

Insurance Coverage

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Employment Practices Liability Insurance for Employment Class Actions: Are You Buying the Coverage You Need?

The explosion in the number of employment actions filed in federal courts and in the size of the jury awards has been well publicized over the past several years. Beyond the dramatic statistics, the media have reported on the host of major corporations in virtually every industry — media, beverage, energy, insurance, restaurant, retail, grocery, and automobile, to name just a few — which have been the targets of employment class actions, typically alleging gender, race, or age discrimination. The amounts of the publicly announced settlements and verdicts is astounding, with one settlement reaching \$508 million, several settlements ranging between \$100 to \$200 million, and many more settlements and verdicts in the tens of millions.

Given the relative ease with which an employment discrimination class action can be alleged, it may be that employment class action litigation alleging systemic age, gender, or racial discrimination is in its infancy. The gravamen of many of the employment class action complaints filed consists of little more than this recipe: (a) the recitation of selected statistics regarding disparities between members of a protected class and others in the corporation with respect to (i) compensation, (ii) hiring, (iii) promotions, (iv) job assignments, or (v) termination; (b) allegations that the corporate policies and procedures utilized to make these personnel decisions are “excessively subjective,” “arbitrary,” “secret,” “inconsistently applied,” or “easily

manipulated”; and (c) broad allegations that the statistical disparities cannot be accounted for except as the result of the discriminatory formulation or application of the challenged corporate policies and procedures. Because most major corporate policyholders today are potential targets of such actions, and because this legal theory represents huge exposures to such entities, corporate policyholders have sought to manage their risk of employment class actions through the purchase of Employment Practices Liability (“EPL”) insurance or other lines of liability insurance.¹

Corporate policyholders who are considering purchasing (or renewing) EPL coverage face an often bewildering array of choices. Although the Insurance Service Office has promulgated a standard-form EPL policy, many insurers do not use it. Each insurer typically uses its own policy form. Moreover, although the current insurance market is “hard” (*i.e.*, a sellers’ market), insurers, if pressed, may be willing to negotiate the terms and conditions of EPL coverage. In any event, the scope of available EPL coverage may vary significantly from one insurer to the next. Because employment class actions may represent enormous exposures — the size of the class can be in the tens or hundreds of thousands, with defense costs proportionally large — and because insurers have argued that common EPL policy provisions bar

¹ For an analysis of coverage for employment claims under Commercial General Liability, Employer’s Liability, and Errors and Omissions policies, see James E. Scheuermann, Liability Insurance Coverage for Employment-Related Claims, 11B *The Law of Liability Insurance* (R. H. Long, ed., Matthew Bender 1995); James E. Scheuermann, Employer’s Liability and Errors and Omissions Insurance Coverage for Employment-Related Claims, 18 W. New Eng. L. Rev. 71 (1966). See also, James E. Scheuermann, Employment Practices Liability Insurance: Navigating the Hazards When Exploring the Market, 29 *The Brief* 64 (Fall 1999). Copies are available on request.

coverage for such class actions, prudent risk management may involve careful analysis of the corporation's EPL coverage for potential employment class actions.

A few potential issues that might be implicated by policy wording are discussed below.

WHAT IS A CLAIM AND WHEN IS IT MADE?

EPL policies are written either on a claims-made basis — that is, a claim first made against the policyholder during the policy period (or extended reporting period) triggers the carrier's coverage obligations — or claims-made-and-reported basis — that is, a claim first made and reported to the insurer during the policy period (or extended reporting period) triggers coverage. There is now a substantial body of case law, arising both under EPL policies and other types of claims-made or claims-made-and-reported policies, which attests to the potential for disputes both as to what constitutes a claim and when a claim is made. These issues assume heightened significance under EPL policies when the underlying claims are asserted in an employment class action.

Many EPL policies define "Claim" to include EEOC charges and similar state administrative proceedings. EPL insurers have argued that if even just a single putative class member filed an EEOC (or equivalent state) charge or an individual civil action prior to the effective date of the policy's coverage, then there is no coverage for the entire class action.

In a pending EPL coverage action filed by National Union Fire Insurance Company of Pittsburgh, PA ("National Union") against its policyholder, a major retailer, National Union seeks a declaration of noncoverage on the grounds that because at least one (and maybe more) of the 700,000 putative class members filed a charge with the EEOC prior to the "Continuity Date" (which is defined to be one year prior to the inception of the EPL policy), the entire underlying class complaint falls within an exclusion for claims "alleging, arising out of, based upon or attributable to any pending or prior" known EEOC proceedings. Because the statutes at issue in employment class actions typically require that the named plaintiffs have exhausted their administrative remedies through the EEOC (or equivalent state agencies), and because one or more of these administrative proceedings often will have begun prior to the policy period (or "continuity" or retroactive date), if National Union's argument is

accepted by the court, and applied as proposed by National Union, it may defeat coverage entirely for the underlying class action. Without having written an employment class action exclusion into its EPL policies, the insurer thus effectively may have defeated its policyholders' reasonable expectations of coverage for one of their most significant exposures.

Insurers have not yet tested in court whether they can mount the same type of argument and pray for the same declaration of "no coverage" through reliance on other common policy terms regarding what constitutes a claim and when it is made. Although EPL coverage is broad and expressly designed to provide coverage for a broad range of employment practices claims — however procedurally packaged — undoubtedly the day will come when those arguments will be heard in a court. Such arguments may implicate grants of coverage, exclusions, and policy conditions such as the notice provision. As to the notice issue, it is significant that under claims-made policies many courts have adopted a "no prejudice" notice standard, even in jurisdictions which have adopted a prejudice standard with respect to late notice under occurrence-based policies. *See, e.g., Hornsey Architects, Inc. v. Harry David Zutz Ins., Inc.*, 2000 Del. Super. LEXIS 240, at *36-42 (Del. Super. May 25, 2000). While this deviation from the prejudice standard is not universal, *see, e.g., Utica Mut. Ins. Co. v. Hickman*, 2000 U.S. Dist. LEXIS 15779, at *13-14 (N.D. Tex. Oct. 24, 2000) (applying Maryland law), it may be an obstacle to coverage under EPL policies in some jurisdictions for employment class actions.

FALLING INTO THE GAP

The often-broad definition of "Claim" in EPL policies and the "batch" clause (which provides that all Claims which are "related," "causally connected," "arise out of," or "result from" the same or related facts, circumstances, transactions, or events constitute a single "Claim" under the policy) may create the opportunity for an insurer to argue that an unintended gap in coverage exists. Suppose that during EPL policy period 1, an employee files an EEOC charge against the corporate policyholder. The policyholder does not report the claim to the carrier for whatever reason (*e.g.*, the Risk Manager believes it lacks merit or will never exceed the deductible amount). The EEOC charge ripens into a class action in the following policy period, period 2. The policyholder gives notice of the class action to its EPL carrier, which we assume issued both EPL policies. The insurer may argue that the claim is

not covered under the earlier policy because it was not reported during policy period 1 (or extended reporting period), and is not covered under the later policy because the claim was first made during policy period 1 and the later policy (like EPL policies generally) covers only claims first made during policy period 2. Asserting just this argument, one insurer prevailed on its motion for summary judgment under its EPL policy. *See Pantropic Power Prods., Inc. v. Fireman's Fund Ins. Co.*, 141 F. Supp. 2d 1366 (S.D. Fla. 2001), *aff'd without opinion*, ___ F.3d ___ (11th Cir. Mar. 29, 2002) (TABLE, No. 01-15110).

This purported gap in coverage can emerge whether the EPL policies are issued by the same insurer or are issued by different insurers. While two insurers each may have an incentive to point the finger at the other in denying coverage under this scenario, a single carrier on the risk under both policies may be at least equally motivated to take advantage of this purported gap.

Conversely, a perceived gap may appear by way of a not uncommon exclusion for losses arising out of any "Claim, fact, circumstance, situation, transaction, or event" of which the insured gave notice under any prior insurance policy or which was identified in the policy application. Suppose the policyholder reported such a "fact, circumstance, situation . . ." that may give rise to a loss or claim under the prior policy, but the "fact, circumstance, situation . . ." did not ripen into a Claim until after the prior policy period (or extended reporting period). The policyholder then reports the Claim under both the prior and current policies. The carrier that issued the earlier policy may deny coverage because the Claim was not first made during its policy period (or extended reporting period). The current carrier may deny coverage on the basis of the "Claim, fact, circumstances . . ." exclusion. If the Claim reported is an employment class action, the denial, if not later reversed, may be potentially devastating.

Because claims encompassed in an employment class action may in fact or as a consequence of policy language arise out of or be connected to other claims asserted in earlier policy periods, and because reported "facts, circumstances, and situations" giving rise to a Claim or loss may span several policy periods, obtaining coverage for employment class actions may require attention to these possible defenses. While there are good responses to insurers' potential arguments on these points, policyholders should be aware that some insurers may attempt to decline coverage based on such purported gaps.

DEFENSE AND SETTLEMENT ISSUES

Reimbursement of Defense Costs

Many EPL policies do not obligate the carrier to assume the defense of claims. Often the insured has the duty to defend claims and the right to select defense counsel. The insurer's only defense-related obligation may be to reimburse defense costs for a claim "prior to its final disposition." Because cash flow is virtually always an issue for corporate policyholders, and because the cost of defense of employment class actions can be enormous, in most cases the policyholder would be better off with language that requires the insurer to reimburse defense costs "as incurred by the insured," or "monthly," or "quarterly."

The insurer's ability to withhold reimbursement for defense costs until a check is cut to the underlying claimants can also change the dynamics of any coverage dispute. The policyholder typically would be better off when the insurer has reimbursed defense costs and is trying to get the money back because final judgment in the underlying class action suggests coverage issues, rather than having to negotiate or litigate against the insurer for both defense and indemnity outlays.

The "Hammer" Clause

Many EPL policies contain what is known as a "hammer" clause. Such clauses vary but many provide that if there is a settlement opportunity and the "insured refuses" to settle, then the insurer will not be liable for any subsequent settlement or verdict in excess of the refused settlement (or, in some versions, that it will only have to pay some percentage of what it would otherwise owe in excess of the settlement opportunity). Some insurers may attempt to apply and enforce such clauses in particularly onerous situations, such as when the policy has a large self-insurance feature and the insurer insists on the insured's acceptance of a settlement within the deductible or self-insured retention, even though the insured believes the case is defensible.

If the insurer insists on a "hammer" clause that gives rise to a discount for an insurer when an insured passes on a settlement, one negotiating point that may minimize disputes over the application and meaning of the clause may be to specify that the "hammer" clause does not apply to defense costs. That is, the insurer's discount, when appropriate, would only apply to later settlement or judgments in excess of the initial settlement opportunity. Arguably this balances the

insurer's need to make sure there is some penalty to the insured for "unreasonably" passing on settlement opportunities that cap an insurer's liability and the insured's expectation that defense costs will be covered as long as it is acting reasonably or on advice of counsel.

Some EPL policies purport to include a reciprocal "hammer" clause that addresses the consequences of an insurer's passing on a settlement opportunity. That provision may in fact do nothing but say that the insurer will be liable for loss amounts up to the limits of the policy and not impose a penalty for the insurer, such as liability in excess of otherwise applicable limits. This lack of penalty for the insurer in passing on settlement opportunities that might expose (foolishly or unreasonably) the insured to liability in excess of limits can be used in negotiating the point mentioned above regarding defense costs.

WHO IS AN "EMPLOYEE"?

A relatively new development in the EPL market is the express expansion of coverage to include claims asserted by nonemployee third parties. Many EPL policies now provide coverage for claims brought by nonemployee third parties who allege discrimination, harassment, or violation of civil rights (if occurring in relation to discrimination or sexual harassment). Class actions alleging discriminatory purchasing practices, for example, may be within the coverage of an EPL policy.

RETENTIONS AND LIMITS

Many EPL policies have deductibles or self-insured retentions ("SIRs") applicable "to each Claim." Does a class action complaint constitute one claim or as many claims as there are members of the putative class? For purposes of calculating applicable deductibles or SIRs, policyholders may argue for fewer rather than more claims, while insurers often take the opposite tact. The policy's definition of "Claim" (including the presence of a "batch" clause) and the nature of the allegations of the complaint may be critical. If the policy's per Claim limits are significantly less than the aggregate limits and if a class action complaint is treated as one Claim, the policyholder may find its insurer contending that the

policyholder's accessible coverage is far less than its nominal policy limits and, perhaps, far less than its exposure for the class action.



The willingness of insurers to negotiate the terms of EPL coverage, the variety of EPL forms, and the aggressiveness of the plaintiffs' employment bar in filing and litigating employment class actions all suggest that corporate policyholders may find it beneficial to review the terms of their EPL policies to understand better their available EPL coverage for employment class actions and nonemployee third-party class actions.

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