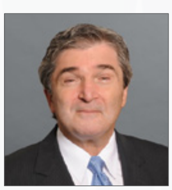
Employment Practices Liability Insurance Policies and Coverage

Given the rising volume and costs of employment-related claims and litigation, employers are increasingly looking to employment practices liability insurance (EPLI) to mitigate risk and reduce costs. However, employers must understand the unique attributes of EPLI to maximize the benefits of EPLI coverage.



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Employment-related claims are an unwanted but necessary cost of doing business for even the most well-intentioned employers. Employment practices liability insurance (EPLI) policies allow employers to mitigate risk and reduce the costs associated with certain employment-related claims and litigation. EPLI policies are a relatively new insurance offering and have become increasingly popular because of:

- The rising volume and costs of employment practices litigation.
- The employment practices exclusions added to many other insurance policies.

Given recent trends, EPLI policies may help employers manage the high costs of defending even meritless employee claims. However, employers must understand the unique attributes of EPLI, including how EPLI policies differ from other types of insurance, to maximize the benefits of EPLI coverage.

This article discusses:

- The general characteristics of EPLI policies.
- Key defined terms and other EPLI policy provisions.
- Common EPLI policy exclusions.
- EPLI policy limits on liability and defense costs.
- Other unique features of EPLI policies.

Search Employment Practices Liability Insurance (EPLI) Policies and Coverage for the complete, online version of this article, including information on the benefits of obtaining EPLI coverage, the interplay between EPLI and other insurance policies, and tips for employers purchasing EPLI policies.

OVERVIEW OF EPLI POLICIES

EPLI is a form of insurance that employers can obtain for certain employment practices liability. It generally covers claims alleging that the employer engaged in unlawful conduct in connection with the employment relationship, including claims made by:

- Employees.
- Former employees.
- Applicants for employment.

Certain EPLI policies also may cover claims made by the Equal Employment Opportunity Commission (EEOC) on behalf of these individuals.

Common claims covered by EPLI policies include allegations of:

- Discrimination.
- Harassment.
- Wrongful termination, including constructive discharge and retaliation.
- Defamation, including libel and slander.
- Invasion of privacy.

EPLI does not generally cover claims under the Fair Labor Standards Act (FLSA) or comparable state wage and hour laws, such as claims for:

- Unpaid overtime.
- Minimum wage violations.
- Misclassification of employees as exempt or nonexempt.
- Misclassification of independent contractors.
- Unpaid meal or rest breaks.

EPLI also does not generally cover contract-based claims and certain other statutory claims.

EPLI can be purchased as a stand-alone policy or as an endorsement (or addendum) to another type of policy, such as a commercial general liability (CGL) or directors and officers (D&O) liability insurance policy.

STAND-ALONE EPLI POLICIES VERSUS ENDORSEMENT COVERAGE

There are key differences between stand-alone EPLI policies and EPLI coverage purchased as an endorsement to another insurance policy, such as a CGL or D&O policy. For example, stand-alone EPLI policies:

- Often have broader coverage than endorsement policies. For example, endorsement coverage under a D&O policy may cover only directors and officers, leaving the company vulnerable if employment practices claims are based on lower-level employees' conduct (as they often are).
- Often carry the broader duty to defend rather than a duty to pay.
- Have separate policy limits. With endorsement coverage, the policy's aggregate limit may include both EPLI claims and those brought under the underlying CGL or D&O policy. If purchasing endorsement coverage, a company should ensure the aggregate policy limits are sufficient for all anticipated claims. However, separate policies have high deductibles or premiums.

Companies should understand these differences when obtaining EPLI insurance to avoid the unanticipated consequences of purchasing the wrong kind of coverage.

DIFFERENCES BETWEEN CLAIMS-MADE AND OCCURRENCE-BASED POLICIES

There are several kinds of EPLI policies. Companies should be aware of the differences because the kind of EPLI policy affects the scope of coverage it provides. EPLI policies can be:

- Claims-made policies.
- Claims-made-and-reported policies, which are a variation of the claims-made model.
- Occurrence-based policies.

EPLI policies typically are claims-made policies.

Search Insurance Policies and Coverage: Overview for more on claims-made and occurrence-based insurance policies.

Claims-Made Policies

A claims-made policy protects the policyholder against claims made against insured persons during the policy period, or during any extended reporting period, if the insured purchases

Unlike an insurer's duty to pay, an insurer's duty to defend extends to any claim that is potentially covered by the EPLI policy, even if it is meritless or fraudulent.

extended coverage. Under a claims-made policy, depending on the policy language and applicable state law, an insured's failure to promptly notify the insurer of the claim may bar coverage, even if the insurer is not prejudiced by the delay.

A claims-made policy does not cover claims asserted after the policy period expires, even if the conduct giving rise to the claim occurred during the policy period. However, some claims-made policies provide "prior acts" coverage and cover claims arising from conduct that occurred before the policy period, but reported by the individual harmed during the policy period.

Claims-Made-and-Reported Policies

Claims-made-and-reported policies (also called double anchor policies) require both that:

- The claim is made against the insured during the policy period.
- The insured reports the claim to the insurer during the policy period.

For double anchor policies, notification to the insurer of a claim is critical because reporting the claim during the policy period is generally a precondition to coverage. When possible, and absent compelling reasons, companies should try to avoid these policies because they can create coverage gaps if the company cannot report a claim to the insurer that was made during the policy period. Alternatively, if using a double anchor policy, the company should try to negotiate a grace period for reporting claims after the policy period expires.

Occurrence-Based Policies

An occurrence-based policy obligates the insurer to pay for claims arising out of occurrences (as defined in the policy) during the policy period, regardless of when the harmed individual reports the claim against the company or the company reports the claim to the insurer. Although less common than claims-made EPLI policies, policy endorsements to CGL and D&O policies may be written as occurrence-based coverage. Many employment claims, such as sexual harassment, discrimination, or hostile work environment claims, involve conduct occurring over many years. For these claims, occurrence-based coverage may result in lengthy and costly coverage disputes about whether an occurrence took place during the policy period.

DUTY TO DEFEND

When choosing an EPLI policy, employers must decide between policies with a duty to defend and policies with a duty to pay (or duty to indemnify). The duty to defend generally includes the insurer's obligation to:

- Defend the claim or lawsuit.
- Cover all legal fees and costs (up to the policy limit).
- Pay for any covered liability (up to the policy limit).

A duty to defend policy gives the insurer greater control over the defense of the employment claim, including key decisions about:

- Selecting counsel.
- Settlement.
- Trial strategies.

Some companies may benefit from the insurer's increased control over the defense that accompanies the duty to defend. For example, a smaller or less legally sophisticated company may prefer relinquishing control of defending its employment practices claims to an experienced insurer. Conversely, companies that want to maintain their ongoing relationship with outside counsel should ensure that the EPLI policy specifically allows use of the company's selected counsel or that the desired law firm be added to the insurer's list of approved panel counsel.

Duty to Defend Versus Duty to Pay

The duty to defend is broader than the duty to pay. Unlike an insurer's duty to pay, an insurer's duty to defend extends to any claim that is potentially covered by the EPLI policy, even if it is meritless or fraudulent. The duty to defend therefore may exist even where:

- EPLI coverage is in doubt.
- EPLI coverage is ultimately denied.
- No damages are awarded.

In contrast, an insurer's duty to pay provides for the indemnification or advancement of defense costs. The duty to pay does not require the insurer to directly defend any claims potentially covered by the policy, but rather only to reimburse the insured for covered costs and losses. The insured controls the defense of the claim together with the insurer, which typically has the right to approve certain activities, but cannot unreasonably withhold approval.

Duty to Defend Reasonably Related Claims

A major benefit of EPLI coverage is that a duty to defend policy typically requires the insurer to defend covered claims, as well as any reasonably related claim, even if:

- The reasonably related claim is not otherwise covered by the policy.
- Defending the covered claim benefits the reasonably related non-covered claims.

Because discrimination and harassment claims (typically covered by EPLI) are often combined with related claims, such as wage and hour claims (typically not covered by EPLI), a policy with a broad duty to defend may provide employers with greater protection against the substantial costs of defending excluded claims.

KEY DEFINITIONS AND OTHER PROVISIONS

Many EPLI coverage disputes turn on the interpretation of defined terms in the policy. State law controls the interpretation of any vague or undefined terms and may limit or expand coverage.

The terms or definitions that are most important to EPLI policies or most often litigated are discussed below.

DECLARATIONS PAGE

The front page or pages of an EPLI policy contain a declaration of key policy terms. The insurance declarations page simplifies the contract review process by giving the policyholder a basic overview of the EPLI policy on the first page. The declarations page typically lists:

- The primary insured.
- The insured's address.
- The policy limits.
- The policy deductible or self-insured retention amounts.
- The policy period.
- Other named insureds.
- Other key information that varies from insured to insured.

Companies should ensure that the key terms and definitions are consistently represented in each of the declarations page, the policy, and the insurance binder outlining the parties' initial agreement.

INSURED

EPLI coverage issues often involve determining whom the policy insures. EPLI policies typically define the insured broadly to include the company (sometimes also called the organization) and other insured persons. Employers must carefully review these definitions to ensure that the policy covers all relevant actors within the company and any related entities.

The definition of company also directly impacts whether a claim is covered. Coverage disputes often arise regarding related business entities, such as subsidiaries. An employer should not assume that an EPLI policy covers related business entities of the specifically named insured entity. If an employer comprises several entities, such as parent companies or subsidiaries, the EPLI policy should expressly cover all these entities as insureds. This may be done by including them in the definition of company or organization or by adding them as additional named insureds. This is especially important where employees regularly transfer among related business entities.

INSURED PERSONS

Insured persons generally include any current or former employees of the insured company or organization. Unlike D&O policies, which protect only directors and officers, EPLI policies may insure directors and officers of the company, as well as a broader category of workers, such as:

- Full-time, part-time, or seasonal employees.
- Managers or supervisors.

Insured persons may also include:

- Volunteers.
- Third parties.
- Independent contractors working for the named insured.
- Temporary or leased employees working for the named insured.
- Owners and their families (for partnerships and sole proprietorships).

This broader EPLI coverage can be especially valuable to companies where lower-level managers have hiring and firing responsibility or where co-worker disagreements give rise to employment disputes, which commonly occurs.

EMPLOYEE

Some EPLI policies expressly define employee as any person who receives wages or salary from the insured for work that is directed and controlled by the insured. This means that, unless otherwise expressly included, volunteers who do not receive compensation, but who perform services for the company, may be excluded. Independent contractors may similarly be excluded under this definition. Further, a policy that requires that a worker be "acting in his or her capacity" as an employee to be covered under the policy may lead to fact-intensive disputes about whether employees were working within the scope of their employment when they committed the alleged wrongful acts.

When EPLI policies do not expressly define the term employee, courts rely on common law principles (which vary by state) to determine whether an individual is an employee of the insured for coverage purposes. This inquiry generally includes several non-dispositive factors, including who:

- Pays the employee.
- Controls the details of the employee's work.

Independent Contractors

EPLI policies generally exclude independent contractors or are silent on the issue, in which case coverage is not assumed. If a company wants coverage for its independent contractors, it should ensure the policy explicitly lists independent contractors as insured persons. Any definition of independent contractor should clearly delineate who is covered.

If an EPLI policy allows for coverage of independent contractors, it often limits that coverage to:

- Claims brought against independent contractors in their capacity as a contractor.
- Situations in which the insured and the independent contractor have a written agreement confirming the independent contractor relationship.

If independent contractors are not expressly included, coverage disputes may turn on whether the independent contractor is actually an employee who is wrongly classified. For example, if an employee sues the company based on the conduct of an independent contractor, the company on one level wants to distance itself from the independent contractor to avoid liability for that conduct. However, if it has an EPLI policy that does not expressly cover independent contractors as insured persons, it must either forego insurance for that claim or argue that the individual is actually an employee and therefore covered as an insured. Seeking coverage for this claim, however, may create greater potential liability for the employer on the misclassification issue than the underlying lawsuit.

Employers should understand that defining independent contractors as insureds does not generally provide coverage for misclassification claims by independent contractors against the company, and those claims typically are not covered by EPLI policies. Some employers, however, have sought coverage for misclassification claims under a misrepresentation theory (claiming that the employer misrepresented to the individuals their employment status), though not with much success (see, for example, *Admiral Ins. Co. v. Kay Auto. Distribs., Inc.*, 82 F. Supp. 3d 1175, 1182 (C.D. Cal. 2015) (finding fraud claim regarding employee wages and misclassification fell within wage and hour policy exclusion)).

Search Independent Contractor Classification for more on the classification of individuals as independent contractors, including penalties for misclassification.

Leased or Temporary Employees

Leased or temporary employees raise another issue regarding the scope of EPLI coverage. While employers may use leased or temporary employees provided by staffing agencies to avoid payroll hassles and reduce benefit-related expenses and issues, claims against these employees and the company based on their alleged bad acts may not be covered under the company's EPLI policy. When an EPLI policy is silent on the issue, some courts have held that the EPLI policy did not cover the leased worker's actions against the company leasing the worker (see, for example, *Home Ins. Co. v. Liberty Mut. Fire Ins. Co.*, 830 N.E.2d 186, 188-89 (Mass. 2005)).

If a company uses leased or temporary employees and wants EPLI coverage for their actions, it should negotiate with:

- The insurer to include in its own EPLI policy either or both:
  - the staffing or leasing agency with which it works as a named insured; or
  - leased employees as insured persons.
- The staffing or leasing agency to either or both:
  - include the client company as a named insured on the staffing or leasing agency's EPLI policy; or
  - indemnify the client company for actions of the temporary or leased employees.

Search Temporary Employee Staffing Agreement for a model agreement for a private employer to use when engaging a temporary staffing agency to provide the employer with short-term workers, with explanatory notes and drafting tips.

Third-Party Claims

EPLI policies typically cover claims made by current and former employees. They may also be drafted to cover claims brought by third parties, such as leased employees, independent contractors, customers, clients, suppliers, and visitors.

While third-party coverage has increased in recent years, it is still not the norm. When provided, insurers generally restrict the coverage to certain types of harassment or business relationships, such as claims alleging that an employer allowed a customer or vendor to harass an employee. Third-party coverage may be especially important to companies whose employees interact with the public frequently, such as those who work in the hospitality or entertainment industries, at educational facilities, and in other client-facing businesses. Employers also should confirm whether coverage exists for the wrongful acts of third parties when committed against the named insured's employees.

PRIOR ACTS AND RETROACTIVE DATE

Like other claims-made policies, most EPLI policies provide a degree of prior acts coverage for claims based on conduct that predates the policy period. Full prior acts coverage, which is unusual, does not contain a retroactive date and covers claims made during the policy period based on prior acts no matter when they occurred. More often, insurers include a retroactive date, which limits coverage to claims that occur after the retroactive date and are reported by the harmed individual to the company during the policy period.

To avoid coverage gaps, employers should ensure that the retroactive date is not the same date as the effective date of a new policy. For example, if a claim concerning a company with claims-made-and-reported EPLI coverage arises but was not reported to the insurer during the policy period:

- The current claims-made-and-reported policy does not cover the claim because it was not reported during the policy period.
- If the company switches to a claims-made EPLI policy with a retroactive date that is the same as the first day of the policy period, the claim would not be covered by the new policy

either, because it was not made after the retroactive date in the second policy.

Search Insurance Policies and Coverage: Overview for more on prior acts and retroactive dates.

WRONGFUL EMPLOYMENT ACTS

The definition of wrongful employment acts determines what workplace conduct is covered by the EPLI policy. At a minimum, EPLI generally insures against claims of:

- Discrimination alleging that an employment decision was based on age, sex, race, religion, color, national origin, or another protected class.
- Retaliation.
- Unlawful harassment.
- Wrongful termination, including constructive discharge and retaliatory discharge.

EPLI policies may cover discrimination or harassment based on a claimant's membership in:

- Specifically identified protected classes.
- The protected classes in the federal anti-discrimination statutes.
- A catch-all category of protected categories that are not covered under federal anti-discrimination statutes, but are protected under state or local law.

Many insurers provide enhanced coverage for a broader universe of employment-related claims, such as claims for:

- Misrepresentation to an employee or applicant.
- Defamation, including libel and slander.
- Invasion of privacy.
- Negligent training or supervision.
- Wrongful failure to promote, discipline, or deprivation of career opportunity.
- False imprisonment or detention.
- Violation of certain leave laws.

EPLI policies vary greatly. For instance, an increasing number of EPLI policies are beginning to cover various leave claims, such as allegations of retaliation or interference under the Family and Medical Leave Act (FMLA). Ultimately, an employer exploring EPLI should carefully review the types of claims (or wrongful employment acts) covered and excluded by the EPLI policy to ensure it captures the claims that most concern the employer.

CLAIM

The definition of claim in EPLI policies determines what event:

- Triggers coverage.
- Triggers the insured's duty to notify the insurer of the situation.

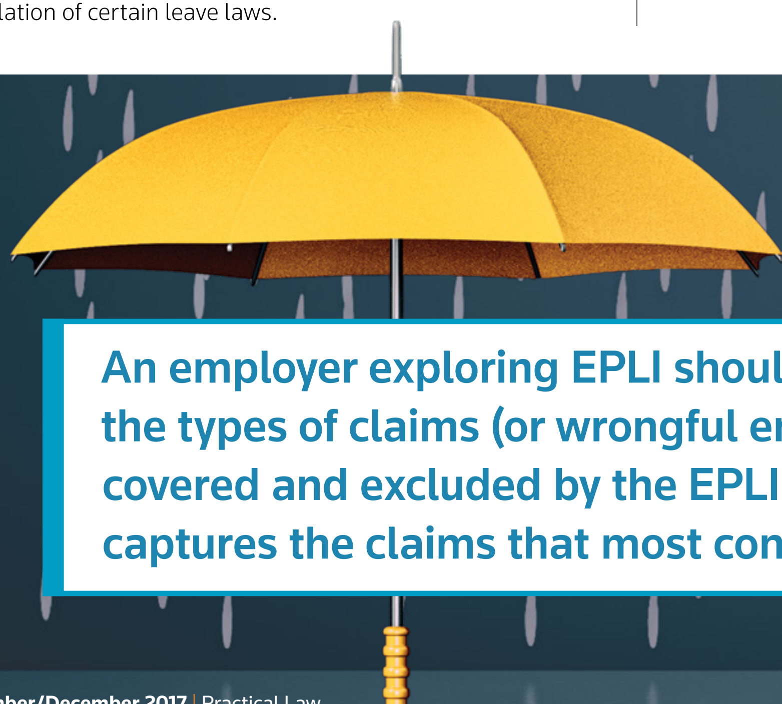
Claim is commonly defined in EPLI policies as a judicial or administrative proceeding, lawsuit, or demand made by or for a current, former, or prospective employee for damages (or other relief) because of an alleged wrongful employment act. Sometimes an EPLI policy limits a claim to a written demand. Some EPLI policies also cover proceedings (including audits) brought by the EEOC or an equivalent administrative agency.

A claim typically contains:

- Facts regarding an alleged wrongful employment act or acts.
- A demand for monetary or other relief (although some policies do not cover claims solely for declaratory or injunctive relief).

Some EPLI policies define claim more specifically, such as further defining when a lawsuit occurs or explicitly listing what proceedings or hearings constitute a claim.

The definition of claim in a claims-made policy is particularly important when determining coverage for discrimination claims brought by the EEOC. For example, if an employee files a charge with the EEOC, and the EEOC brings a claim against the company based on that charge, the claim may be deemed made when the employee files the charge, and not when the EEOC files the subsequent lawsuit (see *Cracker Barrel Old Country Store, Inc. v. Cincinnati Ins. Co.*, 499 F. App'x. 559, 566-67 (6th Cir. 2012)).



An employer exploring EPLI should carefully review the types of claims (or wrongful employment acts) covered and excluded by the EPLI policy to ensure it captures the claims that most concern the employer.

Some courts, however, have found that an EEOC charge and a subsequent lawsuit arising from the same facts are separate claims, with each claim triggering coverage (see, for example, *John Marshall Law Sch. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA,* 223 F. Supp. 3d 733, 736-37 (N.D. Ill. 2016)). This determination depends on the EPLI policy language and applicable state law.

LOSS

Loss is commonly defined as the amount the insured is legally obligated to pay in:

- Damages, including:
  - back pay;
  - front pay; and
  - compensatory damages, including emotional distress damages, but not damages for bodily injury.
- Settlements (if entered into in accordance with the policy).
- Defense costs.

Damages typically do not include:

- Punitive or exemplary damages (though some policies may cover them to the extent allowed by applicable law).
- Liquidated damages (though some policies may cover liquidated damages under the Age Discrimination in Employment Act (ADEA) or the Equal Pay Act (EPA)).
- Fines or penalties.
- Matters deemed uninsurable under applicable law.

COMMON EPLI POLICY EXCLUSIONS

Some types of employment claims are commonly excluded from EPLI coverage. An employer should realize and understand the limits of an EPLI policy's coverage before purchasing it.

Common exclusions include:

- Claims for bodily injury (such as assault and battery) and property damage (commonly covered by a company's CGL policy).
- Wage and hour claims, including claims under the FLSA and related state laws (see, for example, *Payless Shoesource, Inc. v. Travelers Cos., Inc.*, 585 F.3d 1366, 1376 (10th Cir. 2009) (finding that FLSA exclusion barred claims for violations of similar state laws)).
- Workers' compensation claims (covered by a company's workers' compensation policy).
- Unemployment insurance claims.
- Claims for breach of express or implied contract, such as claims regarding:
  - stock options;
  - profit-sharing plan payments;
  - bonus plans or payments; or
  - arbitration awards, where the claims are derived from a contract providing for arbitration (see, for example, *TVN Entm't Corp. v. Gen'l Star Indem. Co.*, 59 F. App'x 211, 212 (9th Cir. 2003)).
- Claims arising from labor relations disputes, such as:
  - unfair labor practices (ULPs) under the National Labor Relations Act (NLRA);
  - violations of the Railway Labor Act (RLA) or other traditional labor laws; or
  - breaches of or conflicting interpretations of rights under collective bargaining agreements with unions.
- Claims under other federal statutes, such as:
  - the Worker Adjustment and Retraining Notification Act (WARN Act) or similar state law (mini-WARN) claims;
  - the Occupational Safety and Health Act (OSH Act);
  - the Employee Retirement Income Security Act of 1974 (ERISA); and
  - the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA).
- Claims arising from fraudulent, dishonest, or criminal activity.
- Claims excluded for public policy reasons.

FLSA AND OTHER WAGE AND HOUR CLAIMS

Most EPLI policies do not cover wage and hour claims, such as claims brought under the FLSA or applicable state law for off-the-clock work, overtime pay, misclassification of employees as exempt or nonexempt, and similar claims. For example, a policy may contain an exclusion for any "loss for any claim for violation of responsibilities, duties, or obligations imposed on an insured under any wage and hour law."

Historically, the rationale for this exclusion was that the employer has the ability to control how and when employees are paid, so an insurer should not bear the risk of intentional misconduct. In practice, insurers are reluctant to cover these claims because they are expensive to defend and carry potential liability in the millions of dollars, especially in class or collective action lawsuits.

Notably, however, in the past few years, some insurers have begun to offer narrowly tailored coverage for select wage and hour claims in stand-alone policies or as endorsement coverage to EPLI policies. Typically, these wage and hour policies cover only defense costs (up to a cap), although some policies for large employers may also cover the costs of settlements or judgments (see, for example, *Admiral Ins. Co.*, 82 F. Supp. 3d at 1179 (EPLI policy excluded coverage for claims involving wage and hour laws, but covered up to $100,000 in defense costs for those claims)).

Absent specific wage and hour coverage (often offered through an endorsement to an EPLI policy), companies have had limited success obtaining coverage for wage-related claims under most EPLI policies. Some litigants have argued that employee misclassification lawsuits should be covered as an employment-related misrepresentation claim (*Prof'l Sec. Consultants, Inc. v. U.S. Fire Ins. Co.*, 2010 WL 4123786, at *3 (C.D. Cal. Sept. 22, 2010) (denying motion to dismiss, court found allegations of employer's misrepresentation about plaintiffs' entitlement to overtime sufficient to trigger duty to defend and establish potential for indemnity coverage despite FLSA exclusion)).

At least one court has held that the failure to reimburse an employee's necessary business expenses as required by statute may be a covered claim despite an EPLI's policy's wage and hour exclusion, therefore triggering the insurer's duty to defend a wage and hour class action (*Hanover Ins. Co. v. Poway Academy of Hair Design, Inc.*, 2016 WL 6698936, at *3-4 (C.D. Cal. Nov. 14, 2016); *Phase II Transp., Inc. v. Carolina Cas. Ins. Co.*, 228 F. Supp. 3d 999, 1003-04 (C.D. Cal. 2017)).

However, other courts have not interpreted EPLI policies with wage and hour exclusions as covering wage and hour claims under any theory (*Gauntlett v. Ill. Union Ins. Co.*, 2012 WL 4051218, at *13 (N.D. Cal. Sept. 13, 2012); *Cal. Dairies Inc. v. RSUI Indem. Co.*, 617 F. Supp. 2d 1023, 1050 (E.D. Cal. 2009) (rejecting misrepresentation argument as a "strained interpretation" of the policy language)).

PUBLIC POLICY EXCLUSIONS

EPLI policies often do not cover various damages items for public policy reasons. For example, EPLI policies do not usually cover:

- Criminal fines.
- Civil fines.
- Penalties or statutory liquidated damages.
- Punitive damages (for which coverage is expressly prohibited under some state laws).

These exclusions are based on the premise that public policy precludes insurers from condoning and encouraging illegal acts by insuring a company for the intentional injuries it causes. It is feared that companies would disregard the law and public safety if they knew they would be covered monetarily for these violations. However, this is not a public policy concern in every state, especially when the damages or penalties arise from an employer's vicarious liability based on the conduct of its employees (see, for example, *Fairfield Ins. Co. v. Stephens Martin Paving, LP*, 246 S.W.3d 653, 670 (Tex. 2008) (Texas public policy did not prohibit EPLI coverage of exemplary damages for gross negligence)).

COUNTERCLAIMS

Most EPLI policies by definition do not cover counterclaims against employees, as they generally only cover claims made against the insured (*Mt. Vernon Fire Ins. Co. v. VisionAid, Inc.*, 91 F. Supp. 3d 66, 71-72 (D. Mass. 2015)). Even the broad duty to defend does not generally cover defense expenses related to an offensive counterclaim (*Int'l Ins. Co. v. Rollprint Pkg. Prods., Inc.*, 728 N.E.2d 680, 693-94 (Ill. App. 2000)). However, some courts have found that counterclaims that were inextricably intertwined with and strategically necessary to the defense were covered by the insurer's duty to defend (*Safeguard Scientifics, Inc. v. Liberty Mut. Ins. Co.*, 766 F. Supp. 324, 333-34 (E.D. Pa. 1991), rev'd on other grounds, 961 F.2d 209 (3d Cir. 1992)).

OTHER EXCLUSIONS

EPLI policies often limit coverage for certain types of relief, damages, or losses for practical reasons. For example, some EPLI policies exclude certain losses or damages, such as those associated with:

- Reinstatement (though front pay is generally covered).
- Providing accommodations under the Americans with Disabilities Act (ADA).
- Injunctive relief.
- Employee benefits, such as stock options and deferred compensation.

Employee benefits may be excluded because they are contractually based and EPLI policies often do not cover claims for breach of contract (though some EPLI policies provide this coverage). Damages, such as the costs of providing an ADA accommodation or reinstating an employee, are often excluded because they are hard or impossible to quantify.

LIMITS ON LIABILITY AND DEFENSE COSTS

EPLI policies typically limit the amount the insurer must pay for claims and defense costs.

PER-CLAIM AND AGGREGATE POLICY LIMITS

EPLI policies have both a per-claim limit and an aggregate payout limit for each policy period. A per-claim limit is the total amount an insurer will pay on a single claim. An aggregate limit is the total maximum amount an insurer will pay for all claims under that policy during the policy period.

Companies should ensure that the per-claim limit is sufficient for the types of claims it expects to face, as well as for catastrophic claims. Companies should also understand how claim is defined in the policy, for example whether an EEOC charge and subsequent lawsuit count as one claim or two.

The aggregate amount also should be sufficient to cover the anticipated frequency and amount of potential claims, especially given the high costs associated with EEOC enforcement actions and other class-based claims. Defense expenses under EPLI policies typically count toward the total liability limit, making early case resolution an attractive option for both companies and insurers.

SELF-INSURED RETENTION AMOUNTS AND DEDUCTIBLES

EPLI policies usually subject companies to a self-insured retention (SIR) amount. The SIR amount is what the insured must pay out of pocket for defense costs during the initial stages of the claim. Once costs reach the SIR amount, the insurer pays the full amount of costs (up to the policy limit).

Other plans require an insured to pay a deductible on a claim rather than an SIR amount. Like the SIR amount, a deductible is an amount that the insured must pay before the insurer pays out on a claim. The key difference is that with deductible plans the insurer pays the total policy limit minus the deductible. With SIR plans, the insurer is obligated to pay the full policy amount after the employer pays the SIR amount.

Plans with a higher SIR amount or deductible usually offer an employer more control over claims and generally have lower premiums. These policies best serve employers seeking to limit insurance protection to catastrophic claims. In contrast, plans with lower SIR amounts or deductibles generally have higher premiums. These policies may be more appealing to companies that anticipate frequent, less catastrophic employment claims and want to limit their out-of-pocket defense costs.

OTHER UNIQUE EPLI POLICY FEATURES

EPLI policies often have other unique features, including:

- Specific claim notification procedures.
- Detailed procedures and controls over attorney selection and work product.
- Strong control over the settlement process.
- Provisions for reviewing and auditing applicant or insured employment processes.

EPLI policies also sometimes contain dispute resolution provisions that detail how to handle disagreements between an insured and an insurer over the scope of coverage or the payment of costs.

Search Employment Practices Liability Insurance (EPLI) Policies and Coverage for more on arbitration or alternative dispute resolution processes for handling coverage disputes.

Administrative charges and government investigations are a frequent source of EPLI coverage disputes. Courts examine EPLI policy language in detail to determine whether a claim existed at the time of the administrative agency's involvement.

NOTICE PROVISIONS

Most EPLI policies specify what conduct triggers coverage and when an insured must notify the insurer of a claim. Often, when an insured must notify the insurer hinges on how claim is defined under the policy.

Claims Trigger Notice Obligations

Policies vary regarding what information triggers the policyholder's duty to notify the insurer of a claim. For example, typical actions that may constitute a claim and therefore trigger the insured's duty to report include:

- A lawsuit filed in state or federal court.
- A written demand for money damages or other relief, including for arbitration.
- An administrative charge filed with a federal, state, or local governmental agency, such as the EEOC or a state-equivalent fair employment practices agency (FEPA).
- An investigation or audit by a governmental agency, especially if the governmental agency indicates that it has identified a problem or is seeking some remedy.

Administrative charges and government investigations are a frequent source of EPLI coverage disputes. Courts examine EPLI policy language in detail to determine whether a claim existed at the time of the administrative agency's involvement. For example, a federal district court in Texas held that an EEOC charge was a claim related to the subsequent lawsuit, and that under the EPLI policy, related claims were treated as a single claim. The employer's notice of the initial EEOC charge, not the subsequent lawsuit, therefore triggered its obligation to notify the insurer. (*Munsch Hardt Kopf & Harr P.C. v. Exec. Risk Specialty Ins. Co.*, 2007 WL 708851, at *3-4 (N.D. Tex. Mar. 8, 2007).)

Similarly, an EEOC class action against an insured commenced when the first charge leading to the EEOC's investigation and lawsuit was filed, not when the EEOC filed its lawsuit (*Cracker Barrel Old Country Store, Inc.*, 499 F. App'x at 566; see also *Certain Underwriters at Lloyds of London v. Scolari's Warehouse Mkts., Inc.*, 2007 WL 7266254 (D. Ct. Nev. Washoe Cty. Feb. 28, 2007)). However, a New Mexico state court held that an EEOC charge was not a claim, because it did not contain a demand for relief as required under the EPLI policy definition of claim (*City of Santa Rosa v. Twin City Fire Ins. Co.*, 143 P.3d 196, 198 (N.M. Ct. App. 2006)).

Not all employee complaints trigger the duty to report the claim to the insurer. Unless the EPLI policy specifies to the contrary, an employer generally has no duty to report:

- Oral or vague demands.
- Generalized complaints by employees, including terminated employees.
- An attorney's letter offering to meet to avoid litigation.
- An unsigned draft complaint (*SNL Fin., LC v. Phila. Indem. Ins. Co.*, 455 F. App'x 363, 368-69 (4th Cir. 2011)).

Confusion can be avoided by directly and clearly addressing this topic in the EPLI policy. If in doubt, employers should generally report to the insurer in writing rather than risk violating the notice provision and losing coverage.

Discovery Clauses

Many EPLI policies now include discovery clauses, which require insureds to notify the insurer when they become aware of circumstances that may give rise to a claim. In an EPLI policy with a discovery clause, employers should err on the side of caution and report any potential claims to their insurers immediately.

Time Frame for Notice

Insurers typically require the insured to notify them of a claim "as soon as practicable." Some EPLI policies require the insured to report within a specific time frame, such as 30, 60, or 90 days after the claim is made (or in some cases, after the expiration of the policy period). For EPLI policies that include a specific time frame for reporting, prompt reporting is essential, as the insurer can deny coverage based on late reporting. Under any policy, employers should report claims quickly, or they may risk costly and protracted litigation over coverage or a loss of coverage altogether.

Method for Notification

EPLI policies dictate how an insured must notify the insurer of the claim. For example, some policies require written notification. Even if a policy allows for oral notification, the company should also notify the insurer in writing to establish proof of notification. Companies also should determine whether EPLI policies allow or require email or another form of electronic or online notification.

Search Notice of Claim: Claims-Made Policy for a model claim notification letter, with explanatory notes and drafting tips.

ATTORNEY SELECTION AND MANAGEMENT PROCESS

Because many EPLI policies carry a duty to defend, insurers must ensure that qualified attorneys handle the matter. Insurers therefore often exercise control over counsel selection, attorneys' fees, and costs. Insurers often structure EPLI policies to maintain control over the attorney selection and management process in several ways.

Panel Counsel

Many insurers, especially larger insurers, have panel counsel. Panel counsel are a group of law firms or attorneys that the insurer has pre-approved to handle EPLI matters for their insureds. The panel counsel model can provide pre-vetted, experienced employment counsel to insured employers with less experience in legal matters.

While some EPLI policies limit an insured to using panel counsel, others allow insureds flexibility in selecting their attorneys. If an employer has a strong preference for using attorneys of its own choosing, that employer should ensure that it purchases a policy with an insurer that:

- Does not limit it to using panel counsel.
- Has approved its preferred law firm as panel counsel.
- Has approved the use of the employer's preferred law firm as an exception to a panel counsel requirement.

If seeking an exception to use non-panel counsel, employers should support their requests by providing to the insurer:

- The name of the preferred attorney or law firm and their contact information.
- The length of time that attorney or law firm has handled the company's legal matters.
- Any other relevant factors showing the value of that attorney or law firm, such as how:
  - using them can save the insurer money; and
  - they are competent to handle the matter in question.

Conflicts of Interest and Independent Counsel

Even with duty to defend policies, if there is an actual conflict of interest between the insurer and insured, the insured may be entitled to independent counsel at the insurer's expense. A conflict may exist, for example, if:

- The complaint (or agency charge) alleges mutually exclusive theories of liability, that is, one that is covered by the EPLI policy and one that is excluded.
- The complaint (or charge) disproportionally seeks a damage type that is not covered by the EPLI policy (such as punitive damages) compared to covered damages (such as compensatory damages).

Whether a conflict of interest exists is determined under applicable state law. (See, for example, *Nat'l Cas. Co. v. Forge Indus. Staffing Inc.*, 567 F.3d 871, 874-76 (7th Cir. 2009).)

Attorneys' Fees and Expense Caps

To maintain control over the defense of EPLI claims and minimize the costs associated with the defense, many insurers place caps on the hourly rates that attorneys can charge while performing work on EPLI-covered matters. Insurers may require these caps regardless of whether the EPLI policy mandates the use of panel counsel.

As a practical matter, these caps limit which attorneys are willing to handle a matter even if the EPLI policy allows the insured to choose its own counsel. This is because caps on hourly fees can be one-third or less of the attorney's typical hourly rate. Sometimes an employer with a strong preference for its regular outside counsel can get the insurer to pay its attorneys' fees up to the capped amount, with the employer agreeing to make up the difference between the covered amount and the attorneys' regular fees.

Pre-Approval Process

To control costs and ensure that the insurer is informed of strategic decisions in the case, EPLI policies often contain detailed requirements for pre-approval for certain legal work or defense costs. Typical expenditures that require pre-approval under EPLI policies are:

- Computerized or extensive legal research.
- Motion practice.
- Certain discovery, such as videotaped depositions.
- Expert expenses.
- Vendor expenses.
- Conversations or meetings among multiple attorneys within the same law firm.

Some EPLI policies also address whether they cover attorneys' travel time and related expenses, and whether they must be pre-approved. Employers must get the necessary approvals required by their EPLI policy or risk forfeiting coverage for unapproved expenses.

Case Assessments and Status Reports

Some EPLI policies require the insured to provide case assessments and periodic status reports. The law firm handling the EPLI claim generally is responsible for preparing them. This information allows the insurer to be involved in strategic decisions, such as whether and when to settle the claim. It also allows the insurer to set aside reasonable monetary reserves at an early juncture for any anticipated adverse judgment or lengthy and costly litigation.

Many EPLI policies require an initial case assessment within 30 to 60 days of receiving the claim. This requires that the attorney promptly investigate the claim, collect and review documents, and interview relevant witnesses to draft the case assessment. The detail required in the case assessment varies based on many factors, including:

- The insurer.
- The claims representative assigned.
- The complexity and potential liability in the case.

Counsel must keep the insurer informed of major developments in the case. The insured should follow up with any law firm that is not doing this.

CONSENT TO SETTLE AND HAMMER CLAUSES

Because many EPLI policies are written on a duty to defend basis, they typically give the insurer a high degree of control over the settlement process.

Insurer's Right to Control Settlement

EPLI policies commonly contain a "consent to settle" provision, which may:

- Give the insurer the right to settle a claim with the insured's consent as long as that consent is not unreasonably withheld.
- Require the insured to get the insurer's consent to settle the claim.

Companies should generally ensure that a proposed EPLI policy requires the insured's consent before the insurer can settle a claim.

The insurer's right to control the settlement process is often disputed. For example, a company may have more at stake than the settlement amount, and have legitimate reasons not to settle, such as:

- Concerns about harm to its image or reputation if it settles a frivolous claim.
- Fear that settlement with one employee may lead to claims by similarly situated employees, or otherwise set a precedent or establish an unwritten policy.

In contrast, an insurer may be more focused on the value and costs of defending the individual claim.

Hammer Clauses

When the insured and insurer disagree about whether or for what amount to settle a claim, an EPLI policy's hammer clause may be determinative. Hammer clauses typically limit the insurer's obligation to pay additional costs the employer incurs after the insurer would have settled, including any combination of:

- Settlement costs.
- Defense costs.
- Judgments.

The rationale for these clauses is that an insurer should not be obligated to defend a claim for an insured that wants to continue litigating unreasonably.

The scope of hammer clauses varies depending on the EPLI policy. Some EPLI policies follow a traditional approach, which allows an insurer to limit its maximum claim payment to the amount it could have settled for at the time the hammer clause is invoked. Others follow a "soft hammer" approach, which allows the insurer and the insured to share the costs incurred after the insurer would have otherwise settled the claim.

Search Employment Practices Liability Insurance (EPLI) Policies and Coverage for the complete, online version of this article, which includes additional information on EPLI.

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