



GUEST ESSAYS

Employment Practices Liability Insurance, Is It Right For Your Firm?

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If you insure them, they (claims) will come. Is this the mindset that is keeping more firms from buying Employment Practices Liability (EPL) insurance? It is difficult to understand why notwithstanding the availability of inexpensive insurance to cover a wide variety of employment practices claims. Design firms, like other employers, have been slow to embrace the coverage. A 1997 survey conducted by the Society for Human Resource Management (SHRM) and the law firm of Jackson Lewis indicated that only 22% of its respondents are purchasing EPL insurance. It might be argued that the availability of coverage encourages claim activity however the basis of employment practices liability is clearly expanding faster than the use of EPL insurance. As recently as April 27, 1999, the U. S. Equal Employment Opportunity Commission (EEOC) determined that the refusal to cover infertility treatments violates the Americans with Disabilities Act (ADA) and the 1964 Civil Rights Act. Without a doubt, this decision came as an expensive surprise to at least one employer.

What is The Role of Insurance in Managing Employment Practices Liability

There are many ways in which a firm can work to manage the likelihood and severity of employment practice claims. Appropriate use of employment manuals, written procedures, education and the use of risk audits are some of the tools that employers can use to reduce the risk of claims. Insurance does not eliminate the need for firms to establish and enforce proper behavior but it can play an important role. The Insurer's role is to cap the financial loss an insured sustains by assuming most of the risk. This role can be expanded to include useful risk management assistance ranging from sensitizing the insured to potential sources of liability to conducting risk management audits. When considering whether or not it makes any sense to transfer the risk to another through the use of insurance, the following analysis is useful:

1. What is the firm's exposure to employment related claims? The firm should quantify its exposure in terms of likelihood of claims (frequency) and the size of possible claims (severity).
2. Are there viable alternatives to risk transfer? If so are they cost effective?
3. What is the cost of insurance in terms of premium and time involved to implement the coverage?
4. Does the cost of retaining the risk exceed the cost of insuring against it?

What is The Exposure to Employment Practice Claims?

In the last ten years the EEOC alone has obtained 1.6 billion dollars against employers in connection with cases alleging discrimination. There are many factors that have contributed to the rapid increase amount of employment related claims. We might start with a demographic model of employment inequality. White men hold 97% of senior management positions in Fortune 500 companies. In 1997 women earned only 71 cents for every dollar earned by men. Black women earn 63 cents for every dollar earned by white men and Hispanic women with college degrees earn less than white men with high school diplomas¹. Federal and state statutes as well as common law developments have responded to try to create more equality in the employment world. Some of the Federal laws out of which employer liability can arise include:



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1. Title VII of the Civil Rights Act of 1991.
2. Age Discrimination in Employment Act of 1967.
3. Title One of the American's with Disabilities Act of 1990.
4. Equal Pay Act of 1963.
5. Family and Medical Leave Act of 1993.

News reports of large awards and settlements for claims of discrimination and harassment have also contributed significantly to the increase in claim activity. It seems that for any design firm, the question is not whether it will be faced with an employment-related claim, but rather when and how much it will cost to get out from under it.

The Cost of Claims Greatly Exceeds the Relatively Small Cost of Coverage.

About ½ of all EPL claims are closed with no indemnity payment. Including defense costs about ½ of all EPL claims are resolved for a total cost of 50,000 or less. About 5% of these claims have total costs in excess of 1,000,000². Thus, the likelihood of a firm being faced with a costly EPL claim is significant.

The market for EPL insurance is very large and it continues to grow. The demand has not kept pace with the growth and the availability of the coverage. Thus, pressure exists to keep pricing down. Another relevant factor is that since the coverage is new, claims have not yet developed to the point where insurers truly understand the extent of the risks they have undertaken. As mentioned above, the cost of coverage is relatively low. Depending on factors such as firm size, limits of liability, and claim history, the cost of coverage ranges from about 50.00 to 250.00 per employee per year. In many cases, this is less than what an organization pays for its coffee service on a per employee basis.

At last count, we determined that about 60 different insurers provide this kind of coverage. This is still very much a developing area thus there is little homogeneity in terms of policy forms. The typical policy form provides coverage for the following activities:

1. Wrongful dismissal, discharge, or termination (either actual or constructive) of employment, including breach of an implied contract;
2. Harassment;
3. Discrimination;
4. Retaliation (including lockouts);
5. Employment-related misrepresentation(s) to an employee or applicant for employment with the Firm;
6. Employment-related libel, slander, humiliation, defamation, or invasion of privacy;
7. Wrongful failure to employ or negligent employee evaluation, including the giving of negative or defamatory statements in connection with an Employee reference;
8. Wrongful discipline;
9. Failure to grant tenure;
10. Failure to provide or enforce adequate or consistent policies and procedure relating to any enforcement practices violation; or
11. Violation of an individual's civil rights relating to any of the above.

The approach as to the basic coverage grant will vary. Some insurers specifically enumerate covered claims while others use more inclusive language and not specifically enumerate the covered perils. The



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latter approach is preferred, as there is less risk that a particular matter will fall outside the scope of coverage.

Third Party Coverage

In certain circumstances, coverage can extend to claims by third parties such as clients or customers but only in connection with claims of harassment, discrimination, or violation of an individual's civil rights. For example a discrimination claim by a restaurant patron who is denied service due to race might be covered under this type of policy.

Coverage Trigger

To the author's knowledge all EPL policies are written on a *claims made* basis. The making of a *claim*, or notice to the insurer of facts and circumstances that might lead to a claim are coverage triggers under this type of policy. It is inaccurate however to assume that all *claims made* policies operate in the same manner. *Claims made* policies are distinguished from other commercial liability coverage forms that are triggered by an "occurrence". Because the claim is the coverage trigger, the policy must be in effect at the time the claim is made.

Double Trigger

A motivating factor behind the development of the *claims made* policy is the interest of insurers to reduce the number of claims first being reported long after the coverage has expired. Insurers found that moving the coverage trigger down the timeline from the date of the occurrence to the date of the claim was first made, alleviated but did not eliminate the problem. The result, is the development of the *claims made and reported policy*. This type of policy requires not only must that the claim be made during the policy period, but that notice must be given during the policy term or some defined period of time thereafter.

Triple Trigger

In many instances *claims made and reported policies* are structured so that three requirements are necessary to trigger coverage. In addition to the requirements that the claim be made and reported during the policy period, the act, error or omission out of which the claim arose must have occurred subsequent to the inception date of coverage or some other specific date. This is usually referred to as a retroactive limitation of coverage and is more fully explored herein.

Obtaining Coverage Retroactively is also Possible

Typical underwriting sense calls for retroactive coverage to apply as of the date of the first continuously renewed EPL policy. This creates an interesting situation in the world of EPL coverage, as most policies placed today are the first for the firm. For that reason we are finding insurers to be more willing to extend prior acts coverage even if no prior coverage existed. Whether or not prior acts coverage is granted is very significant as respects the scope of the coverage and we would urge that it be obtained whenever possible.

Coverage for Punitive Damages



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This is another area of distinction. Most carriers today are willing to provide coverage for punitive or exemplary damages. At times, there is an additional premium for this coverage and the available limits to cover punitive or exemplary damages are not always equal to the base limit. Some states such as Illinois prohibit the use of insurance to pay punitive damage awards. However, many states allow for insurance in the case of vicarious liability.

Front Pay

Many policies are silent or unclear as to whether or not front pay is covered some of the policy forms however specifically address the issue.

Coinsurance

Coinsurance is the requirement that the insured pay a percentage of any loss in addition to the deductible. Typically the percentage is 5% or 10%. We find that in most cases the coinsurance provision can be waived for an additional premium.

Many Insurers Include Free Risk Management Services

Even though they sell the coverage, insurers still struggle with the notion that they are willing to insure intentional conduct that causes injury. Thus, many insurers attempt to mitigate the likelihood of claims by providing loss control or risk management services. These services are usually free and take many forms. The kinds of services that we see include, a risk management audit, an 800# hotline where advice can be obtained quickly, assistance with handbook creation such as sample wording. One insurer will go so far as to help bear the cost of handbook development. Regional seminars are also common. One insurer is offering software that will assist a firm in conducting a self-audit.

Conclusion

EPL insurance is widely available and very affordable. If your firm is considering looking into the purchase of the coverage remember that there is little if any uniformity in the coverage forms. We recommend a careful examination of the policy and how it compares to others. You should work with a broker who is capable of understanding the distinction in the policy forms and more importantly, the broker should take the time to help you find the right coverage. Insurers have different underwriting guidelines many require employment manuals but the requirement is not universal. Be sensitive to the issue of retroactivity and if you can, try to purchase coverage that is fully retroactive. Finally, EPL coverage might or might not make any sense for your firm however you really cannot make that determination without finding out how much it will cost. Most insurers will provide a premium indication based on a short form application that can be completed very easily. There is really no way to undertake a proper analysis of the coverage without knowing its cost and it is probably worth the few minutes it takes to complete the application.

Cited References:

1. EEOC 1999 Strategic Plan
2. Watson Wyatt Worldwide D&O Survey



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NOTE: This article is intended for general discussion of the subject, and should not be mistaken for legal advice. Readers are cautioned to consult appropriate advisors for advice applicable to their individual circumstances.

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