict in favor of the plaintiff hovers around 66 percent. However, during the same time period, when a case was settled on an out-of-court basis, the median settlement amount was only $69,000. These numbers do not include legal fees, time required to defend the claim, and lowered morale within the organization.

The law firm of Littler Mendelson, P.C. and Employment Law Learning Technologies (ELT) conducted a study in which they developed a list of both “hard” (i.e., quantifiable) and “soft” (i.e., non-quantifiable) costs associated with sexual harassment claims. These costs are outlined in Exhibit 2.1.

Exhibit 2.1
Sexual Harassment Claims Costs

Hard Costs

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

Soft Costs

- Employee distraction and reduced morale
- Manager time expended in the claim process
- Employee time expended in claim process.
- Employee time spent investigating the claim
- Employee time spent preparing for trial
- Increased future insurance costs
- 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 2 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 disparate treatment claim against Joe probably alleges:

   a. conscious bias

   b. desperate impact

   c. disparate impact

   d. unconscious bias

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. 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 2 Review Questions

1. d. Carmen apparently believes Joe unconsciously slights her because of her gender.
2. a. The employment-at-will doctrine deals with termination practices, not hiring practices.
3. d. The right to Social Security benefits from the government has no bearing on an individual employer's agreement with its employees.
4. b. Hostile environment sexual harassment, which may include jokes of a sexual nature, is conduct of a sexual nature that creates an offensive working environment.
5. d. Employers must not only create, communicate, and enforce sexual harassment policies and procedures, but must also act promptly and appropriately to investigate all harassment claims.

Chapter 3
Common Law EPL Exposures (Part 2)

Chapter 3 will discuss the two additional common law claim sources of employment-related claims: retaliation and inappropriate employment conduct.

Retaliation

Recent years have witnessed an explosion in the number of employment-related claims alleging retaliation. The typical scenario surrounding a retaliation claim is as follows. The first portion of an employment-related claim will most frequently (but not always) 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 alleging discrimination based on race, an employee is demoted. In addition, retaliation can occur under a variety of other circumstances, such as an employee being retaliated against for: making a workers compensation claim, for whistle blowing, or for criticizing management.

One especially problematic aspect of retaliation claims is that they can remain even after a court rejects the first portion of the employee's complaint alleging discrimination or other "standard" employment practices allegation. Under these circumstances, the employee still possesses a viable claim of retaliation if he or she can prove that an employer penalized him or her for making a complaint or engaging in some other form of protected activity. Thus, in the example above, a court could rule that there was no discrimination on the basis of race, but that the employee was wrongly demoted in retaliation for making the discrimination claim. In effect, a retaliation claim can still be ruled valid, even if the underlying claim that gave rise to the retaliation is not.

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.

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.

Types of Retaliation Claims

Retaliation allegations are most frequently made in conjunction with claims alleging discrimination on the basis of bringing in a protected category of persons. Examples of these categories include gender, race, or national origin discrimination. In addition, retaliation is also commonly alleged under a variety of other circumstances, including retaliation claims made in conjunction with a claim of sexual harassment or wrongful termination and/or in response to an employee's making a claim under a state workers compensation law.

"Whistle-Blower" 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 "whistle-blower" 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 damage awards and settlements than do claims of wrongful termination, discrimination, sexual harassment, or retaliation. This is because compensation is not merely based only 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 3.1 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 3.1 Representative Inappropriate Workplace Conduct
• Assault and battery • Defamation • Invasion of privacy • Fraud, misrepresentation • Negligence • 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 • Negligent evaluation

Assault and Battery

The tort of assault is an intentional act by one person that causes a second person to legitimately fear harmful or unwanted contact by the first, although there is no actual physical contact between the two. In contrast, the tort of battery is the intentional act of touching another person in a harmful or offensive manner. Assault and battery claims usually arise in the employment context when an employee files a sexual harassment claim.

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 is 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

Invasion of privacy claims are produced by a number of situations.

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 behavior 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 be shown 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.

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. Additionally, if the employer disclosed private or confidential information about an employee to other parties who do not have legitimate business reason to have access to such information, the employer may be found liable for invasion of privacy, such as 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. (However, if the employer reserves the right to search lockers under suspicion of improper employee conduct, a court likely will not find an expectation of privacy.)

Negligent Release of Financial, Identity-Related Data

Identity theft conjures up images of hackers prying into the personal computers of unsuspecting targets, or of thieves combing through the mailboxes and garbage cans of unwary victims. But one of the least considered sources of the data needed to commit identity theft are records kept by corporate human resources 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.

Moreover, employees could also allege that a corporation failed to protect confidential data, even in the absence of identity theft. For example, an employee in the human resources department who holds a grudge against another employee gains access to confidential, adverse financial or medical information about the coworker. The employee then passes it along to fellow employees.

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 does not change employers based on misrepresentations made by his or her current employer and thereby misses out on a favorable opportunity with another employer; 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 had no intention of honoring 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, (3) damages, and (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 is charged with the negligent hiring, training, or supervision of an employee. Several negligent hiring cases have held that employers have an affirmative duty to investigate an applicant’s employment history, to determine if 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 in the workplace or of sexual harassment, 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 steer clear of 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. It can have two aspects:

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

Other commentators have attempted to define "bullying" conduct in terms of certain intentional behaviors, including the following.

- Staring or glaring in a hostile manner
- Treating another in a rude, demeaning, or disrespectful manner
- Interfering 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.

While this list of behaviors is not all-inclusive, bullying is a type of behavior that intimidates, humiliates, or undermines a person and that is repeated over time. And, importantly, the bully can be a supervisor or co-employee.

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 the terms of the contract prohibit termination without cause and that 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 also 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, 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.

Negligent Evaluation

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

Chapter 3 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. the employee was penalized for making the discrimination claim.

   d. 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. While assisting a photographer with a magazine's swimsuit edition, an assistant takes full advantage of every opportunity to help adjust or reposition the models' scanty clothing. Alleging excessive touching on the part of this unsavory character, the models accuse the assistant of:

   a. Assault.

   b. Battery.

   c. Wrongful discharge.

   d. Invasion of privacy.

4. 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.

5. 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.
6. 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 email. 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 3 Review Questions

1. c. Retaliation claims often allege adverse treatment for making a discrimination claim.
2. c. The confidential counseling offer presumably represents a positive attempt to address some types of employee issues.
3. b. Battery is the intentional act of touching another person in a harmful or offensive manner
4. b. Fraud or misrepresentation occurs when the employer has *no* intention of honoring its promises.
5. b. Most EPL policies cover damages and defense costs associated with implied employment contracts.
6. d. 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.

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Chapter 4
Statutory Law EPL Exposures

Chapter 4 will examine the key statutes that form the basis for a substantial number of employment-related claims.

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, which was 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. Exhibit 4.1 provides a list of the most important federal statutes related to workplace discrimination. 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 more important statutes are discussed in the pages that follow.

Exhibit 4.1
Federal Statutes Relating to Workplace Discrimination

- The Fair Labor Standards Act 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 Rehabilitation Act of 1973
- The Pregnancy Discrimination Act of 1978
- Older Workers Benefit Protection Act of 1990
- The Civil Rights Act of 1871 (as amended by the Civil Rights Act of 1991)
- Americans With Disabilities Act (ADA) of 1992
- 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 of 2008

The Fair Labor Standards Act of 1938

The Fair Labor Standards Act (FLSA) requires most employers in the United States to comply with minimum wage and hour standards. Oftentimes, comparable state laws, such as those in California, apply even more stringent requirements. The FLSA's basic requirements (a) govern the payment of overtime wages as respects exempt versus nonexempt workers and overtime wages for nonexempt employees working more than 40 hours per workweek, (b) specify employment limitations for children, and (c) mandate record keeping by employers.

Exempt versus Nonexempt Employees

The issue of who is classified as an "exempt" employee (i.e., exempt from eligibility for receiving overtime pay) versus a nonexempt employee (i.e., one who is eligible for overtime pay), continues to cause employers huge headaches. Basically, there is an overtime exemption for (1) executives, (2) high level administrative employees, (3) professionals, and (4) outside sales employees under the FLSA and under most state labor codes. To be exempt from eligibility for overtime pay, these employees must meet certain tests regarding job duties and responsibilities and be compensated "on a salary basis" at not less than stated amounts. Such tests, however, are highly confusing and even workers paid on a salary basis can sometimes be eligible for overtime pay.

Wage and Hour Claims

Employers throughout the United States are being bombarded with lawsuits alleging violation of the FLSA, known as "wage and hour claims." In 2008, Staples paid $38 million—more than $22,000 to each "assistant manager" who allegedly was misclassified as an exempt employee under overtime laws. Starbucks is also in "hot water," having lost a class certification ruling to 900 "managers" who claim to have been improperly classified as "executives."

But wage and hour lawsuits are not limited to large employers or even to class actions. Their impact upon smaller companies may be far greater. One employee recovered a six-figure settlement because he meticulously documented the time he spent "on call," as a result of his employer's failure to properly utilize time cards. Wage and hour violations are the single largest dollar exposure for employers today, far exceeding that from discrimination claims.

Sources of Wage and Hour Litigation

Perhaps the most pervasive—and costly—myth associated with wage and hour claims is that they result only because employers fail to pay overtime to "nonexempt employees." In fact, there are numerous additional sources of wage and hour claims. These include the following.

- Misconceptions that if an employer pays someone a salary, he or she is automatically classified as "exempt."
- Misclassifying employees as independent contractors and not paying them overtime.
- Not properly paying employees for overtime—i.e., compensation for hours worked in excess of 8 hours in a given day or more than 40 hours in a week.
- Miscalculating the amount of wages owed (i.e., applying the wrong rate, crediting tips, etc.).
- Not paying qualified employees for time they are "on call."

- Allowing employees to work “off the clock” (i.e., not paying for time spent for opening tasks or closing duties, before and after the official workday, or for time spent donning uniforms, attending seminars).
- Not allowing employees to take meal or rest breaks.
- Not paying qualified employees for “on call” time or travel time.
- Not paying employees on a timely basis.
- Not paying all wages due and owing at the time of termination.
- Docking exempt employees’ salaries for absences.

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 which are performed under similar working conditions. 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.

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. 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, 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 as 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.

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

Application of Title VII

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 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 today, following the case of *Miller v. Maxwell's Int'l Inc.*, do not interpret the term "agent" as creating individual liability on the part of supervisors and directors and officers. Rather, the courts following Miller find the term "agent" was included to ensure 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*, 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.

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.

Damage Caps

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 employer's workforce size.

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.

Age Discrimination in Employment Act (ADEA) of 1967

The Age Discrimination in Employment Act of 1967 (ADEA), 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 there is no individual personal liability for supervisors under the ADEA.

Application of ADEA

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.

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.(Liquidated damages are those that are specifically stated or quantified, usually prior to the signing of a contract or agreement. 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.)

Reeves v. Sanderson Plumbing Lowers the Standard of Proof.

Employees' chances of winning age discrimination suits have improved based on the U.S. Supreme Court's 2000 ruling in *Reeves v. Sanderson Plumbing*. Here, a 57-year-old factory supervisor was fired when declining production at the company was blamed on poor attendance by employees for whom the supervisor was responsible. Yet when company records revealed no attendance problems, the plaintiff, who shared the responsibility of maintaining attendance records with a 35-year-old, was fired. The 35-year-old was not fired. By ruling in plaintiff's favor, the court decided that an age discrimination plaintiff need only rely on merely circumstantial rather than direct evidence to prove his/her case. As a result, age discrimination can be inferred based on an employer's false explanation for termination, without other specific proof of age discrimination, such as derogatory comments about the employee's age, physical condition, or appearance based on his/her age.

The Americans With Disabilities Act (ADA)

The Americans With Disabilities Act (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."

The Two Key Requirements

The ADA imposes two broad requirements: (1) equal opportunity and (2) reasonable accommodation. Equal opportunity compels an employer to hire a job applicant, regardless of any disability, provided he or she possesses the requisite sills, education, and experience to handle the duties of the position.

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. For example, if a small business with $250,000 in annual revenues was required to install a special elevator ramp costing $10,000 to accommodate a disabled employee, this would likely be considered an undue hardship. On the other hand, this same expenditure by a company with $25 million in annual revenues, would not.

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.

One of the problems inherent in the ADA is that the law considers a number of questionable conditions as protected "disabilities." For example, mental and psychiatric impairments are defined disabilities within the ADA. Accordingly, employee-claimants sometimes allege that certain undesirable traits associated with these conditions—which are not generally considered "disabilities" (i.e., chronic lateness, hostility to coworkers and supervisors) are protected mental or psychological impairments.

Definition of "Reasonable Accommodation"

Under the ADA, employers must provide a "reasonable accommodation" to qualified individuals with a disability 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" 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. "Undue hardship" means an accommodation that would cause undue hardship or expense when considered in light of such factors as the nature and cost of the accommodation needed, the overall financial resources of the employer, and the nature of the employer's business.

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, a debate exists among the federal circuits as to whether individual supervisors may be held individually and personally liable under the ADA. Again, the majority rule is that there is no individual liability under the ADA.

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 Family and Medical Leave Act (FMLA) of 1993

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

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 work site; (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, there is no minimum limit on the time period associated with a leave and, in fact, leave can be taken in one-minute increments! Human resources professionals routinely cite this as one of the greatest challenges under the Act because tracking intermittent leave is so tedious.

The Problem of Chronic Conditions

The greatest 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 human resources management systems (HRMS). Given the difficulty of tracking leave in such small blocks of time, a number of companies and their attorneys have requested of the Department of Labor that intermittent leave be allowed on no less than a half-day basis, and not in minutes, as is currently permitted.

Damages Recoverable under FMLA

Employees may enforce their rights under the FMLA in federal court or through the United States 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 the employer intentionally violated the FMLA.

The Uniformed Services Employment and Reemployment Rights Act (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 still retain reemployment rights.

What is the Magnitude of the Exposure?

The current wars in Iraq and Afghanistan, coupled with the requirements of USERRA, have created a significant liability exposure for employers.

According to the Department of Defense, from September 2001 through November 30, 2007, 254,894 National Guard and 202,113 Army, Navy, Marines, and Air Force Reserve personnel have been deployed to Iraq and Afghanistan. Admittedly, a low percentage of situations involving the assertion of USERRA rights end up in court. Nevertheless, given the fact that nearly half a million people have served in these operations, the magnitude of this exposure, given the sheer number of potential plaintiffs it has created, is still apparent.

As reported by the *New York Times* on June 21, 2008 ("After Duty, New Chance for Old Job"), a verdict rendered in favor of a reservist, who was denied his old job upon returning from Iraq, directly addressed this exposure. The case highlighted the difficult issues surrounding reemployment of National Guard and Reserve personnel who have served in Iraq and Afghanistan.

The Purpose of USERRA

The law attempts to encourage non-career 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 who 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.

Employer Eligibility

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

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.

When Reemployment is Excused

An employer is not required to reemploy a service man or woman when: (1) the employer experiences "changed circumstances" and (2) when there is "undue hardship."

Changed Circumstances

Reemployment of a person is excused if an employer's circumstances have changed so much that reemployment of the person would be impossible or unreasonable. A company-wide layoff or "reduction in force," that would have included the person, is an example of changed circumstances.

Undue Hardship

As is also the case with the ADA, employers are excused from making efforts to return service members to their previous jobs or from accommodating individuals with service-connected disabilities when doing so would be of such difficulty or expense as to cause "undue hardship" to the employer.

The Genetic Information Nondiscrimination Act of 2008

The Genetic Information Nondiscrimination Act of 2008, also referred to as GINA, is designed to prohibit the improper use of genetic information in health insurance and employment. The Act, which will become 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.

Application of GINA

Here is an example of how the law might apply in an employment scenario. A company requires pre-employment 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 for the particular position she had been hired. 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.

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 whistle-blower statutes.

Fair Employment Practices Laws

Every state has enacted Fair Employment Practices (FEP) legislation, which bars discrimination by private employers against defined categories of individuals. The FEP laws are generally 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. As already noted, some local fair employment laws are broader than corresponding federal statutes. This has the effect of subjecting small businesses to local laws, even though they are not bound by federal statutes. Often, aggrieved employees will bring claims under local laws, as a result.

Whistle-Blower Statutes

The federal government protects employees from retaliatory actions by their employer when the employees report violations of any law on the part of their employer. 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 4 Review Questions

1. All of the following are exempt employees of the Kansas Bible Company, except:
   a. James King, a highly skilled professional translator.
   b. Neil O'Tatum, janitor.
   c. Moses Pray, an outside salesman.
   d. Pepper Moon, company president.
2. 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 the employer's conduct was willful.
   c. her boss's job.
   d. the difference in pay.
3. 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 $2,000,000.
4. 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 Age Discrimination in Employment Act 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.

5. Which of the following individuals does not qualify for protection under the Americans with Disabilities Act?
   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.
6. Autumn's family seems to have many health problems. Although she is not paid during her absence, the Family and Medical Leave Act (FMLA) of 1993 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.
7. After completing her education, Marina worked for a small insurance agency with six employees before giving her employer 2 weeks' notice because she has volunteered to join the Peace Corps. After 2 years with the Peace Corps, she returns to the insurance agency and wants her job back. Marina is not covered under the Uniformed Services Employment and Reemployment Rights Act (USERRA) of 1994, because:
   a. she did not serve in one of the uniformed services.
   b. her employer has fewer than the required number of employees.
   c. she gave her employer advance notice that she was leaving.
   d. she was absent for more than 1 year.
8. The Genetic Information Nondiscrimination Act of 2008 (GINA) prohibits the use of individuals' genetic information in all of the following cases, except:
   a. to charge higher group health insurance premiums to currently healthy individuals deemed likely to develop some hereditary disease.
   b. when making hiring decisions.
   c. when making promotion decisions.
   d. to identify criminals based on crime scene evidence.

Answers to Chapter 4 Review Questions

1. b. A janitor does not qualify as an executive, a high-level administrative employee, a professional, or an outside sales employee.
2. c. The Equal Pay Act provides only for the recovery of damages.
3. a. Damages for pain, suffering, mental anguish, and punitive damages are available only to victims of intentional discrimination
4. a. A 2000 U.S. Supreme Court ruling indicates that age discrimination may be inferred from circumstantial evidence such as an employer's false explanation for termination.
5. a. The ADA does not protect individuals with addictions to controlled substances.
6. d. The FMLA does not allow employees to take unpaid leave from work to care for a niece.
7. a. "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.
8. d. GINA is designed to prohibit the improper use of genetic information in health insurance and employment.

Chapter 5
Rating and Underwriting Employment Practices Liability Coverage

Chapter 5 discusses the factors that are considered in developing rates for EPLI coverage.

The Rating Basis for EPLI Policies

Employment practices liability insurance 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 5.1 and explained in the pages that follow.

Exhibit 5.1 Employment Practices Liability Rating Factors
• Jurisdiction • Industry • Number of employees • Leased employees • Union employees • Profitability • Mix of exempt/nonexempt employees • Leased employees • Union employees • Claim history • Written 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. 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, a fact that accounts for considerable statewide variation in EPL rates.

Mix of Locations

Underwriters also consider the number of locations at which an insured operates. This is an important factor because the greater the geographical dispersion, the more difficult it is to implement and monitor loss control policies and procedures within a corporation. Larger, decentralized firms pose a greater risk of claim frequency and severity (than do single location businesses) and are surcharged accordingly Enforcing safety rules would be more difficult than if the contractor worked at only a single location. The company might be surcharged as a result.

Industry

Industry is the second most important factor affecting EPL policy premiums. Firms in certain industries are more susceptible to being sued and for being subjected to substantial judgments. For example, under the Insurance Services Office, Inc. (ISO) employment-related practices liability policy's rating plan, coal mining risks are surcharged, whereas agricultural operations receive a credit.

Number of Employees

Not only does the number of employees provide an indication of the number of potential plaintiffs, it 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. Whether one agrees with such reasoning or not, the thinking is that such firms have greater financial ability to implement fair employment practices, and as such, they should 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. Second, even if not insured (or insured with a high retention) larger companies have the kinds of deep pockets that will produce sizeable settlements or jury 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, in recent years have yielded a number of enormous 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 EPL insurance on such personnel. In cases where the insured must purchase such coverage according to the terms of a leasing agreement, the underwriter will add such personnel to the head count when developing 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 is also an important underwriting consideration. This is because union workers are more likely to make a claim than nonunion workers, 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 claims associated with grievances related to union contracts are excluded by most EPL forms. In addition, many minor disputes are resolved—without lawsuits—by agreements between union representatives (i.e., shop stewards) and the employer.

Profitability

An employer’s profitability and net worth are key underwriting issues. Since employees are often terminated for financial rather than performance reasons, firms in questionable financial condition are much more susceptible to wrongful termination claims compared to companies that have strong earnings. This is because layoffs are frequently a consequence of financial losses. Thus, financially weaker companies often have to pay more for EPLI coverage.

Profitability Indicators

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 during such periods, despite the fact that they intend to re-hire 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 problematical 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.

The “Re-Employment” Factor

Exempt employees 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. Moreover, once a highly-compensated individual has been terminated, this often makes it harder to obtain similar employment, given the stigma associated with having been dismissed from a high-level position. Finally, such employees, given the condition of their finances, can often hold out longer than rank-and-file employees and can resist initial settlement offers by their former employer, thus enhancing their ability to continue the litigation process.

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 the company agreed to a substantial settlement—of a magnitude indicating more than mere nuisance value and hence culpability—and the officer remained with the organization following the settlement.

Written Procedures

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

Policies are Helpful in Defending Claims

Although written employment procedures may not necessarily prevent claims, they are nevertheless helpful in defending against them (provided the company has followed those procedures). For example, the existence of detailed performance reviews indicating a terminated employee's specific performance shortcomings, along with evidence that the company has given the employee ample opportunity to rectify these deficiencies (e.g., cautions, oral warnings, written warnings, probation), will make it easier to refute allegations of discrimination-based termination.

Critical Policy Areas to Address

Key corporate 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.

Promulgation and Enforcement of Procedures is Most Important

It should be mentioned that firms not having such procedures are now the exception rather than the rule. This is because within the past 5 years such materials have become widely available from a number of sources, yet employment-related claim activity shows no signs of abating. Indeed, a company's failure to have such materials available would send up an immediate red flag for most underwriters. Accordingly, underwriters are particularly concerned about the extent to which such policies are disseminated and enforced. Simply having such documents in a personnel manual is of little value in preventing claims if the "spirit" underlying these documents is not promoted throughout a company.

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 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 larger problems that sometimes manifest themselves in losses, and ultimately, a high turnover rate among rank-and-file employees, often because of large-scale layoffs.

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 or, alternatively, impose a surcharge, based on the clear increase in exposure caused by these circumstances.

Corporate Culture

Although not easily quantified, 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 evaluation of an organization's culture remains a subjective exercise and is difficult to assess.

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 5 Review Questions

1. Madd Capp Company's employment practices liability insurance premium will increase as its ____________ increases.

    a. claims count

    b. employee count

    c. payroll

    d. sales volume

2. A Nebraska-based company specializing in high-quality beef is a profitable food products manufacturer with 500 employees. Which of the following factors has the greatest effect on its EPL policy premiums?

    a. association with the food industry

    b. number of union employees

    c. profitability

    d. total number of employees

3. 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.

4. 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.

5. 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.
6. 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 5 Review Questions

1. b. Employment practices liability insurance policies are generally rated on a cost "per employee" basis.
2. a. After location, industry is the second most important factor affecting EPL policy premiums.
3. c. Questionable financial condition often leads to layoffs, increasing a firm's susceptibility to wrongful termination claims.
4. d. It is generally more difficult for exempt employees to find jobs following termination.
5. d. Workers compensation policies are insurance policies, not a firm's corporate policies.
6. c. Planned layoffs within the near future clearly increase the exposure.

Chapter 6
Employment Practices Liability Loss Control

Chapter 6 explains how to control the exposures to employment litigation. In addition to preventing claims, these approaches will reduce the size of a claim, once it is made against an insured. The material in this 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

Effective Hiring

It can be argued that at least half of all employee lawsuits are a direct result of hiring the wrong person for a particular job. A corollary to this statement is the belief among many human resources professionals that "good employees don't sue." 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, a secretary who types 60 words per minute, with mistakes, will be less effective than a secretary 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. Under these circumstances, a supervisor will criticize the first secretary for lack of productivity, even when the secretary is putting forth her best effort.

Avoiding Discrimination Allegations Associated with Skills Testing

Most 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 pre-employment 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 under-qualified 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 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.

Do Not Use Psychological Test Scores as the Sole Criterion

One means of reducing the risks associated with lawsuits is not to use a candidate's scores on psychological tests 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 sole 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 test 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 if this person were not offered the sales job.

Interviewing and Background Checking

Thorough pre-employment interviews and background checks, 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

There are three powerful interview questions that 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 this 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.

Check Criminal, Credit, and Driving History

Such checks, which can usually be performed by services specializing in such work for under $100, can prevent a number of obvious "horror stories" in the hiring process. Unfortunately, a majority of employers do not take such precautions but suffer harsh consequences as a result of this omission.

Obtaining References on Prospective Employees: Secure Releases from Former Employers

Prior employers are often reluctant to provide detailed, subjective information about previous employees. Therefore, when checking the background of a prospective employee, attempt to obtain a "Post-Employment Release of Employment Information" Request. When signed by a former employee, that person's former employer is authorized by the former employee to provide detailed information about that person's tenure with the organization. But most important, this form releases the prior employer from liability claims associated with providing this information. Such a form, a standard feature found in human resources software packages, will make it easier to obtain meaningful reference information from prospective job candidates.

Ask the Rehire Question

Although many firms refuse to release any more than "name, rank, and serial number" despite receiving a release from a former employee, 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 question.

Verify Academic Backgrounds

The problem of degree fraud was illustrated several years ago when it was revealed that Jayson Blair, a now-former *New York Times* reporter, had fabricated many of his articles while working there. In his application for employment, Mr. Blair falsely claimed to have been awarded a bachelor's degree in journalism from the University of Maryland. Unfortunately for the Times, no one ever attempted to verify the authenticity of Mr. Blair's degree, yet had the Times done so, it is likely he would not have been hired.

The potential for degree fraud is becoming ever more likely, given the emergence 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.

An Easy Solution

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. 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 they are furnished directly by a job candidate.

Using Protective Legal Documents

Despite the publicity garnered by large employment-related verdicts, many firms still fail to use protective legal documents. Some of the more important ones include "at-will" employment agreements, management rights statements, and agreements in which employees assent to arbitrate (rather than litigate) employment-related claims. In addition, have outside counsel specialized in employment law 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. As already explained, the "at-will" doctrine is recognized in most jurisdictions (although there are certain exceptions to it, where, in a handful of states, such statements are considered contrary to public policy).

Avoid Implied Promises of "Permanent" Employment

If a company considers this approach too harsh, the firm must at least avoid 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 (either through signed statements or contract provisions) that no oral understandings or promises are incorporated into the employment relationship.

Audit Employee Handbooks

Employee handbooks should also be audited to ensure that they contain no statements that could be interpreted to guarantee permanent employment. In effect, employees should be given no assurances of continued employment, future promotions, or specific levels of monetary compensation.

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 personnel policies and practices without advance notice and at its 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

Binding arbitration agreements, which preclude an employee from suing an employer, and instead require that employment disputes be settled by binding arbitration, should be used by most employers. 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, especially if the employer is a large corporate entity, 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 to understand the reasoning behind legitimate business decisions made by an employer.

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 associated with arbitration.

Affords Earlier Resolution

The time between the filing of the 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

Most employers want to keep their workplace disputes out of the public fishbowl known as the courtroom. Private arbitration allows that.

Use Legal Counsel To Review Employer-Produced Material

All employer-produced written material (e.g., employee handbooks, “at-will” statements, arbitration agreements, benefits descriptions, and HR policies) should be reviewed by both internal and external counsel for possible misleading statements regarding the employer-employee relationship. Ideally, the counsel should specialize in employment law.

Watch Out for “Contractual Exceptions” to the “At-Will” Doctrine

Frequently, plaintiffs allege that an employee handbook created a contractual exception to the employment-at-will doctrine. Therefore, the handbook should contain a specific and thorough disclaimer regarding promises of continued future employment. The disclaimer should acknowledge that the employee is cognizant of his or her at-will status, and that the handbook does not intend to create contractual rights in favor of the employee.

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 6.1 and discussed in the paragraphs that follow.

Exhibit 6.1 **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. 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

Do Not Sidestep Problems

If performance problems do exist, they should be duly noted at the time of the reviews, rather than sidestepped to avoid conflict. For example, if an employee's performance is marginal and requires significant improvement, he or she should not be given a rating of "satisfactory" simply to avoid a confrontation.

Record Derogatory Information Carefully

However, 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.

Discuss and Document Performance Shortcomings

Directly addressing such 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. Rather, shortcomings should be openly and promptly discussed, and the employee given a fair opportunity—within an agreed-upon time frame—to take remedial action.

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, this is easier to accomplish for some positions compared to others.)

Record the Need for Remedial Steps

If, after providing fair warning, coupled with a plan for performance improvement, when 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. Indeed, 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.

Performance-Related Terminations Should Never be a Surprise

A termination based on poor performance should not surprise anyone, especially the employee. If the employee has been warned, disciplined properly, and encouraged to improve his or her performance or change his or her conduct, there should be little room for surprise when someone is eventually terminated.

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. Conflict is the breakdown of communication coupled with an emotional override. This emotional override can result in poor decision-making. 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, 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

Termination is certainly one answer when an employee’s performance is substandard, but not the only one. Other alternatives are to restructure the person’s job, move that person to another department or location, or demote 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

The fastest way to get hit with a discrimination or wrongful termination claim is to treat one person differently than another under a similar set of circumstances. If there is a company termination policy, follow it consistently. Employers must make sure that any action taken is consistent with the manner in which the company has 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 a human resources executive or other company manager. It is highly recommended that the organization's director of human resources approve all terminations. Whoever reviews the termination decision, that person can 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?).

Independent Review of the Decision To Terminate

In addition, consider obtaining an independent, outside review by an employment attorney when confronted with a termination decision that appears problematic.

When, Where, and How To Fire

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 such a 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 is also required to give a COBRA notice for continued medical coverage, an unemployment insurance benefits notice, information on transferring their health insurance, and 401(k) plan details.

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. Explain 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, request a response to the release 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. Finally, 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.

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

Assist in Finding New Employment

Unless an employee was dishonest or deceitful, it is often a good idea to make an effort to help them 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.

Preventing Claims from Providing References

Providing references about former employees have 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," whereby former employers knowingly give favorable references concerning former problematic employees. 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."

This alleviates the former employer's potential of being sued 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 6.2 and discussed in the paragraphs that follow.

Exhibit 6.2 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 corporate policy against sexual harassment.

Contents of a 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
- A confidential complaint-reporting mechanism
- Notification that harassers will be subject to disciplinary action, including discharge
- Designation of an employee representative to whom complaints should be made
- A statement that all complaints and investigations will be held confidential

Communicate the Policy

The policy must be communicated to all employees and supervisors. It should be placed on bulletin boards, in the HR office, and in employee manuals or handbooks. Most importantly, the policy should be communicated directly, in meetings with employees. Recent U.S. 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 secretary 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., human resources) within the company. This will help to maintain confidentiality and reduce the risk of retaliation.

Investigate Complaints

Once complaints are made, they must be promptly and thoroughly investigated. Absent such action, the policy will have little effect and will be perceived as paying mere lip service to the problem rather than being a sincere attempt to eliminate sexual harassment within the organization. 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. For example, Manager A is alleged to have committed sexual harassment. Under these circumstances, an independent investigator would probably be more objective in investigating the complaint, compared to Manager B, a colleague of Manager A.

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 either 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. Otherwise, the policy will lose its effectiveness.

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 assure its continued effectiveness.

Chapter 6 Review Questions

1. Job candidates' scores on psychological tests:
    a. are inherently discriminatory.
    b. can appropriately be used if experience has demonstrated its 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. The Olympic Company fires Micky Phelps for poor performance. His termination should not come as a surprise if he has been previously:
    a. punished, demoted, and tortured.
    b. threatened, punished, and demoted.
    c. warned, disciplined, and encouraged to improve.
    d. warned, threatened, and placed on detention.
5. 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 was the problem. 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.

6. Linda's office is open from 9 to 5, Monday through Friday, but she usually arrives late and leaves early. Linda doesn't know it yet, but she will soon be fired by HR Director Arnold, known not-too-affectionately as The Terminator. 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.
7. Providing references about former employees can lead to lawsuits based on wrongful hiring. Which example best illustrates the "wrongful hiring" exposure?
   a. Meredith, Contessa's former employer, truthfully tells her prospective employer that Contessa was fired because she attempted to become a millionaire through embezzlement. The prospective employer hires Contessa.
   b. Steinburner, Costanza's former employer, tells his prospective employer that Costanza is a conscientious worker; however, he fired Costanza for being lazy and incompetent. The prospective employer hires Costanza.
   c. Radio Punxsutawney, Phil's former employer, tells Phil's prospective employer that Phil's weather forecasts were usually inaccurate. The prospective employer hires Phil.
   d. Sam, Rhoda's former employer, accurately tells her prospective employer that he fired Rhoda because she was rude to his customers when she should have been cheerful. The prospective employer hires Rhoda.
8. Any employer's written sexual harassment policy should include all of the following, except:
   a. examples of sexual harassment.
   b. notice that harassers will be disciplined and possibly discharged.
   c. reminder that complaints and investigations are public information.
   d. strong wording prohibiting sexual harassment.

Answers to Chapter 6 Review Questions

1. b. It is appropriate and non-discriminatory to use a test that experience has proven valid.
2. a. 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.
3. a. Arbitration avoids the risk of a jury whose members identify more readily with the employee than with the employer.
4. c. A termination based on poor performance should not surprise an employee who has been warned, disciplined properly, and encouraged to improve his performance.
5. d. Many knee-jerk terminations end up as lawsuits
6. a. Consensus is that employees should be terminated in the morning on Monday, Tuesday, or Wednesday and that the decision be communicated on neutral grounds.
7. b. Steinbrenner provided a knowingly false reference, which could lead to a lawsuit based on wrongful hiring.
8. c. An effective policy should state that all complaints and investigations will be held confidential.

Chapter 7
Employment Practices Liability Coverage Options

Chapter 7 discusses the various sources of employment practices liability coverage. These sources include:

- Stand-alone EPLI policies
- Coverage under D&O policies
- EPLI coverage endorsements to D&O policies
- Management liability policies
- Businessowners policies (BOP)

Before examining these sources in more detail, this chapter begins by explaining why EPL coverage is not provided under commercial general liability (CGL) policy forms.

The Lack of EPL Coverage under CGL Policy Forms

During the past 20 years, CGL policy forms became 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 introduction of stand-alone EPL forms beginning in the early 1990s, and the proliferation of such forms by the late 1990s, have made it apparent that CGL insurers do not intend to cover employment-related claims.

CG 21 47 (7/98): The Employment-Related Practices Exclusion

By 1998, CGL insurers had developed a standardized exclusionary endorsement that significantly restricts the scope of EPL coverage available under their policies. Accordingly, nearly all CGL policy forms are currently being written with endorsement CG 21 47 (7/98), known as the Employment-Related Practices Exclusion, that bars coverage of employment-related claims.

More specifically, the endorsement precludes coverage for bodily injury and personal injury resulting from "refusal to employ," "termination of employment," "coercion, demotion, evaluation, reassignment, discipline, defamation, harassment, humiliation, discrimination or other employment-related practices, policies, acts or omissions."

As a result, stand-alone EPLI policies that fill this significant coverage gap have become increasingly available; as has EPL coverage under a number of other arrangements such as EPL coverage endorsements to D&O policies, management liability package policies, and businessowners policies (BOP).

Stand-Alone EPLI Policies

Buying a stand-alone EPLI policy has become a popular option as more than 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 three advantages of this approach include (1) added coverage breadth, (2) protection of D&O policy limits, and (3) availability of risk management and claim prevention advice.

Added Coverage Breadth

First, breadth of coverage is a decisive advantage. EPL exposures are "specialty" risks, much like D&O, intellectual property infringement, media liability, and other exposures that typically are addressed with specialty 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 EPL insurance market. By using a well-crafted, stand-alone EPLI policy, the insured obtains cutting-edge coverage breadth on a continuous basis.

Protection of D&O Policy Limits

Second, insulating an insured's D&O program of coverage from EPL claims is another advantage. By using a stand-alone EPLI program, rather than endorsing a D&O policy (an alternative discussed later in this chapter), EPL claims are contained, without impairing the limits of the D&O form (i.e., limits are available to protect the directors and officers that could potentially be used to pay employment-related claims).

Risk Management and Claim Prevention Advice

Third, the availability of risk management advice and practical loss prevention tools is also a significant advantage offered by a stand-alone EPL policy. Many stand-alone EPLI insurers offer no-cost or low-cost, yet effective advice for managing EPL risk, such as providing a hotline for labor and employment lawyers, assisting in writing employee manuals, and giving advice on potentially volatile situations—such as terminating a problem employee in a way that minimizes the firm's exposure to liability for a wrongful termination claim.

Cons

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

Higher Premium Cost

First, the cost of a stand-alone policy is significant. An insured typically will spend substantially more in premium for a stand-alone policy than for an EPL endorsement to a D&O liability policy.

Added Risk Management Program Complexity

Second, such policies are yet another stand-alone product that adds 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 was once covered by CGL forms.

Employment Practices Liability Coverage under D&O Policies

One key point to recognize is that most D&O policies do not specifically exclude coverage for employment-related claims. On the other hand, neither do they provide explicit coverage for such claims. In addition, there are a number of other limitations associated with the scope of EPL coverage D&O forms provide. These limitations are discussed below.

Limitations of EPL Coverage under D&O Forms

The actual scope of EPL coverage that D&O forms afford is limited by the following provisions.

Only Directors and Officers are Insureds under the Policy

Only directors and officers are insureds under a D&O policy written to cover publicly-traded corporations. Yet, because non-director/officer employees are routinely named as defendants in employment claims, this omission creates a significant coverage gap.

No Coverage for the Corporate Entity

Most D&O policies written to cover publicly-traded corporations contain what is known as "entity coverage." In addition to covering individual directors and officers, D&O forms that include entity coverage also protect the corporate entity, when the entity is named as a defendant in a lawsuit. However, such protection only applies to claims involving the company's securities. The coverage does not apply to any other type of claims, including employment claims.

Insured versus Insured Exclusions

These exclusions, which preclude coverage for lawsuits by one director/officer against another, will defeat coverage in a number of situations. For example, because it is common for an officer, after he or she is terminated; or a director, after being asked to step down from a corporate board, to sue the directors and officers of the company, insured versus insured exclusions frequently preclude coverage for such claims. (Note that "former insureds" are also considered "insureds" under D&O policies, so that the insured versus insured exclusion is still operative, even after termination.)

Employment Practices Liability Exclusions

The true intent of D&O policies written to cover publicly-traded corporations is to cover claims caused by the business decisions of the firm's directors and officers. Accordingly, a handful of such forms contain blanket exclusions of all claims associated with the employment process.

Employment Practices Liability Endorsements to D&O Policies

Given the serious coverage limitations associated with relying on a D&O policy for coverage of EPL claims as noted above, beginning in the mid-1990s, D&O insurers began offering specialized D&O coverage endorsements, in conjunction with the standard D&O policy form.

The EPLI Coverage Endorsements

Typically, the endorsement costs an additional 10 percent of the D&O premium, although in certain instances, insurers will provide such coverage for no additional premium.

Even if the full 10 percent premium is charged, obtaining EPL coverage in this manner is cost-effective, compared to buying a stand-alone policy.

Pitfalls of D&O Coverage Endorsements

Despite this cost advantage, there a number of substantial drawbacks to these endorsements, the nature of which are noted below.

Limits Dilution

EPLI endorsements do not create a separate limit of insurance. Rather, the coverage is subject to the existing aggregate limits available to cover claims against directors and officers. Accordingly, these limits can be diluted by EPL claims, something that directors and officers do not favor.

Higher Deductibles

EPLI endorsements are subject to the same deductibles as are applicable to D&O claims, which are typically much higher than those applicable under a stand-alone EPLI form. Thus, all but the most serious EPL claims will fall below this figure, thereby precluding insurer reimbursement.

Frequent Lack of Coverage for the Corporate Entity

Although entity coverage for securities claims is available under D&O policies, allegations naming the corporate entity when it is a plaintiff in an EPL suit are covered by most, but not all, EPLI endorsements to D&O policy forms. In contrast, virtually all stand-alone EPLI forms routinely cover the corporate entity as a named insured.

Frequent Lack of Coverage for Non-Directors and Non-Officers

EPLI endorsements to D&O policies can create yet another critical coverage gap since again, most, but not all EPLI endorsements to D&O policies, cover non-directors/non-officers.

Fewer Covered Perils Compared to Stand-Alone Forms

Virtually all EPLI endorsements to D&O policy forms cover the four key employment-related perils: wrongful termination, sexual harassment, discrimination, and retaliation. However, EPLI endorsements to D&O policies generally cover only a limited number of what are referred to as the various types of “inappropriate employment conduct.” Such conduct includes, but is not limited to breach of an oral or written employment contract, employment-related misrepresentation, wrongful failure to promote, wrongful discipline, wrongful deprivation of a career opportunity, failure to grant tenure, constructive discharge, negligent evaluation, invasion of privacy, employment-related defamation, and employment-related emotional distress. Usually, an EPL endorsement to a D&O policy will only cover four to six of these items, compared to an average of about a dozen under stand-alone EPLI forms.

Management Liability Policies

Management liability 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, and special crime coverage (also known as kidnap/ransom insurance). Therefore, management liability policies can be considered "package policies," because they combine more than one line of coverage under a single policy.

A Flexible Structure

Usually, an insured must only select two of these four types of coverage, to be eligible to purchase EPL coverage under a management liability policy form. In other words, an insured seeking EPL coverage need only buy one other of the following coverages to obtain a management liability policy: D&O, fiduciary, or special crime coverage.

Common Policy Conditions

Management liability policies always contain a set of common policy conditions that apply to all of the four lines of insurance afforded. Such provisions are, of course, general in nature and pertain to matters such as cancellation, subrogation, and cooperation with the insurer in the event of a claim.

Coverage-Specific Policy Forms

In addition to the common policy conditions, management liability policies contain a coverage-specific policy for each of the different types of coverage selected by the insured. These forms address areas particular to the line of coverage purchased, such as an enumeration of the types of covered acts of inappropriate employment conduct.

Cost Advantage

Management liability policies afford meaningful premium discounts, compared to what would be charged, if an insured were to purchase the aforementioned types of coverage separately. This is because there are cost efficiencies inherent in the underwriting and policy issuance process when more than one coverage line is provided under a single policy. Specifically, an insurer needs much of the same data to underwrite EPL coverage as for D&O, fiduciary, and special crime insurance.

Limited Eligibility

Typically, management liability forms are only made available to privately-held firms, not-for-profit organizations, and relatively small publicly-traded companies (i.e., those with annual sales of under $25 million).

Nature and Scope of EPLI Coverage

Management liability policies overcome virtually all of the disadvantages created by EPLI endorsements to D&O policies. Specifically, such policies:

- Contain separate limits and separate deductibles for each of the coverages, so that a single large claim does not reduce or exhaust the limits available for other types of claims.
- Cover non-directors/non-officers as insureds.
- Cover the corporate entity as an insured.

- Provide a much broader scope of inappropriate conduct perils than what is available under EPL endorsements to D&O forms, which, under a number of insurers' forms, are as broad as that afforded by a typical stand-alone EPLI policies.

Combined Single Limits

Although, as indicated above, most management liability policies are written with separate limits for each of the coverages selected, 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. It is adequate for small insureds that have very low claim frequency. For such companies, the probability of sustaining both an EPL and a D&O, fiduciary, special crime claim in a single year is remote. Thus, for such organizations, a policy containing a separate EPL limit may not justify the additional cost. (Management liability policies are most often used by small, privately-held companies.)

EPLI Coverage under Businessowners Policies

Yet another source of EPLI coverage is businessowners policy (BOP) forms. Such coverage is provided by attaching the Employment-Related Practices Liability Endorsement, form BP 05 89 (01 06), to a BOP. This endorsement is part of the portfolio of coverage forms offered by Insurance Services Office, Inc. (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. A "package policy" is one that combines several different coverages under a single form, most often, general liability insurance and property insurance. 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 policies noted earlier, there are cost efficiencies inherent in the underwriting process when more than one coverage line is provided under a single policy.

Eligibility

As already noted, the ISO BOP is designed for insuring small businesses. Eligibility is based on the nature as well as the size of the insured's business.

There are two basic requirements that a business must meet to be eligible:

- none of its locations can exceed 25,000 in square footage (excluding basements not open to the public), and
- it must not exceed $3 million in annual gross sales.

Ineligible Businesses

The following types of businesses 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 Employment Practices Liability is Covered under BOPs

BOPs do not automatically cover employment practices liability exposures. Rather, the policies cover EPLI exposures by means of an employment-related practices liability endorsement, form BP 05 89 (01 06). 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 commercial general liability (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 one of the four approaches noted at the beginning of this chapter. 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 is determined by applying a state-specific rate, for the $10,000 basic limit of coverage provided by the endorsement. The specific rate is a function of: (1) the type of business being covered and (2) the number of covered employees. The basic rating unit is a cost per employee.

As noted, the basic limit available under the ISO EPLI coverage endorsement is $10,000. However, 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

For the most part, the coverage afforded by the endorsement uses the same provisions found within stand-alone EPLI forms.

Positive Features

And 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, an extended reporting period limit reinstatement, no punitive damages restrictions; coverage areas that will be discussed later in this course).

Negative Features

Conversely, there are a few areas in which the coverage falls below customary stand-alone approaches, 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 such as 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 will be discussed in Chapter 12 of this course).

The 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 not really sufficient to address the kinds of employment practices liability 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 they are typically approved by regulators.)

Chapter 7 Review Questions

1. Queue Ballroom Company's standard CGL policy has an Employment-Related Practices Exclusion endorsement that precludes coverage for bodily injury and personal injury resulting from all the following, except:

   a. defamation.

   b. harassment.

   c. job-related accidents.

   d. refusal to employ.

2. Ear Drums, Inc.'s corporate stock is publicly traded. Ear Drums, Inc.'s employment practices liability coverage, provided by its directors and officers (D&O) liability policy, protects ___________________ against employment claims.

   a. directors, officers, and full-time employees

   b. directors, officers, and shareholders

   c. only Ear Drums, Inc.

   d. only directors and officers

3. An employment practices claim against Global Warning Signals, Inc. (GWS) was made and settled during the current policy term for $200,000—including expenses. Fortunately, the claim was covered by an EPLI coverage endorsement to GWS's D&O policy that carries a $1 million limit. If two shareholders each bring a D&O claim against GWS later during the same policy term, the maximum amount of D&O coverage still available to GWS is:
    a. $800,000.
    b. $1,000,000
    c. $1,800,000.
    d. $2,000,000.
4. 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.
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.
    d. excluded under most EPLI policies.

Answers to Chapter 7 Review Questions

1. c. Coverage for job-related accidents is precluded by the CGL's workers compensation and employers liability exclusions and are not addressed by this endorsement.
2. d. Only directors and officers are insureds under a D&O policy written to cover publicly traded corporations.
3. a. The $200,000 claim dilutes the policy's aggregate limit.
4. b. 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.
5. c. A BOP is a businessowners policy. Insurance Services Office (ISO), as well as many individual insurers, has promulgated the policy language used in BOP forms. Bee Insurance Company apparently uses the ISO form.

Chapter 8
Covered Organizations, Covered Persons, and Covered Acts Provisions in Stand-Alone EPL Policies

Chapter 8 will discuss the: (1) covered organizations, (2) covered persons, and (3) covered acts provisions contained in stand-alone employment practices liability insurance policy forms.

Covered Organizations

Unlike D&O liability policies, 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 a defendant, the policy would also cover XYZ Corporation.

Covered Persons

Under nearly all of the policies, officers, directors, partners, managers, and employees are typically "covered persons." In addition, the forms cover (1) personal representatives of insureds such as heirs, administrators, and executors and (2) spouses, but only for their "status" as spouses, if they are also named in a lawsuit, but not for any actual wrongful acts. If a claim were made against an employee, coverage would also extend to the employee's spouse, but only as 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
- Part-time employees
- Leased employees
- Temporary employees
- Seasonal employees

- Interns
- Volunteers

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 1/3rd of the usual per employee premium.

Coverage of Independent Contractors

Independent contractors are not included within the definition of "employee" under EPLI policy forms and are therefore not covered. However, about half of all insurers' forms can be endorsed to provide such coverage by individually listing the independent contractors it wishes to cover and by paying additional premium. In contrast, other insurers' forms specifically preclude such coverage under any circumstances.

Covered Acts

Most EPLI forms cover five specific categories of employment-related perils: (1) discrimination, (2) wrongful termination, (3) harassment, (4) retaliation, and (5) a number of other specifically-enumerated acts, referred to collectively as "inappropriate employment conduct." In effect, most are considered named perils policies.

Discrimination

There is often variation between the manner in which the different policies define the term "discrimination." Typically, the forms indicate that coverage applies to various types of discrimination, and they specifically enumerate such discrimination on the basis of: "race," "color," "religion," "age," "gender," "sexual orientation," "national origin," or "disability." However, such lists are not all-inclusive (nor can they ever really be, given the ever-increasing categories of protected classes of persons), because they sometimes omit various bases for discrimination, such as HIV status, pregnancy, Vietnam-era veteran status, disability, appearance, and so on.

Catchall Discrimination Coverage Provisions

Since it is difficult to list every possible basis on which employment-related discrimination can be alleged (because the number of categories is expanding constantly), most, but not all, policies also contain what are known as "catchall provisions" or "omnibus clauses." These provisions apply to claims alleging various types of discrimination and, in addition, include within their definitions of discrimination the statement that coverage also applies to "... any other status that is protected pursuant to any applicable federal, state, or local statute or ordinance." This wording is a positive feature for insureds because federal, state, and local laws vary with respect to their individual definitions of "protected persons." It is also valuable because discrimination laws are a constantly changing and especially dynamic aspect of the law. Accordingly, such provisions assure that the broadest possible range of bases upon which discrimination can be alleged, will be covered.

Wrongful Termination

Most, but not all, of the policies define the term "wrongful termination." However, it is actually to the insured's advantage when "wrongful termination" is not defined by an EPLI policy. 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 and are considered by insurers to be a business risk, for which coverage is not intended. In recent years, however, a handful of insurers have begun to offer coverage, via endorsement and for additional premium, for defense coverage required by such claims.

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 or in (2) an employee handbook created an "implied" contract of employment.

Harassment

Up until around 2002, virtually all EPL policy forms covered "sexual harassment" rather than "harassment," as is now the case under a majority of insurers' policy wording. This change occurred because it became apparent that harassment is usually, but not always, of a sexual nature.

Coverage for Harassment of a Nonsexual Nature

Accordingly, coverage for non-sexual harassment also became necessary because it has become common in the workplace. For example, one employee may purposely and continually annoy another employee by means of name-calling and taunting, although not in a sexual manner. Or, one employee may constantly make demands that another employee loan him money. Under a policy that only covered liability for "sexual harassment," claims arising from these situations would not be covered.

The importance of having coverage for harassment of a nonsexual nature is evidenced by a study conducted by the National Opinion Research Center at the University of Chicago. Specifically, managers at one in four of the workplaces surveyed reported bullying and three out of five said that uncivil behavior (e.g., berating and the "silent treatment") had occurred within the past year.

Accordingly, an EPLI policy form should address such situations by covering “harassment” and defining that term so it covers both sexual harassment and nonsexual harassment. The policies usually define harassment as comprising one (or more) of four key elements. Specifically, harassment 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

Retaliation claims, which are covered by virtually every insurer’s form, are most frequently made in conjunction with Title VII claims, in which discrimination is alleged on the basis of gender, race, or national origin. In addition, retaliation is frequently alleged under a variety of other circumstances, including in conjunction with a claim of sexual harassment or wrongful termination, or in response to an employee’s making a claim under a state workers compensation law or whistleblower statute.

“Inappropriate Employment Conduct”

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” that enumerates a variety of other employment-related perils not falling within any of the preceding four categories. Importantly, this is the area in which the actual scope of coverage provided by the policies varies most significantly. This is because the exact list of items that are classified as “inappropriate employment conduct” differs from insurer to insurer and must therefore be examined on a policy-to-policy basis. Clearly, the broader the scope of perils falling within a policy’s definition of “inappropriate employment conduct,” the more favorable the policy is for the insured.

Exhibit 8.1 indicates a number of the more common acts considered to be “inappropriate workplace conduct.”

Exhibit 8.1
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
- 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
- Wrongful deprivation of a career opportunity
- Retaliatory treatment
- Employment-related misrepresentation
- Wrongful failure to employ or promote
- Defamatory statements in connection with an employee reference

An "All Risks" EPLI Policy: The Ultimate Scope of Coverage

As noted earlier in this section, the vast majority of EPLI policies are written on a named perils basis (e.g., coverage for harassment, discrimination, wrongful termination, retaliation, and inappropriate employment conduct). However, a handful of insurers, responding to competition, offer "all risks" policies which afford superior protection, compared to named perils policies. Like named perils policies, these forms explicitly cover the four key covered perils (harassment, discrimination, wrongful termination, and retaliation). In addition, such policies also note that the policy covers "all other workplace torts." Since there is virtually no limit to the kinds and types of employment-related allegations that can be made (in part, due to the creativity of plaintiff's attorneys), an all risks policy is valuable. Consider a claim where an employee alleges that her employer had promised her a company car if she met a certain sales target. The employee met the target, but the employer failed to deliver the car as promised. There is no standard EPL policy peril to cover such a claim. However, under an EPL form written on an all risks basis, an insurer would be hard-pressed to deny coverage in this situation. The effect of this wording is to convert a named peril EPLI policy into an all risks EPLI policy, which is clearly favorable for an insured.

One Final Caveat: Check the Scope of Policy Exclusions

Certainly, there are significant advantages associated with EPLI policy forms written on an all risks basis. Nevertheless, there is one important pitfall associated with such forms. Specifically, the scope of the "Exclusions" sections of such policies tends to be more extensive than those ordinarily found in EPLI policies written on a named perils basis.

Chapter 8 Review Questions

1. 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.
2. 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 which breaches an implied agreement to continue employment.

Answers to Chapter 8 Review Questions

1. b. Independent contractors are not included within standard EPLI definitions of "employee," although coverage might be available by endorsement.
2. a. Any definition of "wrongful termination" restricts rather than expands the scope of coverage available.

Chapter 9
Third-Party Liability, Covered Damages, and Definition of “Claim” Provisions in Stand-Alone EPL Policies

Chapter 9 will discuss the third-party liability coverage, covered damages, and definition of “claim” provisions within EPL policies.

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 in conjunction with their employment. However, in recent years, there have been a number of incidents in which non-employees (most often customers, clients, and vendors) have also made claims alleging harassment and discrimination, committed by employers and their employees. These claims have been termed “third-party liability claims.”

Third-Party Liability Claims: Two Examples

Two high-profile examples of third-party liability allegations have been those made by customers belonging to minority groups, in which they claimed to have been discriminated against by Denny’s, the national restaurant chain, and Adam’s Mark, the national hotel chain. In addition to these two claims, both of which produced multimillion dollar settlements, numerous other third-party claims are being reported with increasing frequency. Accordingly, given the expanding nature of this exposure, EPL insurers have responded by offering what is known as “third-party liability” coverage.

The Need for Third-Party Liability Coverage

Coverage for third-party liability employment claims is needed because commercial general liability (CGL) policies provide little, if any coverage for most workplace-related claims. First, as already noted in this course, CGL forms exclude coverage for work-related harassment and discrimination—the two causes of action most likely to be alleged in claims by third parties. In addition, coverage under CGL forms requires that damages produce: bodily injury, property damage, contractual liability, or advertising injury. Since the latter three items virtually never involve employment-related claims and because few such claims involve bodily injury, separate coverage is required.

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

A firm's exposure to third-party liability claims is driven largely by 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. Similarly, a car rental agency has greater third-party EPL exposure than would an accounting firm.

How Third-Party Liability Coverage Is Provided within EPL Forms

Third-party liability coverage is afforded under EPL policies in one of two ways: (1) by endorsement or (2) such coverage is built into the policy.

Most often, third-party EPL coverage will be added by endorsement, whereby a pre-printed endorsement containing the applicable coverage wording, is attached to the policy and for which additional premium is required.

Less often, both "regular" EPL coverage and third-party EPL coverage wording is included within an EPL form's insuring agreements. If the insured organization seeks third-party coverage, it simply pays the additional premium required. Under such circumstances, the declarations page will note that the insured has purchased third-party coverage and a premium amount will be included on that page.

Scope of Third-Party Liability Coverage

It is important to check the actual scope of third-party coverage provided. This is because the breadth of coverage is not necessarily the same as that afforded within the regular EPLI policy, depending on the individual insurer. For example, a few third-party endorsements (or built-in coverage wording) exclude coverage for class action (i.e., multiple plaintiff) lawsuits. From the insured's standpoint, coverage on this (or any basis less comprehensive than that afforded under the regular EPLI form) should be rejected. This is because class action lawsuits by customers have, in recent years, proven to be the most costly type of third-party claim. Rather, third-party coverage endorsements should be subject to the same scope of coverage offered by the rest of the policy, and the insured should negotiate for coverage on this basis.

Covered Damages Definition

EPLI policy forms cover judgments, settlements, and defense costs. There are, however, a number of other items that do not fall within, and are therefore precluded by, the policies' definitions of "loss" or "damages."

Punitive Damages

Punitive damages are usually found within an EPLI policy's definition of "damages." This is because in recent years nearly all insurers' forms started granting coverage for punitive damages, provided punitive damages are insurable in the jurisdiction within which a claim for such damages has been brought. Since employment practices liability claim judgments frequently include punitive damages, the value of such coverage is considerable.

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 are 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.

When Most Favorable Jurisdiction Provisions are Critical

A most favorable jurisdiction provision would be important in the following scenario. Assume that an insured is incorporated in a state that bars insurance payment of punitive damages and that a punitive damage award is made against the insured in this jurisdiction. However, the insured has an EPLI policy written with a most favorable jurisdiction provision and the insurer is incorporated in a state where punitive damages coverage is permitted. As a result, the insurer will indemnify the insured for payment of the punitive damages award, regardless of the fact that the insured is incorporated in and punitive damages were awarded in a jurisdiction that bars such payment. Accordingly, most favorable venue wording is imperative (a) when purchasing an EPL policy in a state where punitive damages are not insurable and (b) for insured companies having multistate operations and who 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 punitive damages are excluded by the policy (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.

Fines, Penalties

Virtually all of the forms' definitions of "loss" or "damages" preclude coverage for fines, penalties, and similar items. To provide coverage of fines and penalties would contravene public policy. For example, there would be no coverage if an employer were required to pay a fine for violating the Worker Adjustment and Retraining Notification (WARN) Act, a law that requires employers to provide certain minimum advance notice periods, prior to conducting large-scale plant closings.

Stock Benefits

This refers to stock made available by means of: (1) stock option grants, (2) employee stock ownership plans, and (3) employee stock purchase plans. The policies' definition of covered damages/covered loss precludes "stock benefits" because it is not their intent to make payments in conjunction with executive terminations in which it is alleged that as a result of such terminations, the executive was wrongfully denied stock options. In addition, most stock benefit claims involve employment contracts, an area that EPLI insurers also avoid covering since the insured corporation is in control of such contracts, thus constituting an uninsurable business risk.

Nor do the policies intend to cover losses sustained from employee stock purchase plans involving 401(k)-type programs. Rather, such exposures are addressed by fiduciary liability policy forms.

ADA-Associated Costs

Virtually all EPL policies' definitions of "loss" or "damages" preclude payment for the costs of modifying buildings as required by the ADA, when it is necessary to accommodate employees who fall within the purview of this law. Such costs are excluded because they constitute a business risk. The policies do not, however, exclude coverage to defend allegations that an insured failed to comply with the ADA. For instance, if a prospective employee sues a company for discrimination because it failed to hire her and also refused to build a wheelchair ramp, the policy would cover defense costs associated with such allegations. However, it would not cover the cost of building the ramp.

Non-pecuniary Relief

Coverage for relief not involving 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.

Damages Associated with Employment Contracts

Coverage for damages involving contracts of employment, such as liquidated damages in the event an employee is terminated without cause, do not fall within EPLI policies' definitions of "loss" or "damages." For instance, if, under an employment contract, an executive claimed that he was owed 2 years' salary if he is terminated without cause, the policies would not cover the corporation's obligation to pay 2 years' salary. The rationale for this approach is that the drafting of employment contracts is within the control of the insured organization, thus constituting an uninsurable business risk.

Insurance Plan, Pension, or Savings 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 (e.g., health insurance, 401(k) plans as part of judgments or settlements. The rationale underlying this position 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 justification for this definition of loss is that the policy does not intend to cover items that could be addressed by a fiduciary or 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 again considered business risks to which firms in particular industries, especially those subject to collective bargaining agreements, are exposed.

Claim Definition

The manner in which EPL policies define the term "claim" is an important coverage issue. The broadest possible definition is ideal because it tends to accelerate the trigger of coverage under an EPL form, which is usually advantageous from the insured's standpoint. Although the exact definition of "claim" varies from policy to policy, the following are events that trigger a "claim" under the typical policy.

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. Often, claims will be made orally by an employee-claimant's attorney (e.g., when he/she calls the insured company, notifying it of the intention to sue). In other instances, oral claims are made by employees. 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

Virtually all of the policies' definitions of "claim" encompass administrative proceedings before the EEOC, as well as proceedings and hearings before applicable local, state, and federal agencies. This is critical because frequently, and prior to hiring an employment lawyer to bring a claim, an employee will contact the EEOC who, in turn, will call for a hearing in regard to the employee's grievance. (In addition, other local, state, and federal agencies routinely bring claims on employees' behalf.) Accordingly, it is advantageous for coverage to be triggered under an insured organization's EPL policy under these kinds of circumstances.

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 also require defense coverage for the criminal indictment. Frequently, such indictments occur prior to the receipt of a civil lawsuit so that the trigger of coverage in this manner is advantageous for the insured.

Chapter 9 Review Questions

1. In the context of employment practices liability, "third-party liability claims" refers to claims brought by:
   a. Employees.
   b. Employers.
   c. Fellow employees.
   d. Nonemployees.
2. 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.
3. Which of the following would not be covered by most EPLI policies' claim definition?
   a. An oral demand to pay damages.
   b. An OSHA inspection.
   c. Administrative proceedings before the EEOC.
   d. Criminal proceedings associated with employment litigation.

Answers to Chapter 9 Review Questions

1. d. Third-party claims are brought by nonemployees such as customers, clients, and vendors.
2. d. Virtually all EPLI forms' definitions of "loss" or "damages" preclude coverage for fines, penalties, and similar items.
3. b. The Occupational Safety and Health Administration (OSHA) is concerned with employee safety, not employment-practices issues.

Chapter 10
Claims Management, Defense Cost, and Special Conditions in Stand-Alone EPL Policies

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 10 examines these provisions in detail.

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

The vast majority of EPL 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 pay defense costs incurred from the point at which the insured takes over the defense of the claim.

Coinsurance Hammer Clauses—A Favorable Variation

One favorable variation of the hammer clause 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 for (2) a sharing of any settlement amount or judgment amount that is larger than the settlement amount that the insurer originally wanted the insured to accept. Most common sharing percentages typically are 50/50 but can go higher (e.g., 70 insurer/30 insured).

Why Coinsurance Hammer Clauses are Valuable

Coinsurance hammer clauses are important because they continue coverage on a partial basis if the insured decides to litigate rather than settle a claim based on an insurer’s recommendation. Given the precedent-setting implications of employment litigation, this option is especially valuable because such provisions reduce the financial risk associated with contesting a meritless claim that could, if settled—rather than litigated to a "no liability verdict"—encourage similarly groundless allegations against the insured in the future.

For example, assume that an employee was terminated for poor performance, that the insured organization had convincing documentation of the sub-standard work, and that the organization had given the employee ample time to improve her performance. Despite these circumstances, the former employee brings a wrongful termination claim. If the company were to settle the case, it could send a message to other employees (and potential future claimants) that the firm will compromise even groundless claims, a clearly unfavorable precedent. However, under an EPL form containing a co-insurance hammer clause, if the employer did not want to settle the claim, it could continue to contest the case, but at much less financial risk than if its policy contained a standard hammer clause.

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 often has the option to purchase what is known as a non-duty to defend form.

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 indicating that the insurer has "no 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 the entire claim when one or more allegations associated with a given claim are not covered by the policy.

The Right to Select Defense Counsel

The first difference between these two types of policies is that under a "duty to defend" policy, unless specifically negotiated otherwise in the policy, the insurer has the sole right to choose defense counsel.

In contrast, under a "non-duty to defend" policy, the policyholder is able to use any lawyer of its choosing, subject to insurer approval (which is nearly always agreed to, unless the selected counsel has little or no EPL claim handling experience).

The Right to Control the Defense of a Claim: Advantages and Disadvantages.

The second key difference between a "non-duty to defend" EPLI policy and a "duty to defend" policy 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 it permits 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 "hammer" clause or co-insurance hammer clause (discussed earlier), if the insured wants the coverage afforded by the policy.

Consider the following three corporate litigation philosophies. Insured Company A automatically settles all claims, regardless of merit, in an effort to close them as quickly as possible. Insured

Company B vigorously resists frivolous claims by taking all such claims to trial, but is amenable to settling meritorious cases. Insured Company C takes all claims to trial, even meritorious claims, despite potential adverse consequences. Regardless of an insured company's preferred approach, corporate policyholders generally favor the opportunity to make the determination to settle or defend, rather than have this decision made for them by an insurance company. A non-duty to defend EPL policy allows this, whereas a duty to defend policy does not. Under a non-duty to defend policy, Companies A, B, and C would have free hand to resolve claims in its respective preferred manner. Under a duty to defend form, the companies would not have such latitude.

Despite the fact that a non-duty to defend policy allows an insured, rather than its insurer, to handle claims and decide to defend or settle individual cases, duty-to-defend policies confer an important advantage upon an insured. Specifically, a duty-to-defend provision may benefit an insured, as compared to a non-duty to defend policy, 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. However, for firms that are more familiar with the details of the EPL claim handling process (typically larger companies which are more routinely faced with such claims), an EPLI policy containing non-duty to defend language may be preferable. (It should be mentioned that there is generally no premium difference between a duty to defend and a non-duty to defend policy.)

Insurer Obligation To Defend Non-Covered Claim Allegations

The third important 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 this point. A former employee with 20 years of service is terminated by an insured company. In her wrongful termination lawsuit, she alleges damages from lost wages, as well as the fact that prior to her termination, the company failed to pay her overtime (i.e., a wage and hour claim).

Although damages arising from the first allegation are clearly covered by a standard EPL policy form, the wage-and-hour claim is excluded. However, since coverage exists for the first allegation, 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 first allegation made in the claim. As this scenario illustrates, "all allegations" defense coverage, which is available under a duty to defend form, but not under a non-duty to defend policy, is advantageous for an insured.

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, (3) the cost of appeal bonds, and (4) pre- and post-judgment interest. Under some, but not all, insurers' forms, defense costs also include costs that the insured must incur while assisting the insurer during the defense and investigation of claims (subject to a per day limit of $100 to $250), such as attending trials or depositions.

Expenditure of Defense Costs Reduce Policy Limits

Under virtually all EPL policies, the expenditure of defense costs reduces the limits available to pay claims. 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.

One key factor to consider when selecting EPLI policy limits is that, in addition to settlements and judgments associated with employment-related claims, defense costs such as legal fees, adjusting expenses, and court costs are also covered by EPLI policies. And under virtually all EPLI policies, payment of defense costs reduces available policy limits. (This is in contrast to the approach used in commercial general liability (CGL) policies, in which defense costs are paid in addition to policy limits.) Often, defense costs can far exceed the actual settlement figure or judgment rendered against an insured in employment-related claims. Accordingly, in addition to projecting potential judgment and settlement amounts, careful consideration should be given to likely defense costs when attempting to select an appropriate limit of coverage under an EPLI policy form.

Special Conditions

EPL policies are written with several special conditions that can have a considerable effect on the application of coverage. These conditions include: (1) provisions that reduce deductible amounts, (2) other insurance provisions, and (3) value-added provisions.

Provisions that Reduce Deductible Amounts under EPL Policies

Some insurers will allow insureds to reduce the amount of the deductible/retention specified in the declarations page of the policy. Specifically, insurers sometimes assent to such reductions if insureds agree to:

- Report “incidents” to the insurer before they mature into formal “claims,” or
- Consult with an employment attorney (designated by the insurer) prior to making any termination decisions, or
- Have employee sign mandatory arbitration agreements.

Typically such reductions are 50 percent of the regular policy deductible/retention so that, for example, a $10,000 deductible would be reduced to $5,000 if the insured agreed to any of these actions, prior to policy inception.

Early Incident Reporting

The thinking behind granting a reduced deductible in return for the early reporting of “incidents” is that it will encourage insureds to report potential claim circumstances well before a lawsuit is filed against the insured. As a general rule, the earlier an insurer becomes involved in an employment-related claim (or any claim, for that matter), the better the chance that it can be resolved without the employee hiring an attorney. And if, under these circumstances, the employee does retain counsel, the probability of settling the claim without a trial is also much improved if the insured promptly notifies the insurer of a potential claim.

An Example

After taking the company’s aptitude test, a job candidate is advised that he will not be offered the position for which he has applied. He immediately calls the company’s HR director and says “that test was used to discriminate against me and I’m going to sue you and the company for denying me a job for which I was totally qualified.”

By immediately notifying the insurer of the potential claim associated with this sequence of events, the insurer will be in a better position to defend against a lawsuit, if one is eventually brought against its insured. Among other things, the insurer can examine the test that was administered, as well as the other information submitted by the applicant. Based on such details, if a claim is eventually made, the insurer will be better equipped to decide:

- if an expedited settlement offer is appropriate (perhaps the test did discriminate), or
- if the claim is completely without merit (if the test did not discriminate and the applicant was otherwise unqualified for the position), or
- if some other course of action is appropriate.

Regardless of the insurer's initial assessment, the insured's expedited notice of a possible claim will assist the insurer in the claim management process, a fact that will ultimately reduce the overall cost of the claim. This is the rationale for offering a lower deductible when an insured reports such incidents, before they result in a formal claim.

Consulting with an Employment Attorney Prior to Terminations

By requiring an insured to contact employment counsel designated by the insurer, prior to terminating any employee, an insured will receive the benefit of the lawyer's expertise, which can assist in reducing claim potential under these circumstances.

The manner in which a termination is handled has a significant impact on two key variables: (1) whether the employee will bring a wrongful termination lawsuit and (2) if a lawsuit is brought, the extent of the damages that he or she can collect.

Accordingly, a number of EPL policy forms contain provisions allowing for a reduction in the policy's deductible if the insured agrees to consult with an employment attorney prior to terminating employees.

Mandatory Arbitration Agreements

Mandatory arbitration agreements, which preclude an employee from suing an employer, and instead require that employment disputes be settled by binding arbitration, provide the employer with a number of advantages in the claims settlement process. These advantages include avoidance of runaway jury awards, reduced costs compared to litigation, faster claim resolution, and removal of the dispute from public view.

Given these positive features of the arbitration process, insurers will also sometimes agree to reduced deductible provisions when an insured requires both new and existing employees to sign mandatory arbitration agreements.

Other Insurance Provisions

The purpose of "other insurance" provisions is to determine the order of priority for payment of claims when multiple policies cover a single loss.

An "other insurance" provision in an EPLI policy is needed if coverage for an employment-related claim is also available under another insurance policy. Often, such coverage is in place under an EPLI endorsement to a D&O policy (which was discussed earlier in this course). Moreover, even if an insured corporation has not purchased an EPLI endorsement, D&O policies do not exclude coverage for employment practices liability exposures (although directors and officers would be the only persons insured under the policy). Therefore, duplicate coverage could exist if an insured company has a D&O policy, even in the absence of an EPLI endorsement to that policy.

EPLI Policy Should Be Primary

Under such circumstances, it is preferable that the other insurance provision make the EPLI policy expressly primary to the coverage afforded by either an EPLI endorsement on a D&O policy or to an unendorsed D&O policy. This is because it is not advisable to expose a D&O insurance program to employment-related loss experience, since doing so could mean not only premature exhaustion of the D&O policy, but also higher premiums for renewal policies.

Therefore, insureds should seek language in the EPLI policy's "other insurance" clause expressly making the coverage afforded by that policy to function as "primary" to the D&O policy.

Loss Control Services

Depending on the insurance company, EPLI policies often come with loss control attached. These loss control 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 considerably with respect to the scope of coverage, there is a correspondingly wide range of possible "value-added" services available. These services include the following.

- A free human resources law compliance audit conducted by an attorney or human resources professional.
- Personnel forms, software for creating employee handbooks, and other policies and procedures.
- Training materials in print or online format.
- Continuing education workshops aimed at presenting approaches that reduce and control claims.

Online Self-Audits

In recent years, a few insurers have begun to offer their insureds the ability to perform a self-audit of their human resources policies, using online computer programs. The advantage of such programs is that they afford an employer the ability to verify that its policies and procedures are up-to-date. This is especially important, given the rapid and continuous changes in the laws applying to the employment process. These programs take the insured through a series of detailed questions and, based on the answers to the questions, the program provides an assessment of the areas in which the organization could be vulnerable to claims. Such programs offer valuable insight into a company's human resources practices and target the activities most likely to give rise to employment practices liability litigation.

Hot Lines

Some insurers also provide access to "hot line services" manned by employment law attorneys or human resources specialists. Hot lines are an especially valuable service because they can assist in managing on-the-spot compliance issues, problems, and disputes, which can often prevent a claim from happening. There are two types of hot line services available: those that provide access to a human resources person and those affording contact with a labor-employment attorney. The latter are more valuable.

Chapter 10 Review Questions

1. Armand Tool Company has an EPLI policy with a $1 million limit. The 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. circuit breaker.

    b. claw hammer.

    c. deal breaker.

    d. hammer clause.

2. Blue Suede Shoe Company has a "duty to defend" EPLI policy. Sue, a Blue Suede employee, brought a suit against 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 her podiatrist's medical fees resulting from this repeated on-the-job trauma. The harassment claim is within the scope of the EPLI, but the medical fees are covered by workers compensation. 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.

Answers to Chapter 10 Review Questions

1. d. 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. c. Under a duty-to-defend policy, the insurer is obligated to defend *all* allegations in a lawsuit, as long as at least one such allegation is covered by the policy.

Chapter 11
Exclusions in EPL Policy Forms

EPL forms differ significantly with respect to the actual wording of the exclusions they contain, which has 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 11 analyzes wording of the most common EPL policy exclusions, which are those pertaining to:

- Criminal, fraudulent, or intentional acts
- Bodily injury
- WARN Act liability
- Liability under workers compensation and similar laws
- Contractual liability
- Liability under the Americans With Disabilities Act
- Strikes and lockouts
- Wage and hour claims
- Claims about which an insured had prior knowledge
- Claims for nonpecuniary relief
- Claims for breach of employment contracts
- Claims for insurance benefits

Criminal, Fraudulent, or Intentional Acts

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

In addition, such exclusions are usually written on a "severable" basis, whereby so-called innocent insureds who are accused of wrongful conduct will have defense coverage, although culpable insureds will not. For example, if three department managers are named in a sexual harassment lawsuit, but only one actually committed the harassment, the other two innocent insureds will have defense coverage under the policy. (In addition, the employer itself will also have defense and indemnity coverage available if the top management was unaware of the wrongful conduct.)

Bodily Injury

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

Key Exception Language

However, nearly all versions of this exclusion "except," and therefore cover, damages caused by: (1) emotional distress, (2) loss of reputation, (3) mental anguish, or (4) humiliation. This exception applies 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 given the broad exclusionary language in such policies as respects employment-related claims.

WARN Act Liability

Under the federal Worker Adjustment and 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 EPL policies preclude coverage for claims alleging failure to provide such notice as required by this law. The rationale for the exclusion is that if claims result from failure to comply with the requirements of the WARN Act, such failure is within the control of the insured organization and could presumably have been avoided.

Favorable WARN Act 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, provided the insured organization consulted with attorneys prior to the claim being made and attempted, in good faith, to comply with the law, yet was sued nevertheless.

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 those requiring payment of disability and unemployment compensation benefits.

Exception Language for Retaliation and Other Types of Claims

The exclusion does, however, contain important exception language for various types of employment-related claims. Specifically, such wording affords coverage by "excepting" retaliation and other types of employment-related claims if they are associated with acts involving workers compensation (or similar) laws. For example, there would be coverage (for retaliation) if, after an employee files a workers compensation claim, her supervisor retaliates against her by sexually harassing or demoting her.

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

However, nearly all EPL policies contain an exception providing coverage for liability that would have attached in the absence of a contract. For example, assume an insured organization agrees to indemnify an employment agency (that leases workers to the insured organization) for the wrongful acts of the insured's employees committed against the employment agency's employees. Under these circumstances, the insured organization would be liable, even in the absence of the contract, to indemnify the employment agency. Consequently, if one of the insured's employees harasses an employee of the employment agency, the contractual liability exclusion will not apply and coverage will be available under the insured organization's EPLI policy.

Americans With Disabilities Act (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 if, for example, an insured is required to install handicapped 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, this exclusion would not apply if, for example, a handicapped person were to allege discrimination because he or she was denied employment 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

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.

Strikes and Lockouts

Most, although not all, of the forms exclude coverage for claims by employees who are striking, locked out, or temporarily or permanently replaced. Most insurers' forms contain this exclusion, although it is doubtful that other insurers would provide coverage for such claims, since this is a business risk.

Wage and Hour Claims

Virtually all EPLI policies exclude coverage for what are known as "wage and hour claims." Employees are either "exempt" or "nonexempt." Exempt employees need not be paid overtime, whereas nonexempt employees are owed such wages. Wage and hour claims arise from an employer's alleged failure to pay overtime to employees who should have been treated as nonexempt employees and are therefore eligible to receive overtime pay.

The key federal law governing the payment of overtime wages is known as the Fair Labor Standards Act, enacted in 1938. In some instances, wage and hour laws in individual states apply even more stringent standards as to which employees are eligible to receive overtime pay.

The most common misconception associated with wage and hour claims is that simply because someone receives a salary, rather than an hourly wage, that they are exempt from receiving overtime pay. However, in 2007, Staples stores paid $38 million (i.e., $22,000 each) to a group of salaried assistant managers who were allegedly misclassified as exempt under the overtime laws.

Coverage for Defense of Wage and Hour Claims

In response to such claim trends, a handful of insurers have begun to offer defense (but not indemnity) coverage for wage and hour claims.

Limits Available

Under these policy forms, coverage for defense is provided, subject to a sublimit (most often $100,000 or $250,000). As a result, payments for defending wage and hour claims do not reduce the policy's annual aggregate that is available for other types of employment-related claims; rather, the policy's wage and hour defense sublimit is a wholly separate amount of coverage, a fact that is advantageous for the insured.

This defense coverage is written on a first-dollar basis, meaning that it is not subject to a deductible/retention, which is yet another advantageous feature for insureds.

No Special Underwriting Requirements

Additionally, under such policies, there is typically no requirement that the insured undergo an audit (to evaluate the extent of the company's wage and hour exposure). Rather, insurers will agree to provide the coverage on the basis of the insured's answers to questions on the application, pertaining to its wage and hour exposures.

The new product is a boon to employers—especially smaller ones—previously left to defend against this costly and increasingly common litigation without the benefit of insurance.

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

In addition to the defense coverage of wage and hour claims that has become available, most insurers' wording of the wage and hour exclusion 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. While this law does not involve the typical wage and hour claim, absent a clarifying endorsement, an insurer could stretch the intended scope of this exclusion and deny coverage for a claim alleging violation of the Equal Pay Act.

Prior Knowledge of Potential Claims

Nearly all EPLI policies exclude coverage for claims produced by circumstances or incidents about which the insured had knowledge, prior to policy inception, about incidents or circumstances that have the potential to result in claims. This exclusion is appropriate because 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.

Problems with the Prior Knowledge Exclusion

However, the exclusion as sometimes written can be a frequent source of claim denials. Specifically, if a prior knowledge exclusion states that knowledge of an incident or circumstance by an "insured" or "employee" is excluded, coverage would, for example, be precluded in scenarios where employees—but not management personnel—had knowledge of circumstances that could give rise to a claim.

An Example of How the Exclusion Could Create Problems

After being terminated, an employee tells a co-worker, "I'm going to see my lawyer about this." Following the incident, the coworker does not advise his supervisor. If an investigation by the insurer receiving the claim revealed that an employee was aware of such circumstances, a claim denial could result.

Only Knowledge by Officers, Managers, or HR Department Supervisors Should Be Considered "Prior Knowledge"

Accordingly, a prior knowledge exclusion should be written so that it precludes coverage only if one of the following, a: (1) supervisor, (2) officer, (3) manager, or (4) HR manager had prior knowledge of the circumstances surrounding a potential claim. A number of insurers, but not all, offer such wording.

Nonpecuniary Relief

Most of the policies exclude coverage for nonmonetary damages. Coverage of such damages, also known as "injunctive relief" (e.g., as 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.

Breach of Employment Contracts

Most EPL forms exclude coverage for damages accruing when the insured organization breaches an employment contract. Such exclusions also preclude payment of the severance amounts provided by such contracts. 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. Thus, such circumstances are considered uninsurable risks that involve business decisions (i.e., the decision to hire that particular person, under a specific set of conditions). For example, the CEOs of major corporations often obtain employment contracts stating that they cannot be fired without just cause and that if they are terminated without such cause, they will receive a stipulated lump-sum payment. If a former CEO were to bring a claim based upon such a contract, there would be no coverage under an EPL policy.

Defense and Indemnity Cost Exception for "Implied" Contracts

There are, however, favorable versions of this exclusion that do provide coverage of both defense costs and indemnity expenses associated with allegations that the insured organization breached an "implied" employment contract. One rationale for this exception is that former employees sometimes assert, for example, that an offer letter, which specified a certain salary and level of benefits, constituted an "implied contract of employment." In other instances, employee lawsuits have cited that material in employee handbooks created an implied contract of employment. For this reason, some insurers' forms agree to fully cover such claims which allege breach of implied employment contracts.

Defense Cost Exception for "Explicit" Employment Contracts

A handful of EPL insurers' forms go a step further and provide defense coverage, for claims made in conjunction with explicit employment contracts (i.e., those for a specific term of years, which include actual compensation amounts, and usually specify that damages will be due unless the person, usually an executive, is terminated without cause.) However, virtually no EPL insurers' form cover indemnity payments associated with such explicit employment contracts.

Insurance Benefits

Nearly all EPLI forms contain exclusions precluding coverage for insurance benefits. One 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 EPLI policies.

Another justification for this exclusion is to preclude coverage for a risk that could also possibly be covered by fiduciary/employee benefit liability insurance policies. For example, assume that an employee was told by the benefits administrator at a company that his retirement pension would be $2,000 per month. In reality, when he retires, his monthly benefit is only $1,200. If he sues the company for the difference between the promised and the actual benefit amount, this exclusion will preclude coverage, which is appropriate since this type of claim would be covered by a fiduciary liability policy form.

On the other hand, this exclusion could also bar coverage if, as part of a wrongful termination claim, a former employee claims a loss of health insurance resulting from his termination. Absent an exception in this exclusion for loss of benefits as a result of wrongful termination, no coverage would apply.

Still another reason for excluding insurance plan benefits is that their actual cost, on a long-term, "going-forward" basis, is highly speculative. As pointed out earlier, health insurance premium cost increases during the past 20 years have varied considerably, a fact making it difficult to predict the actual cost of such benefits that many years into the future.

Exception for Coverage of Benefits as a Part of Claim Settlements

Fortunately, favorable versions of this exclusion "except" from their definitions of "benefits," and therefore cover, insurance benefits when they are part of claim settlements or judgments associated with wrongful termination claims.

Chapter 11 Review Questions

1. ABC employment agency leases workers to C&C Contractors, which is insured under an EPL policy that contains a typical contractual liability exclusion. C&C has agreed to indemnify ABC for any wrongful acts that C&C employees commit against ABC employees. If a C&C employee harasses an ABC employee:
    a. C&C's contractual liability coverage will apply because of the indemnification agreement.
    b. C&C's EPLI coverage will apply because liability exists independently of the indemnification agreement.
    c. C&C has no coverage because harassment does not qualify as a wrongful act.
    d. C&C has no coverage because of the contractual liability exclusion in its EPLI policy.
2. 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. reduces Locks' premium without sacrificing important coverage.

Answers to Chapter 11 Review Questions

1. b. Nearly all EPL policies contain an exception to the contractual liability exclusion that provides coverage for liability that would have attached in the absence of a contract.
2. a. Knowledge of these circumstances by the coworker, who is an insured, triggers the exclusion—assuming the discussion occurred prior to policy inception.

Chapter 12
Coverage Triggers in EPL Policies

Chapter 12 examines the coverage triggers found within EPL policies, all of which are written on a claims-made basis.

Operation of Claims-Made Coverage Triggers

EPLI policies are written on what are 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 EPL insurance 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. Thus, retroactive dates preclude coverage for claims stemming from acts that took place before a policy's retroactive date.

Purpose of Retroactive Dates

Retroactive dates have the effect of excluding 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. They also preclude 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 (or at least a retroactive date coinciding with the commencement of the company's operations), if such coverage is available. Otherwise, no coverage will be available for claims that are made against the insured during the policy period if the insurer can demonstrate that they were caused by acts taking 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, a replacement insurer should include a retroactive date that is no later than the retroactive date found within the current policy, unless the insurer has a specific underwriting reason for excluding coverage based on known, specific events.

Discovery Provisions

Circumstances often arise under which it is probable that an act or omission 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 of the 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 produce a future 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.

Extended Reporting Periods

If an insured cancels or nonrenews an EPLI policy, unless a replacement policy is purchased that contains a retroactive date that is the same as (or earlier than) the policy being canceled or nonrenewed, there will be a gap in coverage. To prevent such a gap, an insured can purchase an "extended reporting period (ERP) endorsement." An ERP covers claims that took place during the expired or canceled policy but are made against the insured during the extended reporting period. The ERP does not, however, cover claims produced by wrongful acts that took place during the ERP itself; it only covers claims made against the insured and reported to the insurer during the ERP.

Chapter 12 Review Question

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.

Answer to Chapter 12 Review Question

1. c. 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.