



MANAGING WORKPLACE EXPOSURES

WITH EMPLOYMENT PRACTICES
LIABILITY INSURANCE

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INTRODUCTION

Cases of employees bringing action against their employers have become a common sight. The media interest that typically surrounds employment claims, along with the pervasiveness of social media, means that the public can closely follow these cases and the unpleasant details that make up this class of claim.

Employment-related risks are among the most potentially damaging exposures due to their inherent link to public notions of community standards and morality. These legal suits can not only result in significant financial loss but also cause irreparable damage to an employer's reputation and brand.

Defending against an employment-related claim is also time consuming, expensive and disruptive to an employer's business. For employers, the growing risk makes it necessary to consider how such a claim might affect the company, from legal fees and settlement costs to damage to reputation and brand, and whether measures are in place to minimise both the risk and the impact.

Employment and workplace relations are governed by complex and rapidly changing laws and regulations. Standard policies, procedures and training are no longer enough to protect employers from employment-related litigation.

Such an environment means that insurance solutions have become imperative.

This paper examines in detail the spectrum of risks faced by employers and discusses the extent to which Employment Practices Liability Insurance (EPLI) could reduce the cost and impact of an employment-related claim.

A blue folder with a silver paperclip and a grey tab. The folder is open, showing a white page with text. The page is titled "BACKGROUND TO EPLI" in large blue letters. Below the title, there are three paragraphs of text in a smaller blue font. The folder has a grey tab on the right side.

BACKGROUND TO EPLI

EPLI was designed to cover employers and their directors, officers and employees for claims brought by past, present or prospective employees alleging employment-related wrongful acts.

The policy largely evolved to fill the gaps in standard general liability policies, professional indemnity and directors and officers liability policies.

The better EPLI policies now include cover for claims by third parties such as clients and vendors.

THE IMPORTANCE OF EPLI IN CURRENT WORKPLACE SETTINGS



ALL BUSINESSES WITH EMPLOYEES HAVE AN EXPOSURE. IT ONLY TAKES ONE EMPLOYEE TO BRING A CLAIM BUT COUNTLESS SITUATIONS THAT COULD LEAD TO GRIEVANCE.

HIRE/FIRE

Every time an employer hires or fires an employee, the employer runs the risk that one of those new hires or recently fired employees may sue down the road.

VICARIOUS LIABILITY

Employers can be held vicariously liable for acts committed by their employees in the workplace.

MEDIA

More than ever, employees are aware of their legal rights as a result of a regular stream of well-publicised cases in this area and a greater level of general awareness of laws that protect them in the workplace.

Increasingly, the media has been used to exert pressure on employers. The key 'trial by media' cases are well known.

ECONOMIC

The consensus appears to be that economic growth in Australia will be subdued as it transitions out of the resources boom. Periods of economic downturn are notoriously marked with increased job losses as employers respond to slowing demand and a general lack of business and consumer confidence.

The current state of the Australian economy has created situations in which employees are out of work for longer periods of time. As a result, employees may be more tempted to file claims against former employers than they would if new jobs were easier to secure.

SOCIAL MEDIA

The prevalence of social media and other online networking sites is also creating significant concern and potential liability for employers.

Although the most common claim arising from employees' or employers' access of social media and networking sites appears to be invasion of privacy, the practice could also lead to claims of discrimination if an employer or supervisor only 'friends' certain employees and not others, or defamation if certain disparaging comments are made about employees. The potential exposure is compounded by the fact that many employers now use social networking sites as part of their background checks on potential job applicants.

THE IMPORTANCE OF EPLI IN CURRENT WORKPLACE SETTINGS *cont...*

SMALL EMPLOYERS

Smaller employers generally don't have the resources to develop, implement and maintain all of the human resources policies, procedures and records necessary to properly protect their businesses or to mount a successful defence if they get sued by an employee.

LARGE EMPLOYERS

Larger employers with offices worldwide on the other hand are faced with different laws in different jurisdictions and unique cultural issues. Multinationals need to make sure that they properly draft and implement policies that reflect local laws and customs. Relying on a 'one size fits all' global compliance policy is dangerous.

Globally, companies of all sizes and in every industry have been affected by the surge in employment-related litigation over the past decade.



PERSONS COVERED UNDER EPLI POLICIES



EPLI COVERAGE CAN VARY SIGNIFICANTLY ACROSS DIFFERENT INSURER OFFERINGS AND COVERAGE ENHANCEMENTS CAN ALSO BE NEGOTIATED.

A typical EPLI policy would include coverage for:

- the employer (company/organisation/entity¹ and all subsidiaries that are more than 50 percent owned, under management control or the control of an appointed board)
- directors, officers and employees² (past/present/future)

An employee may include full-time, part-time, casual, seasonal, temporary, and leased employees. Volunteers also may be included in the definition.

However, independent contractors, consultants, secondees or agents are generally not included nor are their employees including employees of labour hire agencies.

Having said that, more insurers are now willing to include additional parties such as independent contractors as employees.

Policies can be tailored as required to reflect the type of the organisation. For example the definition of insured person is often amended to expressly include partners in EPLI policies for law firms.

Most EPLI policies also provide coverage extension to spouses and domestic partners, heirs, estates, and legal representatives for claims against the estate or spouse of an individual insured as a result of the insured's wrongful act (although wrongful acts of the spouse/domestic partner are not covered).

¹ D&O policies, for example, principally cover insured persons not the entity for employment practices related claims.

² Employees are not always defined.

HOW CLAIMS ARE DEFINED UNDER THE POLICY

A claim is typically defined to include any written demand for legal relief (in some cases limited to monetary damages), any civil proceeding (including industrial arbitration), as well as any criminal or regulatory proceeding made against an insured alleging a breach in employment practices.

The better policies will also include investigations, examinations or inquiries, alternative dispute resolution (such as arbitrations, mediations and conciliations) and appeals.

BY EMPLOYEES

Some definitions require the claim to be brought by or on behalf of any past, present or prospective employees.

BY THIRD PARTIES

The better EPLI policies also include cover for claims brought by third parties such as clients and vendors (third party liability coverage). In some instances, cover might be limited to discrimination and harassment claims.

WORLDWIDE COVER

EPLI policies are generally designed to cover claims made against any insured anywhere in the world.

The definition of 'claim' is a critical policy trigger. Definitions vary from policy to policy and it is important to check policies carefully.

CLAIMS TYPICALLY COVERED

While it isn't possible to offer an exhaustive list of covered claims, typically an EPLI policy can cover claims for the following wrongful employment practice claims:

- wrongful dismissal, discharge or termination, including whistle blower claims
- harassment, including sexual harassment
- discrimination (including but not limited to discrimination based upon age, gender, race, colour, national origin, religion, sexual orientation or preference, pregnancy, disability)
- breach of a contract of employment
- other employment-related torts/ common law violations, such as constructive discharge, defamation, libel, slander; infliction of emotional distress, mental anguish, humiliation, failure to enforce company policies and procedures, invasion/breach of privacy, negligent supervision/ hiring/retention and employment-related misrepresentation

EPLI policies generally do not require the alleged act or omission to occur via any specific medium although the insured must generally be acting in their capacity as an employer to be afforded cover under the policy³.

Importantly, the policy will cover:

- damages and compensation
- judgments (including interest)
- settlements entered into with the insurer's consent
- claimant's costs
- defence costs (preferably with an 'advance payment' promise); The costs of defending employment-related claims can be significant and are often underestimated. Defence costs habitually run into the hundreds of thousands and this is before any settlement payment. Without sufficient resources, an employer might not be able to properly defend allegations made against them or their employee.

The better policies will provide cover for investigation costs, front pay and back pay arising from an order of reinstatement, civil penalties (which are compensatory in nature and awarded against an insured and payable to an employee), multiplied, exemplary and punitive damages (often subject to insurability) and innocent insureds notwithstanding improper conduct by other insureds via severability and non-imputation provisions.

³ Employment practices violations can for example occur by way of electronic communication including via social networking sites.

CLAIMS TYPICALLY EXCLUDED

Most EPLI policies contain the following key exclusions:

- pending and prior litigation or investigations as at policy inception
- claims for which prior notice under any other policy was given
- prior knowledge of human resources (HR), risk manager, or legal department of claim or circumstances that may give rise to a claim
- benefits under and violations of any workers compensation insurance, unemployment insurance, disability policies, Australian Occupational Health and Safety legislation and laws regulating the provision of employee benefits or wages, such as the Fair Labour Standards Act (FLSA) and Employee Retirement Income Security Act (ERISA), however, claims for retaliation and claims under the Equal Pay Act (EPA) portion of the FLSA are typically covered
- assumption of contractual liability of another entity (except to the extent the insured would have been liable in the absence of the contract)
- bodily injury (although the better policies will include an exception

for emotional distress, humiliation and mental anguish)⁴

- amounts payable under written employment contracts; however, defence coverage is typically provided
- industrial disputes
- back pay or compensation attributable to the back payment of remuneration, where the company is ordered by the relevant court or tribunal to reinstate the claimant
- front pay, future loss/damages/compensation or economic loss where the company is ordered by the relevant court or tribunal to reinstate the claimant but fails to do so for any reason
- fraud and dishonesty if established by judgment adverse to the insured or by admission (criminal or malicious acts can also be excluded)
- costs incurred to acquire, modify or construct any building or property
- employment-related benefits due (for example company car/phone,

travel allowance, medical or life insurance expenses, education and training allowance, severance or redundancy entitlements, paid or unpaid leave, bonus or incentive payments (excluding entitlements under a commission scheme); stock options including under an industrial instrument (some policies provide a write back for defence costs)

- payments or contributions under any superannuation, pension or retirement fund or similar scheme
- criminal fines, penalties or civil penalties which are not compensatory in nature and taxes

Exclusions are not always contained in the policy section marked as 'Exclusions'. Often carve-outs are made in various definitions (such as in the definition of 'Loss') and in some cases under policy conditions. It is therefore important that the entire policy is scrutinised.

⁴ It is common for insurers to exclude direct bodily injury and property damage claims under EPL policies, as such claims are typically covered under a public and products liability insurance policy.

AN EPLI POLICY IN ACTION

(I) CLAIMS MADE

Most EPLI policies are issued on a 'claims made' basis, which means that, subject to its other terms and conditions, the policy covers claims made during the policy period and reported during the policy period or the extended reporting period/discovery period (if the latter option is purchased). Claims made policies do not require the incident that gives rise to the claim against the insured to have taken place during the policy period.

Even if your EPLI policy does not explicitly provide for notification of circumstances likely to give rise to a claim, you have a statutory right⁵ to notify your insurer of any potential claim. Any notification of a potential claim must be made as soon as reasonably practicable after you become aware of it and before the end of the policy period.

If you notify your insurer of a potential claim then the policy will, subject to its terms and conditions, cover you notwithstanding that a claim (arising out of the circumstances you notified) is only made after the end of the policy period.

If however, you fail to notify a potential claim within the policy period, your insurer may be entitled to deny any claim that may subsequently arise out of the circumstances you failed to notify. More importantly, any subsequent insurer may also be entitled to deny a claim arising out of circumstances of which you were aware prior to policy inception, as such claims are generally excluded from cover.

While employment-related claims can often be very emotionally charged, it is important to move quickly, ensuring that each step of the process is handled with extreme care, sensitivity and importantly, confidentiality. It is critical that employers pay close attention to the definition of a claim and follow the claims handling conditions as set out in the policy so as to not prejudice cover when they need it most. Problems arise when employers fail to notify insurers when they first receive notice of a charge or complaint, instead reporting the matter when a lawsuit is filed; this is especially so if the charge or complaint was made prior to the inception of the policy.⁶ Most EPLI policies include equal employment opportunity charges and similar state administrative charges in the definition of claim. Remember a class action lawsuit may start with one individual's complaint.

Late notification of claims or circumstances creates unnecessary difficulties between insureds and their insurers. While there is potential for cover to be provided in certain circumstances as outlined above it is not guaranteed. What impact late notification will have is invariably subject to the claim or circumstance in issue and likely to involve an examination of who did what, when and why in relation to the claim or circumstance, and the notification of it. Late notification is an issue that has often required a court-adjudicated outcome. To avoid these complications, always notify any claims or circumstances promptly and during the policy period.

⁵ by virtue of section 40 of the Insurance Contracts Act 1984 (Cth).

⁶ EPLI contain Prior Notice and Prior Litigation exclusions.

AN EPLI POLICY IN ACTION

cont...

(II) WHO HAS THE DUTY TO DEFEND?

EPLI was originally written on an ‘insurer duty to defend’ basis, which means that the insurer has the duty to defend any claim alleging an employment practices breach and has the right to select defence counsel and, importantly, control the defence and settlement of a claim.

A large number of small to mid-sized clients accept (and even prefer) an insurer duty to defend policy simply because they don’t have the expertise or internal resources to manage an employment practices claim.

Mid to large-sized clients however typically prefer to select their own counsel and firm with whom they (rather than their insurer) are likely to have established a relationship, and who know and understand their business and industry. More importantly, mid to large firms want to control the defence of a claim, decide on litigation strategy and have control over settlement decisions. Some EPLI policies now give the insured the right and responsibility to defend employment practices claims. This benefit is however subject to a number of qualifications.

(A) AGREEING DEFENCE COUNSEL

While the insured can select their own defence lawyers, the insurer’s consent is still required. This consent in practice extends to the hourly rate proposed to be charged by the insured’s nominated lawyers. A cause of contention in many EPLI claims is that this rate is often higher than the rates the insurer has negotiated with its own panel firms. Since the EPLI policy only requires insurers to pay ‘reasonable’⁷ fees, costs and expenses as ‘defence costs’, a differential can appear.

Understanding that applicable hourly rates can cause issues and at the worst possible time, (i.e. at the beginning of a claim) the best practice is to aim for pre-negotiation of the defence counsel (and hence hourly cap) before binding coverage.

(B) INSURER INVOLVEMENT

Where the insured has the duty to defend, the insurer is entitled to effectively associate in the defence and settlement of a claim while insureds are contractually obliged to provide insurers with information and assistance to enable insurers to effectively determine their liability under a policy. Importantly, if insurers want to settle a claim and the insured does not (opting instead to contest in court), some EPLI policies contain what is popularly referred to as a ‘hammer clause’, which operates to limit the insurer’s liability to the amount it would have incurred had the insured consented to the settlement recommended by the insurer.

It is therefore important that employers:

- are aware of the period of cover
- review all claims and ‘potential claims’
- notify immediately any circumstances (i.e. complaints) likely to give rise to a claim during the policy period, so as to not prejudice the benefit of cover under the policy for any subsequent claim that may arise. All claims should be notified on receipt

⁷ Some policies also include a “necessary” test.

- do not make any admissions or engage in settlement discussions which may prejudice your insurer's subrogation rights; Always seek insurer's consent for strategy and settlement
- follow the policy's notice requirements. Each insurer's claim reporting requirements often differ by varying degrees
- retain appropriate experts early and always with the insurer's consent
- keep a record of all notifications made to insurers and keep insurers informed of developments at all times
- obtain written confirmation from insurers in relation to any notifications made



CONCLUSION

Globally, companies of all sizes and in every industry have been affected by the surge in employment-related litigation over the past decade.

In periods of economic downturn, companies must remain vigilant in their efforts to prevent or minimise employment practices claims.

While most focus is on the financial cost of any claim payment, given the potential severity of damages payment that can be awarded against the company as well as against individual directors, there are also many hidden costs on the business. This can include negative publicity, damage to reputation and goodwill, poor industrial relations, workplace disruption and loss of productivity (for both employer and employee) along with significant stress for all parties.

With so much at stake, employers should be proactive in addressing employment-related exposures.

While having well maintained policies and procedures in place is critical and will reduce an employer's exposure, experience shows it cannot eliminate the risks completely. EPLI policies are not the whole solution but they are an important tool in mitigating the impact of employment-related risks and protecting a company's bottom line.

EPLI policies are often the last line of defence for employment-related claims and regularly reviewing your EPLI (preferably before a claim is made) will assist in developing a strategy for managing an employment-related claim when it inevitably arrives.





NEXT STEPS

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