

THE 10 MOST MYSTIFYING ASPECTS OF EPL COVERAGE

Over the last two decades, buying Employment Practices Liability (EPL) coverage has become standard for most U.S. organizations. No surprise, given how EPL claims and verdicts have increased in number¹ and settlement figures have grown. Although the coverage is now common, it is often misunderstood. In this *Alert*, we review the 10 most frequently misunderstood questions about EPL insurance. Understanding how EPL policies work will go a long way to maximizing your coverage.



1. SELECTING COUNSEL

Who will assign counsel to defend your company and employees against a claim? You might think that the answer to this question depends on the type of EPL policy you have purchased. There are two basic types of policies – duty to defend and non-duty to defend. If your policy has a duty to defend provision, your insurance carrier is responsible for selecting counsel and has the right to direct the defense of the matter. If your policy is a non-duty to defend policy, you might *expect* to have the power and responsibility to choose your own counsel and direct the defense.

When it comes to EPL, however, many carriers reserve the right to approve defense counsel, *regardless of who has the duty to defend*. Several have a preapproved list of what are called panel counsel firms from which you may be required to select a defense firm. Panel counsel firms have proven expertise and demonstrable results in employment matters. As an added benefit, rate discounts are typically negotiated by the carrier. *When selecting counsel, be sure to request any applicable panel rates.*

¹ Charge Statistics, FY 1997 through FY 2007, available at <http://www.eeoc.gov/stats/charges.html>



2. SETTling CLAIMS

*Do you get to settle claims on your own if your policy does **not** include a duty to defend provision?* Where the total defense costs and the potential settlement amount are within your deductible (or self-insured retention), you might reasonably expect that you don't need your insurer's approval. After all, it's your money. Unfortunately, you could be wrong.

You may completely lose coverage for a claim that you settle without first seeking your carrier's approval. Even worse, if you independently settle the first in a series of claims or a claim that becomes the basis for a later class action, you may lose coverage for all of it. Keep your carrier informed and seek their consent where required!

3. A CHARGE IS A CLAIM (OR THE LATE NOTICE TRAP)

How do you know when you have a claim? One of the best ways to avoid a denial based on late notice is to make sure you understand what constitutes a claim under your policy. Generally speaking, a claim may be triggered by written demands for relief; charges or complaints brought before administrative agencies, including the Equal Employment Opportunity Office (EEOC) and similar state agencies; service of a summons or lawsuit; administrative or regulatory investigations; or any request to toll or waive any statute of limitations. EPL situations are often fluid. How do you know when an internal human resources matter becomes a claim or potential claim? EPL experts can help. An EPL adviser can review any set of circumstances and analyze how your EPL policy might respond. *Don't wait until a lawsuit is filed – it may be too late to get coverage.*

4. BREACH OF CONTRACT

Is breach of contract covered? Among the most confusing employment claims are those alleging breach of employment contract because most policies exclude breach of contract claims. Whether a claimant alleges that their actual employment contract was breached or that there was a breach of an *implied* contract based on the employee handbook, in most cases, claims arising from such allegations will not be covered. It may seem counterintuitive that a breach of employment contract would not be covered under an employment practices liability policy, but EPL policies are generally intended to cover unintentional acts. From the carrier's point of view, if an insured has entered into a contract, the obligation to fulfill that contract is assumed. Contract damages therefore rise out of this assumed, intentional liability.

Exceptions may apply. Breach of contract claims often accompany other covered allegations. When covered allegations are in play, it may be possible to obtain coverage for defense costs for the handling of a breach of contract allegation. When it comes to settlement, be sure to consider whether there is an overlap in recoveries between the uncovered contract claim and an otherwise covered wrongful act. *Don't assume that claims alleging breach of contract should not be submitted to your carrier!*

5. PUNITIVE DAMAGES

When are punitive damages covered? Damages awarded with the intent of financially punishing wrongful actors and deterring future illegal behavior (punitive damages) constitute one of the largest financial exposures that you face when dealing with an EPL

claim. In many cases, they may far exceed compensatory damages. Punitive damages in the tens of millions of dollars are not unheard of. While virtually every EPL carrier makes coverage for punitive damages available, it is important to note that a number of states prohibit insurance for these losses. To address this, many U.S. carriers offer “most favorable law” provisions. If a claim is brought in a state where punitive damages coverage is not permitted, you may be covered if a relevant point of contact – where your company is headquartered or where the policy was issued, for example – is a jurisdiction that legally permits the coverage. *Consider this option along with other possible coverage solutions for this exposure.*

6. TIMING

When do you have to report a claim? Employment Practices claims typically must be reported within the policy period in which the claim is first made against you. If you do not report within the proper time frame, you could risk losing all coverage for the claim. Say, for example, you received an EEOC charge in May 2007, but did not report the matter until a lawsuit was filed in April 2008. If the policy period expired on December 31, 2007, the notice would be late and coverage could be denied on this basis alone.

Policies may also have an additional window of reporting time – generally 30 to 60 days after the policy period ends. *Check your policy to be certain of the claim reporting requirements.*

7. THE BENEFITS EXCLUSION

When is a settlement really a severance benefit? Names or labels can count against you. All too often, a company settles an EPL claim by offering an individual what it labels additional “severance.” Any settlement can cause coverage difficulties (see item 2 above) if done without your carrier’s approval, but settlements in the form of severance benefits can also boomerang. Benefits, **including severance benefits**, are usually **not** covered. *Review your policy and nomenclature before discussing settlement.*


8. THE HAMMER CLAUSE

What is the dreaded “hammer clause?” EPL policies usually contain a provision stating that if an insured does not agree to the first settlement opportunity recommended by the carrier, the carrier’s liability is capped at the amount for which the claim could have settled, plus defense costs as of the date of the settlement opportunity. This is the hammer clause. Where the provision includes a pre-set level of coverage or allocation for any additional loss, it is called a softened hammer.

In EPL claims, the interests of the insured and the carrier may differ with respect to the resolution of a claim. A carrier may view the matter from a solely economic perspective – preferring to settle the matter at the lowest possible value, rather than taking the risk of mounting a defense through trial. An insured, on the other hand, may have additional business considerations, such as avoiding copycat claims and public relations issues. Whether you have a softened hammer or are successful in getting the hammer clause completely removed, to maximize coverage, it is important to keep your carrier informed of the status of any potential claim. *Keep your carrier informed as the claim develops – it’s one of the best ways to ensure cooperation at settlement time.*

9. THIRD-PARTY COVERAGE

What if a customer or vendor alleges that they were discriminated against by your staff? What if a client or visitor harasses your employee? In many instances, coverage may be available under your EPL policy for third-party claims, but the scope of third-party varies widely. Claim scenarios could include the following: A man alleges he was wrongfully denied service at a store based on his race or national origin; a waitress alleges that she was sexually harassed by a customer; a handicapped visitor alleges that a hotel did not have proper ramps for wheelchair access.



You should review your policy to ensure that it provides the appropriate third-party coverage. Businesses with a high frequency of client contact – retailers, financial institutions and companies in the hospitality industry – should be especially concerned with this coverage. *You may also want to review coverage under your General Liability policy for additional or alternative coverage.*

10. HOW YOUR DEDUCTIBLE OR RETENTION WORKS

What is a self-insured retention? EPL policies typically contain a self-insured retention (SIR) or deductible. This policy language details how a claim will be funded. Some agree to pay for costs upfront with reimbursement for costs above the retention. In other cases, the carrier will assume the payment obligation once the retention has been met. In most cases, **a new and separate retention will apply to each new claim in a policy period.** *Be certain that you know the amount of your SIR and how it operates.*

CONCLUSION

EPL coverage is widely available – good news, as claims can be frequent and sometimes severe. Understanding the fundamentals of EPL insurance will make for a smoother claims process and maximize the amount of coverage and, ultimately, your insurance recoveries.

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