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Section
Begins on
Page 13

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Employment Practices Insurance Proliferates

BY LOUIS PECHMAN

IN THE RECENT movie "Jackie Brown," an ex-con played by Robert De Niro asks "who's that?" about a corpse in a car trunk. His boss replies, "that's Beaumont." The Robert De Niro character wonders out loud "who's Beaumont?" to which his boss explains, "an employee I had to let go."

Employers under siege from lawsuits by disgruntled employees might secretly pine for a Jackie Brownesque solution to these workplace problems. Coming to a workplace near you, however, is not the magic of Hollywood, but rather employment practices liability insurance (EPLI), an insurance product which has seen explosive growth in the last few years.

EPLI is designed to provide risk management for the proliferation of lawsuits against employers under federal, state and local anti-discrimination statutes, as well as for common law claims such as wrongful discharge. EPLI policies offer employers some protection against the uncertainties that these lawsuits engender by providing defense and indemnity coverage. EPLI can be obtained either as a stand alone policy or as an endorsement to pre-existing coverage.

According to the Insurance Information Institute, a trade group, 50 percent of Fortune 500 companies have purchased EPLI coverage. Underscoring its universal appeal, the American Bar Association has recently endorsed an EPLI policy for law firms. It is not surprising that EPLI has cap-

tured the attention of risk managers given the frequent press reports of high ticket judgements and settlements in recent years.

Traditional Coverage

Commercial general liability (CGL) policies have typically been an inadequate source of insurance coverage for employment claims. To begin with, insurers can assert that an employment-related claim is not an "occurrence" or "accident" under the CGL policy because discrimination and other employment claims are "intentional" acts. In addition, CGL coverage of "property damage" and "bodily injury" are generally viewed as incompatible with the back pay and lost benefit elements of damages in employment cases.

Moreover, CGL policies often contain an "employer liability" exclusion which excludes coverage for claims by the insured's employees which "arise out of and in the course of employment." Historically, this exclusion is designed to bar claims that are covered by workers' compensation insurance, but it has also been raised by insurance companies to bar employment practices claims. Finally, most CGL policies now have some type of exclusion expressly barring coverage for employment related claims.

Director's and officer's liability insurance (D&O) is also an ineffective protection against employment-related claims. D&O policies typically cover directors and officers personally. As a result, the corporation is not a covered entity under the policy. Moreover, from the liability side, directors and officers of companies within the Second Circuit are not personally at risk for claims of discrimination under the federal anti-

discrimination statutes. They are only at risk under the New York City and State human rights laws if they actually participate in the employment decision giving rise to the lawsuit.

Workers' compensation policies cover injuries to employees arising out of and in the course of employment with the employer. These policies, however, are confined to injury and illness on the job and exclude claims for employment practices. And, with the notable exception of Bill Clinton's defense of Paula Jones' claim of sexual harassment, personal umbrella liability insurance has generally not been available for defense of employment claims because they also specifically exclude coverage for employment-related acts.

While existing insurance policies might be unlikely to offer a source of coverage for employment disputes, it is of course the language of the particular policy which controls. Notably, an insurer may have a duty to defend the entire lawsuit if any of the claims asserted are covered by the policy.

For example, in a case alleging both a discriminatory termination and defamation for giving a bad job reference, an employer could seek coverage on the basis of "personal injury" for slander or libel. Accordingly, a careful review of existing policies should be made when a lawsuit is filed or a claim is made or threatened. The juxtaposition of existing policies against the various claims in an employment law suit may provide a basis for coverage.

EPLI in New York

EPLI emerged as a viable coverage in New York as a result of a 1994 Circular Letter from the State Insurance Department. In that letter, the Insurance Department noted that "discrimination based upon disparate treatment is an intentional wrong

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Continued on page 12, column 4

Employment Law

Risk Management for Employers

Continued from page 9, column 6

whose resultant harm flows directly from the acts committed, and liability coverage for it is impermissible. The Department's longstanding prohibition against coverage for discrimination claims generally originated at a time, some thirty years ago, when virtually all discrimination claims were of this type."

The Circular Letter then proceeded to carve out two exceptions to the public policy concerning insuring against "intentional" acts. First, the Insurance Department held that the public policy prohibiting coverage for intentional acts did not apply to "disparate impact" cases because "the discriminatory result does not directly proceed from specific discriminatory acts against individuals." Second, the Department characterized the issue in discrimination cases as vicarious liability, rather than "intentional wrong."

The Insurance Department explained that an employer "may be held vicariously liable for the discriminatory act of an employee even though it (1) played no active role in the commission of the act, (2) did nothing whatever to aid or encourage its commission, and (3) may have done all that it possibly could to prevent it." The Department then noted that coverage for claims of vicarious liability are generally permissible regardless of whether the underlying wrong is intentional. As such, treating discrimination like other types of covered acts merely conforms treatment of discrimination to the existing treatment of other types of vicarious liability claims.

One interesting issue that may arise as EPLI policies evolve in New York is the extent to which sex harassment by supervisors is deemed intentional in nature and therefore uninsurable. In *Board of Education of the East Syracuse-Minoa Central School District v. Continental Insurance Co.*, 604 NYS2d 399 (4th Dept. 1993), the Appellate Division held that sex harassment, like sexual abuse and child abuse, is intentional in nature and thus not an occurrence under a general liability policy.

In a similar vein, because the quid pro quo harasser, by definition, wields the employer's authority to alter the terms and conditions of the victim's employment, the law imposes strict liability on the employer for the intentional acts of the harasser. Given the public policy concerns regarding uninsurability of intentional acts, an important issue to watch in the coming years will be the manner in which this type of harassment will be treated.

EPLI Coverage

Although the Insurance Services Offices recently issued a model EPLI program, there is no uniformity in coverage provided by insurance carriers, and there are wide variations of EPLI available in the marketplace. The scope of coverage under EPLI policies generally includes the employer, as a corporate entity, and its officers, directors and employees. The coverage may also include, as insureds, former employees, volunteers, customers, independent contractors and leased employees.

Given the fact that employment lawsuits may range from fraudulent inducement in hiring to defamatory references once an employee has de-

parted, the exact coverage provided is the first inquiry in an evaluation of EPLI.

Coverage inclusions to be considered are: wrongful termination, sexual harassment, retaliation, breach of oral, written or implied contract, misrepresentation, wrongful failure to promote or hire, wrongful discipline, negligent hiring, negligent retention, constructive discharge, misrepresentation, invasion of privacy, negligent or wrongful evaluation, defamation, libel, slander, negligent and intentional infliction of emotional distress, tortious interference with business relationships, and of course all types of discrimination prohibited by federal, state or local law.

On the other hand, some underwriters have carved out significant exclusions to coverage, including intentional acts, plant closings, class actions, reasonable accommodation under the Americans with Disabilities Act and claims under employee benefit plans.

Punitive damages are a particular concern for employers in employment discrimination cases. Under Title VII and the ADA, companies may be liable for punitive damage awards from \$50 to \$300,000, depending on the number of individuals employed. Moreover, employers in New York City with four or more employees are subject to uncapped punitive damages under the New York City Human Rights Law. Notably, the Insurance Department's 1994 Circular stated that "in conformity with court decisions on the subject, it remains against public policy to provide insurance coverage for punitive damages."

This gap in coverage has been addressed by some insurers with favorable choice of law provisions. Such provision may provide that punitive damages will be a covered loss to the extent that they are insurable under the laws of any state which has a substantial relationship to the insured, and/or that the underwriter will not challenge the insured's good faith determination that punitive damages in a claim are insurable. Alternatively, companies may obtain Bermuda-based coverage for punitive damage awards.

Emerging Issues

EPLI policies are generally issued on a "claims made" basis, which provides insurance coverage if the claim is made within the policy period. In the context of EPLI, however, determination of when a claim is made may be subject to a variety of interpretations as to what constitutes the insurable event triggering a claim.

Unlike an accident, which happens at a precise moment in time, a claim of discrimination or sexual harassment may evolve over months or even years. Moreover, the "claim" of discrimination may take a meandering path.

For example, an allegation of a discriminatory failure to promote may first be raised with a manager, and then as a formal grievance to the human resources department. In the absence of a satisfactory resolution the employee may file an administrative charge of discrimination with the Equal Employment Opportunity Com-

mission and/or the New York State Division on Human Rights or the New York City Commission on Human Rights.

Alternatively, the employee might file a discrimination lawsuit directly in state court or perhaps seek to resolve the dispute through grievance-arbitration if the employer is unionized. Furthermore, if that same employee is later terminated, the failure-to-promote case, which might have been raised a few years earlier, will be inextricably linked in litigation to the newer claim of discriminatory and retaliatory termination.

Some EPLI policies provide that interrelated claims are treated as one loss. Accordingly, the determination of coverage will, in turn, depend on when the claim is made. Lawsuits regarding when claims arise and where coverage ends are sure to emerge as insureds gain more experience with EPLI.

There will also be important decisions to be made by insureds and insurance companies as to what role the insurer will play in risk management. Some insurers are offering programs to educate insureds about areas of potential liability. They are providing access to employment counsel, through a toll-free hotline, as well as self-audit guides for companies to identify weaknesses in employment practices and policies.

There are also interesting settlement issues which may arise with respect to EPLI coverage. Non-monetary issues such as reinstatement, a letter of reference or a requested promotion may be out of the control of the insurer. In addition, back-pay, a key element of damages in employment cases, may continue to rise while the case is in litigation or sits at an administrative agency for years.

Moreover, the facts of an employment case may still be developing even after a "claim" is made. Employment cases are generally emotionally charged, and companies may take the position that a settlement will make them look like an easy target or will otherwise create an adverse precedent. To address these concerns, insurers have crafted modified "hammer" clauses. When a plaintiff agrees to settle for a specific amount but the insured company instead insists on pursuing the case, the underwriter agrees to pay the amount of the offered settlement plus 50 percent.

Conclusion

The challenge of EPLI is that the liability which it attempts to insure against may have as much complexity as the underlying relationship between the employer and the suing employee. While the termination of an employment relationship might ostensibly appear like a discrete event, it is often the culmination of a myriad of interpersonal dynamics gone sour.

Each workplace is different, and every work relationship has multiple facets that may play themselves out in litigation under a dizzying array of legal theories. It is still too early to tell how EPLI will meet this challenge. It is safe to say, however, that EPLI will be an increasingly important factor for companies to consider in managing their human resources.