What's taking so long in the other room?

A primer on Employment Practices Liability Insurance (EPLI) for plaintiffs' attorneys, and using coverage to drive settlement

By Jeannette Vaccaro

Today, many employers regard Employment Practices Liability Insurance (EPLI) as a key risk management tool. Although larger corporations are more likely to have EPLI, small and mid-size companies are increasingly purchasing EPLI policies to avoid the devastating toll a large verdict could have on their businesses.

Because of the prevalence of EPLI, it is important that plaintiffs' attorneys understand EPLI, how it's structured, how it impacts the employer and insurance carriers, and how to use policy information to make informed strategy decisions or drive settlement.

The history of EPLI's emergence

While insurance coverage for employment-related liability has existed in some form or another for decades, stand-alone EPLI only emerged in the late 1980s. These policies were largely intended to fill in gaps left by general commercial liability policies, which typically excluded employment practices claims.

As the country moved into the 1990s, several events focused the nation's attention on the liabilities associated with employment practices and drove demand for these policies.

First, the Civil Rights Act of 1991 was enacted. That act permits plaintiffs to recover punitive damages, which dramatically increased the stakes for employers. It also permits jury trials of these cases, replacing conservative judges who commentators have long argued favor employers, with jurors who are themselves employees, and may have had negative work experiences.

Second, the Clarence Thomas confirmation hearings in 1991 made "sexual harassment" a household phrase. Anita Hill's allegations not only shocked the conscience, but also brought awareness and discussions regarding appropriate workplace conduct. Later that same year, the Navy Tailhook scandal broke, once again bringing discussions regarding "sexual harassment" to the front of the nation's collective mind.

More recently, the #MeToo movement has again exposed unacceptable predatory behavior in the workplace. With the fall of powerful people such as Harvey Weinstein and Google's Andy Rubin, victimized workers have been inspired to come forward and pursue their claims. Along with this rise in claims, the market for EPLI policies has grown substantially.

What does EPLI cover?

EPLI policies vary widely in their scope and coverage, as well as in terms and conditions. In general, EPLI insures against claims arising from a wide range of covered employment practices, including unlawful discrimination (i.e., based on protected characteristics such as age, sex, race, religion, etc.), sexual harassment, retaliation, wrongful termination (including constructive discharge), violations of leave laws (e.g., Family Medical Leave Act, California Family Rights Act, etc.), infliction of emotional distress, and some types of contract claims, among others. It covers claims or lawsuits filed against a company by an employee, former employee, or employment candidate regarding their employment relationship, and may also cover claims by seasonal employees and independent contractors.

EPLI provides coverage for the company, its directors, officers, current and former employees. Policies usually cover judgments, settlements, back pay and front pay awards, pre-judgment and post-judgment interest, attorneys' fees and cost, and defense expenses. Most policies also cover claims for emotional distress or mental anguish associated with a covered loss. Because EPLI policies differ in language as to what is included or excluded in terms of coverage for policy holders, it is important that each policy is analyzed for coverage according to the claims in each case.

Exclusions

Regularly excluded from EPLI coverage are claims involving wage and hour laws, unemployment benefits, COBRA, Employee Retirement Income Security Act (ERISA), Worker Adjustment and Retraining Notification (WARN) Act, Occupational Safety and Health Administration (OSHA), breach of contract and claims pursuant to the National Labor Relations Act (NLRA). Notably, although claims involving "wage and hour laws" are generally excluded, the California Supreme Court recently used a narrow interpretation of that clause to hold that claims arising under California Labor Code sections 2800 and 2802, as well as derivative claims under Business and Professions Code section 17200 and PAGA were potentially within the scope of the policy and not excluded from coverage. (See *Cal. Pizza Co., LLC v. Certain Underwriters at Lloyd's, London Subscribing to Policy No. 11EPL-20208* (2019) 40 Cal.App.5th 140.) Some employers choose to purchase EPLI riders providing supplemental coverage for these generally excluded categories.

Punitive damages are not covered by EPLI. California law prohibits insurance companies from covering intentional acts. While discrimination is an intentional act, the exception is usually limited to situations in which the final adjudication establishes intentional conduct. This exception is rarely of consequence because employment cases rarely go to trial. Note, the intentional conduct exception does not exclude sexual harassment claims based on an employee-harasser's wrongdoing

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because any liability the business incurs would be vicarious rather than direct. Also generally excluded are claims for bodily injury and property damage, which are more likely covered by General Liability policies or other forms of insurance.

Other types of insurance involving employment issues include Directors and Officers Insurance (D&O) and Errors and Omissions Insurance (E&O). While EPLI covers employers against claims made by workers who have sued the company for violating their rights, D&O policies provide insurance for negligent acts, omission or misleading statements committed by directors and officers. D&O policies can be structured to reimburse the company when it indemnifies the directors or officers, to specifically cover directors or officers when the company doesn't indemnify them, or to provide entity coverage for claims made specifically against the company. E&O insurance coverage protects those people that give advice, make educated recommendations, design solutions or represent the needs of others. Also known as Professional Liability or Malpractice Insurance, it protects against people when they act in the wrong way (errors) or fail to act when they should have (omissions).

Coverage periods, triggers and insured's duties

Occurrence and claims-made policies

EPLI policies can be written on an "occurrence" or "claims-made" basis. Occurrence policies require the insurer to pay for claims arising out of occurrences during the policy period, regardless of when the claim is brought, and are far less common. Rather, most EPLI policies are written on a claims-made basis, which requires that the insurance company defend against claims made during the policy period, or during an extended reporting period (called a "tail"). Claims-made policies also often provide coverage for acts occurring before the policy period. Such "prior acts coverage" is usually only available if a claims-made policy was in force immediately prior to the current policy.

Triggering the policy

The policy itself determines the circumstances in which the insured must inform the insurer that a claim has been asserted. Policies differ on what triggers coverage. It could be triggered by a demand letter, administrative complaint, or a lawsuit. Oral demands are usually insufficient to trigger coverage because of the uncertainty regarding proof and timing.

Once a claim is asserted, most policies require that employers report the claim as soon as practicable. Regardless, plaintiffs' attorneys should nudge the employer toward reporting by including the following language in the demand letter: "Please submit this letter to your insurance carrier to determine if coverage is available." While most employers want to report claims immediately to avoid denial of coverage for late reporting, many smaller employers may not even know that they have coverage. Others may not want to report a claim to insurance out of fear of losing coverage, choosing to pay out of pocket for defense costs and settlement.

Insured's duties

Standard EPLI policies usually impose upon the insurance company the duty to defend as well as the duty to indemnify, although some policies offer defense-only coverage.

An insurer's duty to indemnify is relatively straightforward. In the context of EPLI policies, this duty requires the insurance company to indemnify the insured for covered damages above and beyond the retention (i.e. deductible).

The duty to defend obligates the insurance company to provide competent counsel and pay costs (including attorneys' fees) for covered claims. This duty includes claims potentially covered and claims that would be covered if the factual allegations were true, even if they later turn out to be groundless, false, or fraudulent. Under California law, where one claim is potentially covered, the carrier must defend the entire case. (*Buss v. Sup. Ct.* (1997) 16 Cal.4th 35.) However, the carrier can reserve its rights to seek later reimbursement of those defense costs incurred in defending the uncovered claims.

Usually, the insurer's duty to defend grants them various rights to control the litigation. In particular, carriers prefer to exercise control over the selection of counsel. This is because representation by unqualified legal counsel may expose them to more liability, as well as excessive attorneys' fees. For that reason, insurers often retain authority to select litigation counsel outright, or permit the insured to choose from a pre-approved list.

Finally, while a carrier's duty to defend attaches whenever there is a potentially covered claim, the duty to indemnify only applies if the claim is actually covered.

Understanding important clauses

Because EPLI policies generally include a duty to indemnify the employer for damages related to covered claims, it is vital that plaintiffs' attorneys understand the policy terms in order to formulate a strategy that maximizes your client's potential coverage and recovery.

What's a "reservation of rights?"

Once a claim is tendered to the insurance company, the insurer will determine coverage and notify the insured. In some cases, particularly when there are covered and excluded claims alleged, an insurer will respond by agreeing to provide a defense under a "reservation of rights."

A "reservation of rights" means there is uncertainty regarding the insured's entitlement to coverage, either for defense or indemnification, or both. By issuing a "reservation of rights" the insurer is agreeing to defend while preserving its right to reevaluate, or even deny coverage at a later date. Note that California's form interrogatories require a defendant to disclose whether there is a reservation of rights. (See Employment Form Interrogatory No. 214.1 (f) and General Form Interrogatory No. 4.1(f).) Make sure you get this information in discovery, as coverage disputes can hinder settlement discussions, particularly when the dispute is over the carrier's duty to indemnify.

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What's a "retention?"

The cost of defense is nearly always subject to a retention, or deductible, regardless of whether the policy is "burning." This means the employer will be required to pay the defense costs, including attorneys' fees, until the retention amount is satisfied. Generally, the policy limits are not available until the retention/deductible is met. Larger companies are generally subject to larger retentions because they are exposed to greater risk. Additionally, retention amounts generally increase in proportion to the number of claims. Most policies have a minimum retention so that insurers do not have to defend against minimal or nuisance claims. Although retention amounts vary widely, they are usually between $10,000 and $50,000 for small employers, $50,000 and $100,00 for medium-sized business, and upwards for larger employers. That said, some smaller employers opt for a larger deductible to save on monthly premiums, essentially making their EPLI akin to a catastrophic coverage policy.

What's a "burning" policy?

Probably the most important structural aspect of EPLI policies is whether the defense costs are part of the liability limit – most are. In so called "burning limit" policies (also known as eroding, wasting, defense-within-limits, self-consuming, or exhausting policies), the cost of the defense reduces the total liability limit and therefore eats into the funds available to satisfy any future settlement or judgment.

Understanding the implications of "burning limit" policies

"Burning" policies present important strategy considerations for plaintiffs' attorneys, so recognizing a burning limit policy early is crucial. One strategy is to burn through the defendant's retention as quickly as possible so the plaintiff will have access to a larger pool of settlement funds to be paid by the insurer. Alternatively, because defense costs cut into the total policy limit, another strategy is to limit expenses to the extent possible so that money can be allocated towards a settlement. This determination is largely a result of weighing the expected case value against the total policy limit and retention amounts.

Determining whether a policy is "burning" is not always easy, however, and requires a careful analysis of the policy. Sometimes, defense costs are included as a covered "loss," other times, there are stand-alone provisions addressing the issue. Here are two policy provisions that have been held to make defense costs part of the total liability limit:

- "Damages, judgments, settlements and costs, charges and expenses incurred in the defense of actions, suits or proceedings and appeals therefrom" (See *Continental Insurance Co. v. Sup. Ct.* (1995) 37 Cal.App.4th 69.); and
- "When payment not exceeding the Limit of Liability has to be made to dispose of a claim, costs, charges, expenses and settlements shall be payable up to the Limit of Liability." (*Helfand v. National Union Fire Ins. Co. of Pittsburgh P.A.* (1993) 10 Cal.App.4th 896.)

It is important to understand that a "burning limit" policy places pressure on the insurer, insured, and defense counsel and creates a potential conflict of interest between the three, especially with regard to strategy and settlement. This is because once the policy limits are exhausted, either by resolving claims or by defending the claim, an insurer's obligation to provide a defense, as well as indemnity, may terminate. If the claim exceeds the policy limits left after defense costs and fees are paid, the insured will have to cover the remainder.

Because burning policies directly eat into the funds available to settle a claim, it is important to estimate what remains on the policy (based on the activity in the case and the typically lower-than-market hourly rates for insurance defense counsel) during settlement negotiations and throughout the litigation.

Defense issues

The existence of EPLI can contribute to a variety of issues on the defense side. Instead of one client, defense counsel has two, forming a tripartite relationship. The defense clients may not always agree, particularly regarding strategy and settlement. These issues are oftentimes compounded when the litigation includes both covered and non-covered claims.

While all three parties (insurer, insured, and defense counsel) have the same basic goal to defend the claim, the insurer and insured often view the litigation differently. There is often a tension between the insurer's desire to settle quickly and cost effectively, and the insured's desire to fight employment-related claims, which are often emotional.

For example, an employer seeking to protect its reputation may desire the vindication of a trial, while the insurer may prefer settling within policy limits to avoid additional defense costs. Conversely, the insured may want to settle a claim quickly to avoid embarrassment and publicity, even though the insurer would prefer to litigate vigorously to obtain a more favorable settlement offer. Some employers may also resist settlement because they don't want to set a precedent of settling claims, concerned that this will open the floodgates to other claims. Other employers, typically larger ones, see settlement as a cost of doing business and may even have a budget allocated for litigation expenses and settlements.

In general, insurers utilize a risk management approach and want to settle matters for less than the expected defense costs or for a reasonable amount considering the potential damages and uncertainty of litigating claims. However, an insurer's refusal to settle within policy limits may create grounds for a bad faith claim by the insured.

Most EPLI policies require that the insured consent to settle any claim and requires that consent not be "unreasonably withheld." However, plaintiffs' counsel should remember that the employer, as a party, can always reject a settlement, even if doing so breaches the EPLI policy. In situations where an insurer and the insured disagree over settlement, a "hammer clause" often comes into play. These clauses are intended to protect the

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carrier against a "litigate at any costs" insured.

A "hammer clause" allows the insured to object to the settlement but requires the insured to bear the cost of that mistake. If the ultimate liability is higher than the contemplated settlement, then a "hammer clause" will allow the carrier to limit its claim payment to no more than the amount it could have settled for, plus defense costs. Some "hammer clauses" are less severe, and only require the insured to pay a portion of the defense costs or indemnity beyond the rejected settlement amount. In practice, carriers use good business judgement in their relationships with their employer-clients. If the insured has a good reason to continue the defense, carriers will not enforce their hammer clause. Similarly, insurers are more likely to negotiate with the insured to reach consensus rather than enforce the hammer clause.

Using EPLI info to push your case toward resolution

Assess coverage early – it doesn't hurt to ask

Because EPLI coverage varies widely from policy to policy, it is vitally important for both defense and plaintiffs' counsel to know the limits and contours of coverage before discussing settlement. For this reason, it is essential that plaintiffs' attorneys take into account potential EPLI coverage from the beginning of any potential representation, and throughout the litigation.

It is also important to try and get the policy information as soon as possible. While defense counsel has no pre-litigation obligation to provide insurance policy information, defense counsel is often willing to reveal the existence of an EPLI policy pre-litigation, although not the specific terms. Bottom line: It doesn't hurt to ask and doing so may open the door to further early settlement discussions.

Draft the complaint to maximize the potential for coverage

In drafting the complaint, plaintiffs' attorneys will want to maximize the possibility that EPLI will provide coverage for a claim or award. Because some facts lend themselves to covered and uncovered claims, plaintiffs' attorneys should carefully draft the complaint to stay within coverage.

Another consideration is whether a covered claim would drive the litigation into federal court. If that's the case, it is imperative that you and your client discuss the pros and cons of including or excluding the claim. In addition to a discussion, it is highly recommended that you obtain written authority from your client regarding how to proceed.

Of course, drafting is easy when the stronger claims are clearly covered. But drafting becomes more complex when the covered claim is weaker. It is important to allege sufficient facts to withstand demurrer of the covered claims. Remember, it's in everyone's best interest to have insurance involved – defense counsel is paid, and the client's settlement/judgment is funded, which means you get paid.

Use discovery to obtain insurance information

After litigation commences, both state and federal court rules require disclosure of insurance information. In federal court, insurance information is required as part of an employer-defendant's initial disclosures. (FRCP(a)(1)(A)(iv).) In state court, insurance information is discoverable pursuant to California Code of Civil Procedure section 2017.210, which permits discovery of the "existence and contents of any agreement under which any insurance carrier may be liable to satisfy in whole or in part a judgment that may be entered in the action or to indemnify or reimburse for payments made to satisfy the judgment. This discovery may include the identity of the carrier and the nature and limits of the coverage. A party may also obtain discovery as to whether that insurance carrier is disputing the agreement's coverage of the claim involved in the action, but not as to the nature and substance of that dispute." In other words, the defense needs to disclose whether there is a reservation of rights.

Case law has held that defendants' insurance information is discoverable on the ground that insurance policies are directly relevant because they may assist in resolution of the case. (See *Laddon v. Superior Ct.* (1959) 167 Cal.App.2d 391, 395-396 ["plaintiffs' 'discoverable interest' in defendants' liability insurance arises with the 'very pendency' of the action against the assured. The conclusion is inescapable that ... the insurance policy is relevant to the subject-matter...."].) Moreover, defense costs and fees to date are justifiably discoverable as relevant to resolution, as well as under section 2017.210 since those costs and fees impact the "nature and limits of the coverage."

Analyze the policy to determine strategy

Knowing the policy terms will help to devise a litigation strategy that stays within coverage and better understand the employer's litigation strategy. Once the EPLI policy is received, analyze it thoroughly and take these factors into consideration:

- **Is there both a duty to defend and a duty to indemnify?** If it is a defense-only policy, then you'll want to analyze the employer's financial resources and/or whether they are likely to become judgment proof.
- **What is the policy limit?** If there is a low policy limit, then you'll want to determine whether the employer has other assets which could be used to satisfy a judgment.
- **Is it a "burning limit" policy?** During negotiations, it is helpful to know how much of a "burning limit" policy has been expended by defense costs and fees.
- **What triggers the policy?** This is important to know in the context of "burning limit" policies because it will help you analyze how much defense costs and fees have been expended in the pursuit of the matter at any point in the litigation. This information helps determine how much of total liability has been expended, whether the employer is still paying its retention, or if the matter is being fully funded by the insurer.
- **Is there a hammer clause?** Because hammer clauses are the insurer's way of

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forcing a settlement, the absence of one could signal the case is heading for trial. This is especially true when you have an emotionally invested employer.

Asking these questions from the start of the litigation will help you better understand the relationship between the carrier and the insured, and the rights and responsibilities of each. This, in turn, will assist in devising and revising the litigation strategy. In the case of particularly convoluted policy language, consulting with coverage counsel may be a prudent decision early in the case to ensure you understand the policy and limits at play.

Mediation tips for cases involving EPLI

Successfully mediating cases involving EPLI requires that plaintiffs' attorneys consider the parties involved and their relationship to one another. It also requires working with the mediator to ensure success, even before the mediation date.

Make sure the right people are attending the mediation

That means someone with sufficient authority to resolve the case in the range the parties expect. Well in advance of the mediation session, perhaps even before agreeing to mediate, you should request an agreement that the adjuster will attend the mediation. If the adjuster is in a different state, you may alternatively agree that the adjuster be on the phone at all times when the mediator is in the defense room. Also make sure that different time zones have been accounted for in setting the hours of mediation and the availability of the insurance representative after business hours.

Submit your brief well in advance of the mediation session

Ask defense counsel or the mediator to find out how far in advance the carrier needs the brief in order to properly evaluate the case and obtain appropriate settlement authority. Likewise, share information affecting the value of the case in your mediation brief. Don't produce "surprise" information at the mediation session. It will just upset the carrier and delay the process as they will not have time to vet the information or obtain additional settlement authority.

Write the brief for the audience

Present the facts in a straightforward manner. Don't embellish or exaggerate. Support factual statements with reference to the evidence and include relevant documents as exhibits. Clearly apply the facts and evidence to the elements of each claim. Write the mediation brief as if you were responding to summary judgment and make it clear to the adjuster and employer that the case will survive any such challenge. Damages should be laid out as clearly and precisely as possible. Defense counsel cannot get money from an adjuster without this information.

Make the most of the mediation session

Opt for a joint session if the plaintiff presents well; it may be the only opportunity for the adjuster to meet the plaintiff in person. It also allows the plaintiff's attorney to address the adjuster directly without being filtered by defense counsel. That said, make sure you speak to the personalities in the room. While adjusters live and breathe these cases, mediations can be quite upsetting for employers, especially when the decision-maker is the person accused of wrongful conduct. It is important to emphasize going into a mediation that there is a sincere desire to resolve the case quickly and fairly. Finally, keep in mind that adjusters listen to the employer more than plaintiffs' attorneys think and that many employers play a primary role in the mediation negotiations.

Conclusion

EPLI policies are increasing in popularity in one form or another, so it's important for plaintiffs' attorneys to understand the ins and outs of these policies. Because the relationship between the employer and insurance company affects both strategy and settlement, prudent attorneys will press for insurance information early, and analyze the policies to determine the key terms of that relationship. Finally, understanding EPLI policies helps plaintiffs' attorneys become better advocates during the litigation and during settlement negotiations by shedding light on what's motivating the other side.

What's taking so long in the other room? Now you know.

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