The American experience

EPL in the United States

Michael Rossi offers an insight into recent developments in employment practices liability insurance products in the United States.

In the last several years employment practices liability has received more and more publicity in the US. Correspondingly, insurance products for that liability have continued to develop in the US in various ways. 'Employment practices liability' or 'EPL' means risks associated with wrongful termination, sexual harassment, discrimination and a variety of employment-related practices, procedures and conduct, not only by the corporate employer but also by the corporation's employees.

Risk mangers in the US today have many insurance options from which to choose when deciding how to address EPL exposures. This article attempts to address some of the more salient points about the developments in EPL insurance products in the US and to discuss some of the issues that are being considered when purchasing such products. It is hoped that a discussion of this subject is not only of interest to Australian risk managers, but also proves useful to Australian risk managers who are insuring EPL exposures for their companies.

Express coverage for EPL risks

The insurance industry has responded to the growing publicity of EPL claims with a variety of products. Some commercial general liability (CGL) insurers offer an EPL endorsement to their CGL policies for an extra premium. This endorsement is cumbersome because it is written on a claims-made basis, even when the CGL policy is written on an occurrence basis. Some Directors' and Officers' Liability (D&O) insurers began offering an EPL endorsement on their policies, which extended coverage not only to EPL claims, but also to employees who were not directors and officers. Such an extension of coverage is, in my opinion, problematic, because the D&O policy should be used for directors and officers, not employees who do not fit into this bracket. Other insurers decided to introduce into the market an altogether new product, stand-alone employment practices liability insurance ('EPU'). In the last couple of years, the EPL endorsement to a D&O policy and the EPU policy, alone or used in conjunction, have become the most popular options for US risk managers. The EPL endorsement to a CGL policy is merely used, and its continued viability is questionable.

EPL endorsement on a D&O policy vs stand-alone EPLI policy

Many US risk managers ask themselves -should I buy an EPL endorsement for my D&O policy in lieu of an EPU policy, or should I just buy an EPU policy, or should I buy both? There is no one right answer to this question. However, I offer my

thoughts on the subject and my observations as to how I perceive most US risk managers are addressing this question.

Most EPL endorsements to D&O policies extend coverage not only to directors and officers but also to employees who are not directors and officers. I question the reasonableness of exposing a D&O insurance program to claims against employees who are not directors and officers. In my opinion, the D&O program is intended to be there to protect directors and officers, not non-director and non-officer employees. This issue is even more relevant with respect to EPL risks, because it does not seem efficient to expose a D&O insurance program to EPL loss experience (which could mean not only premature exhaustion of the program but also higher premiums for renewal policies) when there is a ready alternative in the market to pick up that exposure — EPLI policies.

But the EPL endorsement to a D&O policy can be a valuable coverage enhancement for protecting directors and officers. Accordingly, it makes sense for companies to purchase both a stand-alone EPLI policy and the EPL endorsement to a D&O policy, where the EPL endorsement is amended to extend coverage only to the directors and officers. However, priority issues should be expressly addressed in either or both policies so that it is understood which policy, vis-a-vis each other, is primary, and which is excess, for EPL claims.

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Choice of EPLI programs

There are several distinct types of EPLI programs that are offered in the US. These types can be referred to as follows:

* Catastrophic;
* Working layer duty to defend;
* Working layer duty to pay;
* Working layer hybrid duty to defend/duty to pay.

A catastrophic EPLI program is intended to work as you would think from its name. It typically contains substantial limits (such as $25 million, $50 million or more) and substantial retentions (often anywhere between $1 and $5 million per claim). Such a program has been favored by large corporations seeking to insure the one large single-claim hit or large exposures that can arise with multiple related claims or class actions. Such catastrophic policies, like most D&O policies, are 'duty to pay' policies where the insured, not the insurer, has the right to control the defence of claims.

Working layer EPLI programs on the other hand are intended to provide insurance not only for the large single claim hit, multiple related claim and class action, but also the run-of-the-mill EPL claim that typically results in defence and settlement costs under $100,000. There are three types of working layer EPLI policies currently offered in the US market 'duty to defend', 'duty to pay', and a hybrid 'duty to defend/duty to pay'. A 'duty to defend' policy provides that the insurer has the right and duty to defend any claim potentially covered by the policy. A 'duty to pay' policy provides that the insured has the right to control the defence of the claim and the insurer has to pay the defence costs. A hybrid 'duty to defend/duty to pay' policy provides that, for any particular claim, the insured is allowed to choose whether the EPLI policy responds on a 'duty to defend' or 'duty to pay' basis.

Specific issues

Regardless of whether an EPL endorsement to a D&O policy or EPLI policy is purchased, there are many specific issues that must be addressed when reviewing the terms and conditions of the form being used. The following list of issues is not intended to be an exhaustive one. Rather, it is intended to be demonstrative of some of the issues that should be addressed, and are being addressed, by US risk managers.

* Whether 'damages' must be sought to have a 'claim'

Some EPL insurance forms expressly provide that 'damages' need not be sought in order for a covered 'claim' to be at issue. Other policies expressly provide that 'damages' must be sought. Still other policies are ambiguous on the issue. Why is a prerequisite of 'damages' being sought before a claim is considered a covered 'claim'? It is most evident on working layer EPLI policies.

Many types of EPL claims begin with a charge of wrongful conduct with the Equal Employment Opportunity Commission (EEOC). Many times, such EEOC complaints do not seek damages, but rather seek a ruling that will allow the aggrieved employee or prospective employee to sue in a civil court for damages and other relief.

When an EPLI policy provides that a claim, in order to be covered, must seek damages, EPLI insurers typically refuse to cover EEOC claims that do not seek damages. Defending an EEOC claim can run into the tens of thousands of dollars. Other types of claims like EEOC proceedings could also fall outside of the definition of 'claim' that requires as a prerequisite that damages be sought. Accordingly, the requirement of 'damages' being sought in order for coverage to be triggered should be removed.

* Batch clause wording

Virtually all EPL insurance forms are subject to some form of deductible or self-insured retention. Working layer EPLI policies typically contain deductibles in the range of between $5,000 and $25,000 (depending upon what premium the insured is willing to pay for the policy). Catastrophic EPLI policies typically contain self-insured retentions in the range of between $1 million and $5 million (again, depending upon the premium paid for the policy). D&O policies with EPL endorsements are typ-

ically subject to substantial deductibles or self-insured retentions for corporate indemnification coverage. Because such deductibles and self-insured retentions typically apply per 'claim' or per 'one insured event' it is very important, if not vital, that the policies contain a correctly worded 'batch' clause that aggregates multiple claims arising out of similar or related facts, circumstances, wrongful acts, etc. Otherwise, coverage that an insured would expect could be functionally eviscerated by the application of myriad deductibles and/or self-insured retentions.

*** Assumption of defence clause**

There are a few issues that are relevant only to 'duty to pay' or hybrid 'duty to defend/duty to pay' EPL insurance products. One issue is the 'assumption of defence' clause. Some 'duty to pay' and hybrid 'duty to defend/duty to pay' EPL policies and D&O policies with an EPL endorsement contain a clause that allows the insurer, in its absolute discretion, to assume the control of the defence of any claim after the insured has already been defending the claim. Such a clause functionally eliminates the purpose of having a 'duty to pay' or hybrid 'duty to defend/duty to pay' policy -to give the insured the right to control the defence of the EPL claim. Accordingly, such a clause should be deleted from any 'duty to pay' or hybrid 'duty to defend/duty to pay' EPL policy or D&O policy.

*** Consent lo counsel and revocation of consent clauses**

Another issue that is relevant only to 'duty to pay' or hybrid 'duty to defend/duty to pay' EPLI policies and D&O policies with an EPL endorsement is the 'consent to counsel' and 'revocation of consent' clauses. The consent to counsel clause provides that, although the insured gets to choose which lawyer will defend the insured, the insurer must consent to the insured's choice. Such a clause, if it has to be in the policy, should also provide that the insurer's consent shall not unreasonably be withheld. Otherwise, it might be helpful to delineate the specific grounds on which consent can be withheld, such as the chosen lawyer must:

(a) have experience of so many years handling EPL claims,

(b) charge a commercially reasonable rate, etc.

The revocation of consent clause provides that the insurer may, in its absolute discretion, revoke its consent to the insured's choice of defence counsel at any point in time, even after the insured's counsel has spent much time on the claim. Such a clause should be deleted, lest the insurer cause havoc by invoking this right in the midst of the defence of a claim, after the insured's counsel had already spent much time, effort, and partial policy limits defending the claim.

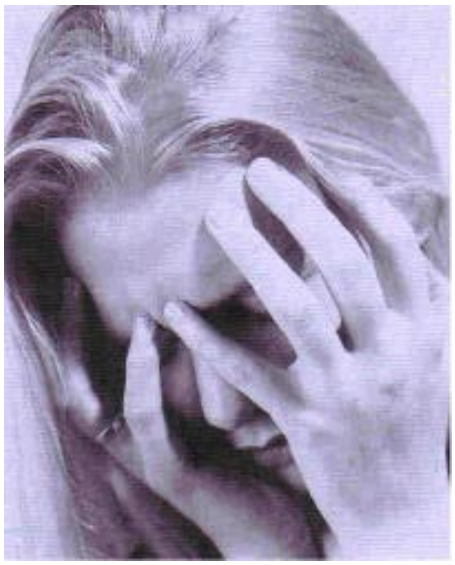
*** Prior acts exclusion**

Most, if not all, EPL insurance products are issued on a claims

made form. Some EPL insurance products do not provide prior acts coverage. Many EPL insurance products do, however, provide prior acts coverage and many insurers will provide prior acts coverage if asked. Prior acts coverage should, therefore, be insisted upon and obtained.

*** Prior knowledge exclusion**

For those EPL insurance products that do provide prior acts coverage, they often are subject to a prior knowledge exclusion. However, not all prior knowledge exclusions are worded the same way. A properly worded prior knowledge exclusion contains language that the insured must not merely have knowledge prior to policy inception of a fact or circumstance that serves as the basis of a claim during the policy period. Rather, a properly worded exclusion provides that it must be reasonably foreseeable that the facts or circumstances known could give rise to an EPL claim during the policy period.



An incorrectly worded prior knowledge exclusion does not contain such reasonably foreseeable language. The problem with such a prior knowledge exclusion is that claims of discrimination based on policies and procedures that exist prior to policy inception and known to everyone and thought by everyone to be lawful and non-discriminatory might always be excluded under it, if the language were given a literal interpretation. In addition to adding such reasonably foreseeable language, the exclusion also should be amended so that only the knowledge of management-level and higher level employees is subject to the exclusion, rather than the knowledge of all employees. This amendment narrows the scope of the exclusion.

*** Intentional injury exclusion**

Although from the standpoint of corporate vicarious liability it is not advisable to include an intentional injury exclusion on an EPL insurance product, such an exclusion should be included to avoid the unfortunate incident of having an employee, who actually committed an intentionally injurious act, successfully make a claim on the corporate insured's EPL insurance program (which could prematurely erode or exhaust limits and result in a higher premium for renewals). That unfortunate scenario already has been the subject of litigation in the US. To avoid this type of result, an EPL insurance product should have some form of intentional injury or wilful conduct exclusion. Such an exclusion should expressly state that it applies only if the employee in fact committed an act with the intent to cause injury.

*** Severability as to exclusions**

Most EPL insurance products do not provide severability as to all exclusions. However, at a minimum, an EPL insurance product should provide severability as to the intentional injury exclusion and prior knowledge exclusion. In other words, if any insured is found liable for committing an intentional injury, that insured's acts should not automatically be imputed to any other insured. Obviously, with respect to the possibility of an employee being found liable for intentionally sexually harassing another employee, this type of severability is very important.

Also, just because one insured has knowledge prior to policy inception of facts or circumstances that reasonably could be foreseen to be the basis of a claim made during the policy period, that knowledge should not be imputed to all other insureds. In the US EPL insurance market, most carriers will provide severability as to the intentional injury exclusion but not the prior knowledge exclusion.

*** Severability as to the application for insurance**

Some EPL insurance forms provide severability as to the application for insurance. Many do not. Such severability is important so that the corporation and other insureds are not barred from coverage merely because of a false representation or statement in, or omission from, the application for insurance by one insured. In addition, some insurers will entertain severability not only as to insureds, but also as to facts. In other words, it is possible to have the severability provisions worded so that if a material mis-statement or omission is discovered, coverage is barred only as to the person responsible for the mis-statement or omission and only as to the claim for which the mis-statement or omission is relevant.

Concluding thoughts

Stand-alone EPLI policies and D&O policies with an EPL endorsement are a welcome sight to the list of insurance products that can help a company finance its risks. However, because of the mad rush of many insurers and insurance brokers attempting to capitalize on the publicity of these two insurance products, EPLI policies and D&O policies providing EPL coverage often are placed without the necessary analysis that should take place by the risk manager, insurance broker and risk management advisor, singularly and collectively. Hopefully, this article will assist you in analyzing any EPLI and D&O policy that you are considering for your company or client.

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