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The Growing Significance of Employment Practices Liability Insurance

By James B. Dolan Jr.

Employment practices liability (EPL) insurance is a form of coverage specially written to insure employers against liability for claims of discrimination, sexual harassment, and wrongful termination by their employees. Because of their dual role as counsel for others and employers in their own right, lawyers should be familiar with the specifics of this coverage. Employees' counsel should be alert to inquiring about the existence of EPL coverage because it may facilitate settlement of claims and collection of favorable judgments. Insurance defense counsel may be retained to defend for EPL carriers. All counsel for employers should carefully explore whether their clients have EPL coverage or might have a right to defense or indemnity under other common policy forms. Coverage counsel may represent insurers, employers, or claimants in EPL coverage litigation. Finally, because lawyers often are employers themselves, they may be involved in decisions about purchasing EPL coverage for their law firms.

Anatomy of an EPL policy. EPL is commonly written either on a stand-alone basis or as a rider for all of the common employer's policies, including directors and officers, employers liability, and comprehensive general liability. In general, these policies offer broad coverage of the sorts of claims now usual in wrongful termination or employment discrimination cases. The policy is written on a claims-made basis with defense costs within its limits. Coverage is triggered by a lawsuit, an administrative proceeding, or a written claim of discrimination, sexual harassment, or wrongful termination. There are often exclusions for punitive damages, contract claims, company downsizing or plant closures, and intentional acts.

Likely EPL coverage issues. Given the growth of EPL coverage in recent years, the paucity of reported decisions is surprising. In spite of this continued lack of guidance from the courts, interpreting these forms should not pose a formidable task for experienced coverage counsel. Because similar language has long been used for various types of errors and omissions insurance, EPL coverage case law will almost certainly follow the general lines of interpretation already laid down for these similar forms.

One EPL coverage problem that may arise concerns the insurability

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of intentional acts. Ordinarily, discrimination is an intentional act. In general, liability insurance does not apply to what is expected or intended from the point of view of the insured. However, there is widespread agreement that, if the named insured is held vicariously liable for an employee's wrongful acts, coverage exists for the named insured but not for the wrongdoing employee. An employee claim against a corporate employer usually succeeds because the corporation is held strictly liable for discrimination by a supervisor or is found liable for negligent failure to prevent harassment. Hence the intentional acts problem is unlikely to prevent coverage for the typical business that purchases an EPL policy.

EPL coverage is written on a claims-made basis. A much more significant coverage problem is likely to be encountered in seeking the answer to the question, what is a claim? Most of us would say that a claim is a written, or perhaps even oral, demand for money damages. However, to the extent that a reader thinks that only this type of claim can trigger coverage under a typical EPL policy, he or she would be sadly mistaken. Most policies, either in their definition of a claim or elsewhere, treat circumstances that make the insured aware of a possible future claim as if they were claims made during the policy period. This is true even if the eventual claim is not made until after the claims-made policy has expired. This approach to the definition of a claim is highly consistent with the basic nature of insurance.

The problem of the insured's awareness of a potential claim can affect EPL coverage in at least three ways:

- responses by the insured to a question in the application about awareness of circumstances that could reasonably be expected to result in a claim;
- the effect of the awareness exclusion on claims made during a policy period when they are based on events prior to the policy period; and
- policy language providing that notice to the insurer of a circumstance that makes the insured aware of a possible future claim will trigger coverage.

If the insured's application fails to disclose its awareness of a circumstance that could reasonably be expected to result in a future claim, the insurer may have a very good chance of canceling the resulting policy for fraud in the application. Of course, the insurer always has the burden of proof as to the insured's awareness. Because awareness is a state of mind, one might think that an insurer seeking cancellation would have the unenviable task of proving awareness to the satisfaction of a jury because summary judgments tend to be disfavored where state of mind is the issue. However, where strong documentary evidence exists about what the prospective insured knew about the circumstance, insurers have succeeded with summary judgment motions.

The awareness exclusion is another aspect of the same problem. It would preclude coverage even if the application did not contain questions about probable claims. As in the case of showing fraud in an application, the burden of proof is on the insurer. Some EPL policy forms prevent coverage for probable claims in their general insuring language rather than in an exclusion. In that event, the burden may be on the insured to show lack of awareness.

This leaves the insured in something of a quandary. What if it becomes aware of a probable claim but no actual claim is made—that is, in the usual sense of a written demand for money damages—before the end of the policy period? Because there is no actual claim, there is no coverage under the policy in effect when the insured becomes aware of the circumstance. When the claim is eventually made, there is no coverage under the policy in effect during a subsequent policy period because of the awareness exclusion. Policy language deals with this by allowing the insured to trigger coverage under the current policy by giving notice to the insurer when it becomes aware of the circumstance that might lead to a subsequent claim.

Meticulous care in disclosure and notice of possible claims is required to preserve coverage under claims-made policies in general and EPL policies in particular. Failure to notify the current EPL carrier of a circumstance may mean that there is no coverage if the actual claim is made during a subsequent policy period. Regrettably, most first-time purchasers of an EPL policy are unaware of this potential trap. The awareness problem is therefore a fertile source of coverage litigation.

Desirable features of an EPL policy. The best advice for anyone interested in purchasing EPL coverage is to locate a competent agent or broker who is knowledgeable about the product. The large number of insurers who sell the coverage and the wide variety of formats in which it is available make this an area where highly specialized knowledge of the market is essential. Important provisions to examine carefully are the general insuring language (which should cover EPL claims in the broadest possible manner) and the exclusions.

All other things being equal, a stand-alone policy is preferable to having the coverage endorsed on another policy because of possible exhaustion of EPL limits by claims made under the other coverage.

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