

Incorporating EPL Coverage into an Insurance Program

Which Approach Is Best for You?

By Michael A. Rossi

The number of different ways to incorporate employment practices liability ("EPL") coverage into a policyholder's insurance program has grown in the past several years.

At one time, it was common to add EPL cover to a directors and officers (D&O) liability policy by way of an endorsement. This approach insured only a firm's directors, officers, and employees (but not the corporate entity). Another alternative was to buy a stand-alone employment practices liability insurance policy covering the corporate entity, as well as its directors, officers, and employees. Now, in addition to these options, insureds can also obtain EPL cover by way of endorsement to commercial general liability (CGL) policies and umbrella liability policies, as well as by adding entity coverage to a D&O insurance program.

This article examines these options in detail. In addition to describing the manner in which EPL coverage can be added to a program, the article also explores the perceived "pros" and "cons" associated with each option. It is hoped that by reading this article and considering the issues discussed, risk managers who have not yet added EPL to their programs can make an informed decision when they choose a coverage option. For those risk managers who have

already included EPL cover within their programs, or have joined a company in which EPL coverage is already in place, it is hoped that this article assists in evaluating how well the EPL cover was meshed with the existing program.

Option 1:

Adding EPL Cover to a D&O Insurance Program

One of the most common ways to insure EPL risks is to add some form of EPL endorsement to a D&O policy. (Based upon the author's experience, this approach is used as often as buying a stand-alone EPL policy.) An EPL endorsement to a D&O policy is typically available in one of three varieties.

(a) EPL coverage is added so that it applies only to claims made against the directors and officers; the corporate entity and nondirector/nonofficer employees are not insureds. (The corporate insured, of course, is covered for indemnity obligations to its directors and officers for EPL claims made against them.)

(b) EPL coverage applies not only to claims made against directors and officers, but also to claims made against nondirector and nonofficer employees; and

(c) EPL coverage applies to claims made against the corporate entity and its directors, officers, and employees.

Some of the perceived "pros" and "cons" of this option without really distinguishing between the three variants of the option are discussed below.

Perceived "Pros"

Some risk management professionals laud the benefits of this approach for one or more of the following reasons.

First, adding EPL to the D&O policy provides ease of EPL program administration. This is because some degree of EPL coverage is already provided by standard D&O policies, even without an EPL endorsement (i.e., D&O policies do not specifically exclude EPL claims). Accordingly, this is an obvious place to expand the EPL coverage already provided by a D&O policy. This method also has the advantage of consolidating an EPL protection policy within a single policy.

Second, obtaining EPL coverage in a D&O form assures consistent defense coverage provisions. A frequent drawback of stand-alone EPL insurance policies is that the majority are "duty to defend" forms. On the other hand, most D&O policies are written on a "non-duty to defend" basis (whereby the insured is obligated to manage the defense of claims, with the insurer paying defense costs on behalf of the insured). Inconsistent defense coverage provisions in

multiple policies that provide coverage for the same claim can prove problematic. For example, Insurer A might want to handle the claim, while Insurer B might want the insured to handle the claim. In another instance, one insurer might choose to settle the claim, whereas the other insurer could seek to contest the claim. However, if an EPL endorsement to a D&O policy is used to obtain coverage, it is likely that defense coverage provisions for EPL claims under the insured's program will be consistent. (There are, however, a few notable exceptions to this general rule whereby some D&O insurers use EPL endorsements that provide duty to defend provisions, as opposed to non-duty to defend provisions, that are standard in D&O forms.) In other words, when an EPL claim is made that impacts both the standard D&O coverage, as well as the EPL insurance provided in the endorsement, both coverage parts should respond the same way: either the insured must hire its own lawyer and defend the claim, or the insurer must hire a lawyer and defend the claim. This approach will prevent the problems described above.

Third, adding an EPL endorsement to a D&O policy is a short-term, cost-effective way of providing substantial limits for EPL risks. Most D&O insurers add EPL endorsements (even ones extending coverage to non-director/non-officer employees) for no additional premium. Even the additional premium for extending the coverage to claims made against the corporate

entity is typically much less than the premium required to buy corresponding limits under a stand-alone policy. Overall, this is a very cost-effective option (at least in the short term—see the "perceived cons" discussed below for the other side of the story).

Perceived "Cons"

The author prefers adding EPL coverage for directors and officers only, and then buying a stand-alone employment practices liability insurance (EPLI) policy. There are several reasons for this preference, all of which are perceived "cons" of Option 1 discussed in this article.

First, not only does this approach increase the risk of claims under the D&O program, but, more importantly, an EPL endorsement to a D&O policy could potentially exhaust the policy's D&O limits for non-D&O claims.

The former problem can be a nuisance, with heightened claims experience leading to higher renewal premiums and/or fewer D&O insurers willing to write the cover. The latter problem can prove calamitous to the personal finances of a director or officer. A serious EPL claim against a non-director/non-officer employee has the potential to exhaust the D&O limits. Accordingly, if a "traditional" D&O claim were made against a director or officer, there might not be enough insurance to cover the claim. If the claim were one that the corporate entity could not indemnify (either because of preclusion as a matter of law or because the corporation was

insolvent), the director or officer would be forced to expend personal assets to defend the claim. The risk of such exhaustion is even greater with an endorsement that provides "entity" coverage (i.e., one that extends EPL coverage to claims made against the corporate entity). In the author's judgment, such a risk should be avoided at all costs, especially when there are viable alternatives in the market to insure EPL risk.

If this is the only way in which a risk manager can obtain EPL coverage, then what some call "separate side-A coverage" should be purchased for the D&O policy. This will cover only the directors and officers, but not non-director/non-officer employees. This coverage provides additional, separate limits for non-indemnifiable claims made against directors and officers.

Second, EPL endorsements to D&O policies do not typically provide coverage terms that are as broad as those contained within stand-alone EPLI policies. While the latter insurance product is ever-evolving and improving, EPL endorsements on D&O policies tend to lag behind the times in terms of coverage breadth.

Option 2:

Adding EPL Cover to a CGL Insurance Program

For many years, if not a couple of decades, a few CGL insurers offered some form of EPL coverage (although typically for a very narrow selection of offenses) by way of an endorsement. However,

after losing substantial EPL insurance premiums to the D&O and stand-alone EPLI markets (given the application of broad form EPL *exclusions* on CGL policies), CGL insurers began entering the market with expansive EPL coverage endorsements that add EPL coverage to a CGL program. Some of the perceived "pros" and "cons" of this option are discussed below.

Perceived "Pros"

First, ease of program administration is a perceived "pro." If, for example, a company does not have D&O insurance, there is no opportunity to add an EPL endorsement to it. In this setting and others, attaching an EPL endorsement to a CGL policy instead of buying stand-alone EPLI policy or purchasing a D&O policy with an EPL endorsement provides for ease of program administration. And if the insured's umbrella liability/excess liability policies do not contain an EPL exclusion, then the insured can run the EPL cover all the way up through and beyond its general liability insurance coverage program (from CGL to umbrella/excess policies). What could be easier?

Second, cost-effectiveness is another perceived "pro." CGL insurers typically add EPL endorsements to their policies for less premium than what it would cost to buy stand-alone coverage providing the same limits.

Perceived "Cons"

As with EPL endorsements to D&O policies, the author is not a fan of adding EPL endorsements to CGL policies.

First, such endorsements, like employee benefits E&O coverage, typically are written on a claims-made form, even when attached to an occurrence-based CGL policy. Claims-made coverage is tricky, and requires special provisions for it to coordinate effectively and avoid coverage gaps when an insured changes insurers. Unfortunately, such provisions are usually missing from many EPL endorsements used with CGL policies. However, use of stand-alone EPL policies avoids these problems.

Second, EPL coverage endorsements to CGL forms, like EPL endorsements to D&O policies, typically do not afford the breadth of coverage that stand-alone EPLI policies provide. In effect, the cost-effectiveness and ease of administration inherent in this approach comes at the expense of broader coverage.

Option 3: Adding EPL Cover to an Umbrella Liability Program

This option comes under the heading of folklore. Many policyholders have said, "I added EPL to my umbrella liability policy." However, upon reviewing such an "addition," the author always discovers that it was nothing more than a stand-alone EPLI policy written by the umbrella liability insurer (or a sister insurer) with a self-insured retention that equaled the limits of the CGL policy in the insured's program. That is a far cry from "adding EPL to the umbrella liability policy." In reality, it is buying a catastrophic EPLI program on a stand-alone basis. Accordingly,

risk managers are cautioned to be very skeptical when a broker or underwriter says that he or she can add EPL to the umbrella liability policy.

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The perceived "pros" and "cons" of this option are more or less the same as the option of adding EPL coverage to a CGL policy. To avoid repetition, the author refers the reader to the issues discussed above for Option 2 to contemplate the "pros" and "cons" of adding EPL coverage to an umbrella liability program.

Option 4: Buying a Stand-Alone EPLI Policy

Buying a stand-alone EPLI policy is a popular option (ranking in the author's experience as equally common as using an EPL endorsement on a D&O policy). Set forth below are the perceived "pros" and "cons" of this option.

Perceived "Pros"

First, breadth of coverage is a decisive advantage. EPL exposures are "specialty" risks, much

like D&O, intellectual property infringement, 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 breadth of coverage on a continuous basis. (The author emphasizes "well-crafted" because there are many stand-alone EPLI policy forms in the market; some are highly effective, others are acceptable, while a few are downright poor.)

Second, insulating portions of the policyholder's insurance program from EPL risk is a perceived advantage. By using a stand-alone EPLI program, rather than endorsing a D&O, CGL, or umbrella liability policy, EPL claims are contained, without prejudicing the limits of other coverages (i.e., limits are available to protect the directors and officers, as well as to secure the company against other dangerous exposures such as products liability and advertising liability).

Third, the availability of risk management advice and practical loss prevention tools is also a significant advantage. Many stand-alone EPL insurers offer no-cost or low-cost yet effective advice for managing EPL risk (from providing labor and employment lawyers to assistance 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).

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Perceived "Cons"

Although stand-alone EPLI policies are the author's option of choice, the author recognizes that there are some "cons," even with respect to this option.

First, such policies are yet another stand-alone product that adds complexity to insurance program administration. Regrettably, the trend with CGL coverage over the past 2 decades is to carve out increasing portions of coverage from such policies. This has the effect of compelling insureds to obtain such coverage on a stand-alone basis, and, in addition, precluding insureds from scheduling such policies as underlying insurance within the umbrella liability program. This forces the insured to maintain several separate "towers" of insurance for such risks. The trend has been alarming in recent years, with some insureds having many separate tiers of liability insurance for risks that could

be written on CGL and/or umbrella liability policies (e.g., EPL, media E&O, intellectual property infringement, and pollution legal liability).

Second, insurance product cost is a significant factor. There is no question that a stand-alone EPLI policy costs money, and sometimes substantive amounts of it. An insured typically will spend more in premium for a stand-alone policy than for an EPL endorsement on a D&O, CGL, or umbrella liability policy. And the adage "you get what you pay for" only goes so far. There is no question that the EPL endorsements used for D&O, CGL, and umbrella liability policies add a fair amount of coverage to the programs that otherwise is not included.

Adding EPL Coverage to More than One Policy

In the author's judgment, one of the most overlooked yet important issues with respect to incorporating EPL cover within an insurance program is what, if anything, should be done if EPL cover is added under multiple policies. The most common scenario is when a company has a D&O policy containing some form of EPL endorsement *and* a stand-alone EPLI policy. Almost always, the result is overlapping coverage, with both programs responding in different ways to the same claim. This can prove very problematic, both from the standpoint of claims handling and insurer involvement in the claim, as well as in determining responsibility for self-insured retentions and/or deductibles.

Less often seen by the author, but just as problematic, are insurance programs where the insured has a stand-alone EPLI policy and has added some form of EPL to a CGL or umbrella liability policy. Here too, overlapping coverage can arise, causing the same or similar problems discussed above.

In the author's judgment, if EPL cover is going to be added to an insurance program under more than one policy, primacy issues between the policies need to be addressed. Each policy on which EPL cover is added should make specific reference to the other policy(ies) in the insured's program that also provide EPL cover. The references should spell out, in some detail, how the policies will respond to claims that fall within the terms and conditions of each.

There are multiple ways to arrange such priorities, based on a number of variables. The following scenario provides one example. Assume an insured has an EPL endorsement on its D&O policy (that does not cover the corporate entity), under which only directors and officers but not non-director/non-officer employees are insured. There is no self-insured retention or deductible applying to directors and officers within the policy. Assume further that the insured has a stand-alone EPLI policy, covering the corporate entity and its directors, officers, and employees, where the self-insured retention or deductible for all insureds is \$100,000 per claim.

One way to address priority issues in such a situation is to

make the D&O policy primary to the EPLI policy for all claims against directors and officers that are not indemnifiable by the corporate insured. Make the EPLI policy primary to the D&O policy for indemnifiable claims against the directors and officers, for all claims against the corporate entity, and for claims against the non-director/non-officer employees. In this way, if a non-indemnifiable but insurable EPL claim is made against a director or officer, there is no question that the D&O policy responds first with its zero self-insurance obligation; the director or officer does not have to face the possibility of being required to fund the first \$100,000 of the claim. If, however, an indemnifiable claim is made against a director, officer, or employee, or is made against the corporate entity, the EPLI form responds first, thereby reducing claims experience on the D&O policy and protecting its limits.

As noted above, there are various ways to address priority issues. The main point to remember is that priority issues, regardless of how they are handled, should be expressly addressed for all policies within the insured's program that provide some form of EPL cover.

Concluding Remarks

Perhaps the different options available to insureds for adding EPL cover to their insurance program have now been exhausted. Having the ability to add the cover to a D&O, CGL, and/or umbrella liability policy

as well as buy a stand-alone EPLI policy seems to cover most, if not all, of the bases. But even if these options encompass all the different ways to add EPL cover to an insurance program, the "pros" and "cons" with respect to each option, in their own right and vis-a-vis each other, will continue to change. Accordingly, *EPLiC* will continue to provide its readers with periodic updates of the "pros" and "cons" of each option, and advise as to whether any new options have indeed been created. For now, however, the author hopes that this article provides a useful starting point for the discussion of this important aspect of EPL insurance.

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Pros and Cons of Combining EPL with Other Coverage Types

EPL with D&O

Pros:

- * Ease of program administration
- * Consistent defense provisions are obtainable
- * Cost-effective

Cons:

- * Potential D&O limit exhaustion by non-D&O claims
- * Lack of coverage breadth

EPL with CGL/Umbrella

Pros:

- * Ease of program administration
- * Cost-effective

Cons:

- * Nonconcurrent coverage triggers (i.e., EPL: claims-made; CGL: occurrence)
- * Lack of coverage breadth
- * Constrained choice of defense provisions

EPL with Multiple Policies

Pros:

- * Potential for stacking of limits

Cons:

- * Typical complications resulting from overlapping policies
- * Added administration, given need to address primacy issues

EPL on a Stand-Alone Basis Only

Pros:

- * Broad scope of coverage
- * No constraints on defense provisions options
- * No constraints on self-insurance options
- * Insulates limits of insured's other policies
- * Availability of risk management and loss prevention services

Cons:

- * Additional policy adds complexity to program administration
- * Higher cost compared to other alternatives