

Employment Practices Liability Insurance and Insurance Coverage for Employee Dishonesty

Michael Conley, Esq.
(267) 216-2707
mconley@andersonkill.com

Employment Practices Liability Insurance

Who Is Exposed To Employment Practices Liability?

- Companies of all sizes and types may be exposed to costly employment practices-related litigation
 - Sizes
 - Large, multi-national corporations
 - Mid-size corporations
 - Small businesses
 - Types and Environments
 - White collar
 - Blue Collar

What Is The Exposure?

- Employment practices-related claims can take many forms:
 - Race Discrimination
 - Age Discrimination
 - Gender Discrimination
 - National Origin Discrimination
 - Sexual Harassment
 - Wrongful Termination
 - Retaliation

What Is It Going To Cost Me?: Jury Awards

- Employment practices-related litigation can be extremely expensive
 - Median compensatory jury award in employment lawsuits:
 - 1997 - \$133,691
 - 2003 - \$250,000
 - Awards of \$1 million and more:
 - 1997 – 7% of jury awards
 - 2003 – 18% of jury awards*

* M. Leone, Buying Bias Coverage: Risk Doesn't Discriminate, CFO.com, March 31, 2005

What Is It Going To Cost Me?: Defense Costs

- Examples of Defense Costs:
 - Dental office employee alleged race discrimination in failure to promote case
 - 4 years of litigation yielded:
 - Settlement amount = \$75,000
 - Defense costs = \$272,000
 - Community bank employee alleged age discrimination in failure to promote case
 - Litigation yielded:
 - Settlement amount = \$45,000
 - Defense costs = \$75,000

Sources Of Coverage For Employment Claims

- Comprehensive General Liability Insurance (“CGL”)
- Directors & Officers Insurance (“D&O”)
- Employment Practices Liability Insurance (“EPLI”)

CGL: Maybe But Unlikely

- Limited Coverage
 1. Coverage A
 - Tangible Damages Requirement
 - Intentional Acts Exclusions
 - Employment Practices Exclusion: has eliminated most coverage under CGL policies
 - Court decisions have limited coverage
 2. Coverage B
 - Personal Injury: may cover defamation or libel

D&O: Maybe But Narrowly

- Definition of wrongful act may be broad enough to cover some employment claims
 - Typically covers only directors or officers and not the company; employment claims typically are made against the employer
 - Directors and officers only covered for actions within the scope of their duties – employment claims typically fall outside these parameters
 - Insured vs. Insured exclusion may bar certain claims

EPLI: Best Source Of Coverage

Available since early 1990's

- Specifically designed to provide coverage for employment practices liability
- Typically include arbitration provisions so most disputes hidden from public eye – very few reported decisions interpreting EPLI provisions
- Often manuscript form although there is an approved ISO form. Many different versions of coverage

Policy Language - Indemnification

- “The Underwriter shall pay on behalf of the **Insureds** all **Loss** for which the **Insureds** become legally obligated to pay on account of any **Claim** by or on behalf of a past, present or prospective **Employee** of the **Company** for a **Wrongful Employment Act** taking place before or during the **Policy Period** if such **Claim** is first made against the **Insureds** . . . during the **Policy Period**”

Policy Language - Defense

- “The Underwriter shall have the right and duty to defend **Claims** against the **Insureds**, even if the allegations in the **Claim** are groundless, false or fraudulent.”
- “The Underwriter’s duty to defend any **Claim** . . . ends when the Limit of Liability applicable to such **Claim** or to the **Policy Period** in which such **Claim** is first made has been exhausted.”

Key Coverage Issues

- Who is covered
- What is covered
- Trigger of Coverage
- When to give notice
- Duty to defend
- To settle or not to settle
- Exclusions

Who is Covered?

- Corporate entity
- Directors and officers
- Supervisors and managers
- Employees

What is Covered?

- Most employment practices insurance policies cover more than the typical discrimination and sexual harassment suits.
- EPLI policies also cover:
 - breach of employment contract
 - whistleblower retaliatory measures
 - defamation
 - failure to promote, negligent evaluation
 - wrongful termination, wrongful discipline
 - workplace torts

Trigger of Coverage

- “Claim” triggers an EPLI policy i.e., when to give notice
 - Typical definition of “claim”:
 - “written demand for monetary or non-monetary relief (including request to toll statute of limitations)”
 - “a civil, administrative or arbitration proceeding for monetary or non-monetary relief which is commenced by:
 - (i) service of a complaint or similar pleading; or
 - (ii) receipt or filing of a notice of charge”
 - **ERR ON SIDE OF COVERAGE:** treat written employee complaints to HR and supervisor as claims and give notice⁴

When to Give Notice

- “Claims-made” coverage: insurance applies to claims first made during the policy period and reported as soon as practicable thereafter
- “Claims-made and reported” coverage: insurance applies to claims first made during the policy period and reported within the policy period or a fixed reporting period
- **WHEN IN DOUBT, GIVE NOTICE!!!**

Defense under the EPLI Policy

- Key element of coverage: defense costs often exceed actual damages in employment-related claims because of company's desire to protect reputation
- Defense costs are usually included in and subject to the limits of insurance
- Assigned Counsel v. Choice of Counsel – Potential Conflict of Interest

Consent To Settle

- Some EPLI policies give insurance company the right to settle claims, without the policyholder's consent
- Other policies require the policyholder's consent
 - If the policyholder does not consent, the insurance company's liability may be "capped" at the amount of the original settlement offer
- Policies may require the policyholder to obtain the insurance company's consent before the policyholder can settle a claim

Beware of Exclusions

- Punitive Damages and multiple damage awards
- Intentional Acts Exclusion
- Statutory Benefits Exclusions
 - ERISA, COBRA, OSHA, Workers Compensation
- ADA Exclusion
- Contractual Liability Exclusion
- Criminal, Fraudulent or Malicious Acts

The EPLI Application

- Complete the application. Don't give the insurance company an excuse to deny your coverage
- Many application questions are vague or are practically difficult to answer
- Specifically, beware of questions asking about claim history
- **ERR ON THE SIDE OF FULL DISCLOSURE**

Bottom Line: Tips

- Review EPLI policy very carefully before purchase
- Evaluate all insurance policies as potential sources of coverage
- Give notice of any potential claim – don't lose coverage before you even start

Insurance for Employee Dishonesty

Overview of Fidelity/Crime Insurance

- Standard insurance coverage purchased by most companies usually includes eight different types of insurance against financial losses experience by businesses because of fraud or theft:
 - “Fidelity” coverage
 - “On Premises” coverage
 - “In Transit” coverage
 - “Forgery or Alteration” coverage
 - “Securities” coverage
 - “Counterfeit” coverage
 - “Computer Systems Fraud”
 - “Fraudulent Mortgage”

Theft, Disappearance and Destruction Coverage

- The term “Money,” as defined in the Crime General Provisions, is limited.
- “Acts Committed By a Person On-Premises:
- What does “disappearance” actually mean?

Theft, Disappearance and Destruction Coverage (cont'd)

EXCLUSIONS:

Losses caused by...

- Accounting or Arithmetical Errors
- Dishonest acts of insured representative
- Exchanges or purchases of property
- Fire
- Money Operated Devices
- Transfer or surrender of property
- Vandalism
- Voluntary parting with the title or possession of property

Coverage Types

- Commercial Crime Insurance
- Blanket Bond Insurance
- Employee Dishonesty Insurance
- Financial Institution Bonds

Fidelity (The Old Story)

- Insurance Companies Will Cover:
“Any loss of Money, Securities or other property which the Insured shall sustain through any dishonest or fraudulent act(s) or dishonest or fraudulent omission(s) of any of the Employees, acting alone or in collusion with others.”

Fidelity (The New Story)

- Insurance Companies Will Cover:
 - Loss resulting **directly** from dishonest or fraudulent acts committed by an employee acting alone or in collusion with others.
 - Such dishonest or fraudulent acts must be committed by the Employee with the **manifest intent**:
 - (a) to cause the Insured to sustain such loss; and
 - (b) to obtain financial benefit for the Employee and which, in fact, result in obtaining benefit.
- As used in this Insuring Agreement, **financial benefit does not include benefits earned in the normal course of employment, including: salaries, commissions, fees, bonuses, promotions, awards, profit sharing or pensions.**

Discovery

“This bond applies to loss discovered by the Insured during the Bond Period. Discovery occurs when the Insured first becomes aware of facts which would cause a reasonable person to assume that a loss of a type covered by this bond has been or will be incurred, regardless of when the act or acts causing or contributing to such loss occurred, even though the exact amount or details of loss may not then be known.”

How Many Policies Apply to a Multi-Year Loss?

- Employee embezzlement schemes may go undetected for years. One insurance company states on its web site:

“[a] trusted employee may carry out a scheme for years, resulting in financial calamity for the company – or worse.”

- Policyholders are likely left with the impression that they are buying a product that protects them from the very peril that the insurance company has brought to their attention – a theft that spans multiple years.
- Insurance companies, however, often take the position that it is only the policy in effect at the time a loss is “discovered” that is available to pay a claim.

Musical Insurance Companies

- While it seems odd, if you change the limits of your crime coverage, you may actually be worse off if you stay with your current insurance company.
- Some policies contain terms that purport to terminate the prior policy if the same insurance company was on the risk in the prior year. These same policies may also attempt to “cap” a loss at the lowest of any applicable limits.
- Look for Policies with “Higher Limits” language

Notice – “Claims Made” or “Occurrence”

- Most crime policies are not written on a claims made basis.
- Crime policies often attempt to exclude claims that are not discovered and reported to the insurance company during the policy period or any tail reporting period.
- Insurance Companies may take the position that the notice provision of the policy “functions like” a claims made policy.
- If a claim is discovered, but notice is not provided within this period, the insurance company may claim that the claim is excluded even if the insurance company suffered no prejudice as a result of the timing of the notice.
- While that assertion is debatable, as with most notice issues – when in doubt provide notice.

Termination

“This bond terminates as to any Employee...as soon as any Insured...learns of any dishonest or fraudulent act committed by such person at any time, whether in the employment of the Insured or otherwise, whether or not the type covered under Insuring Agreement (A), against the Insured or any other person or entity.

Termination of the bond as to any Insured terminates liability for any loss sustained by such Insured which is discovered after the effective date of such termination.”

What To Do When You Have a Claim

1. Notice

2. Investigation

- Determine the scope of the loss and the location of the stolen assets
- Identify all documents that shed light on the scheme, determining the amount of the loss
- Terminate dishonest employees
- Do not cede claim investigation responsibility to the insurance company
- Do not settle with dishonest employees (without approval)
- Never interview the dishonest employees alone

What To Do

When You Have A Claim (cont'd)

3. Identify potentially applicable insurance policies
 - Commercial Crime Policies
 - Dishonesty, disappearance and destruction policies
 - “Blanket” bonds
 - Financial Institution Bonds
 - All-risk Policies
 - Property Policies
 - Comprehensive general liability policies with credit card and depositor’s forgery endorsements
 - Computer crime coverage

What To Do When You Have A Claim (cont'd)

4. Promptly submit the Proof of Loss
5. Cooperate with your insurance company
 - Promptly respond to information requests
 - Never say “no”
 - Insist on attendance at all employee and third-party interviews
6. Stay on the offensive

What To Do When You Have A Claim (cont'd)

7. Take the direct approach to insurance company defenses
8. Duty to Mitigate: Do you have to chase the wrongdoers FIRST?
9. Don't take "no" for an answer.
10. Sue?

Conclusion

- Do not automatically assume a theft loss simply as a business loss.
- Do not shy away from filing a claim. Fidelity policies are meant to cover and do cover theft.

Question and Answer