FLSA EXPOSURES

EPL Insurers Still Avoid Wage-&-Hour Coverage Grants For Large Employers

As fears soar, more offer settlement and defense sublimit to small insureds

BY SUSANNE SCLAFANE

FEAR OF WAGE-AND-HOUR CLAIMS IS ESCALATING AMONG buyers and sellers of employment practices liability insurance, with sellers' fears limiting EPLI solutions for small employers—and resulting in none at all for the largest ones, market participants report.

THE POTENTIAL FOR mass actions is a key issue causing even those carriers that offer some EPLI coverage options for wage-and-hour matters to severely limit the amounts.

"There have been, since the dawn of EPLI, exclusions in the policy for the Fair Labor Standard Act," said Thomas Hams, managing director and EPLI national practice leader for Aon Risk Services in Chicago, referring to the main federal wage-and-hour statute.

"For the most part, most carriers still have that kind of exclusion in place, and they still don't intend to cover wage-and-hour claims"—particularly not class-action suits involving large employers, he said.

Wage-and-hour suits are government actions and private lawsuits alleging violations in FSLA and other federal laws, as well as state laws governing how workers are paid, and EPLI policy exclusion wording also pertains to state laws similar to FLSA, Mr. Hams noted.

The fear of these suits—dealing with issues ranging from missed employee meal breaks to improper classification of employees as exempt from overtime pay—is well founded, according to a January report from Chicago-based Seyfarth Shaw. The law firm's sixth annual report on workplace litigation revealed that collective actions pursued in federal court under FLSA outnumbered all other types of private class actions in employment cases in 2009.

The report also put the monetary value of the top-10 private settlements in wage-and hour mass actions at $363.6 million in 2009, dwarfing discrimination settlements with a total of $86.2 million. (See the "NU Exclusives" section at www.property-casualty.com for a sidebar with more statistics and a discussion of industries at risk.)

"We actually have seen a decrease in discrimination class actions by plaintiffs' lawyers because wage-and-hour claims are so much easier to bring," Mr. Hams said.

John Molka III, senior industry analyst for New York-based Advisen and author of a special report detailing the threat of these suits, noted that some wage-and-hour suits actually start out as discrimination cases.

A worker may go to an attorney intending to bring a discrimination suit that won't stand up in court but leave the office with a wage-and-hour suit. The plaintiffs' lawyers "are well aware of what the law is," and when they have the opportunity to speak with the workers—who often don't even know they are non-exempt—they discover potential FSLA violations, he said.

"That's when they try to get their hooks into the company" to develop a class, Mr. Molka said, noting that federal wage laws are opt-in statutes, meaning that the lawyers obtain lists of non-exempt employees who must agree to actively participate in a collective action.

When the lawyer contacts each employee to say they might be owed some money, "you can imagine how that conversation goes"—especially if the worker is disgruntled or recently laid off, he said.

State laws generally have opt-out requirements, meaning that potential plain-

tiffs are automatically included in state class actions unless they decline to participate, NERA Economic Consulting reported in a separate November 2009 analysis of wage-and-hour trends.

Either way, the potential for mass actions is a key issue causing even those carriers that offer some EPLI coverage options for wage-and-hour matters to severely limit the coverage amounts, brokers and carriers say.

Mr. Hams confirmed that more and more insurers are offering defense-only sublimits of $100,000 or $150,000, and the products are typically designed for employers with 500 employees or less. By doing that, "they're protecting themselves from the class exposures," he said.

"The biggest concern for carriers is that they don't have the ability to underwrite," he added. "It's too complex—there are too many variables. They can't interview all the employees that a company has to see if they have problems with their pay."

Reacting to the concerns, and to growing demand for coverage from large employers worried about mass-action exposures, he said Aon has been working with "the best legal minds" to convince carriers that the law firms can work to make employers better risks. Approaches might be to have law firms perform audits, or to have checklists in place to make sure employers are doing the right things, he suggested.

"To this point, we haven't been successful in getting any true liability coverage for the settlements or verdicts, [but] we're starting to get some more interest simply because the EPLI marketplace continues to be very soft," he said.

"Traditional trading partners, focused on larger risks," are starting to listen to options that would allow them to "test the waters" through pooling or quota-share agreements, he noted, explaining that both coinsurance with employers and quota-shares with multiple insurers could be involved.

"So far, we're still in the development stages of anything meaningful for larger employers," he said.

For small employers, Seth Brickman, a senior underwriter at Windsor, Conn.-based Business Risk Partners, which manages EPLI products for Lloyd's and QBE, said a greater supply of defense-only sublimits is likewise being fueled by the combination of a soft market and buyer anxiety.

In a softening market, "carriers have increasingly been obliged to offer the coverage merely to retain their capability to write business," he said. "Even if the next quote costs $1,000 more, if [that quote has] wage-and-hour coverage, many employers are being spooked into purchasing the additional coverage."

Peter Taffae, managing director of wholesaler Executive Perils in Los Angeles, agreed. "The underwriters are really in a bind. For competitive reasons, they have to [offer some form of wage-and-hour coverage]. On the other hand, they're very, very vulnerable [to claims]," he said.

"It's almost like they're rolling the dice and taking a 50-50 shot on having a loss," Mr. Brickman said, noting that sublimits are often a throw-in, with only minimal underwriting questions asked.

Like Mr. Hams, Mr. Taffae foresees carriers developing completely different coverage approaches, likely involving coinsurance, in the next few years. "They're going to have to reevaluate it, because [while] $100,000 or $150,000 [sublimits are] definitely nice," if an employer gets hit with a real wage-and-hour suit, the longevity of that firm is questionable, he said.

On the other hand, "they're going to have to manage [the exposure because] it truly is like a wildfire," he said. "No one thinks the frequency is going to go down."

DAMAGE CONTROL

Two years ago, when *NU* first reported the lack of any form of wage-and-hour coverage from most lead EPLI markets, one key objection the carrier representatives of those firms raised to offering sublimits was that they were just a "drop in the bucket," which didn't provide meaningful protection in the face of soaring costs. (See *NU*, June 9, 2008, page 12).

"Preventative loss control is really the best way for employers to protect themselves from wage-and-hour lawsuits," said Joni Mason, EPLI product manager for Chartis in New York, which has not changed its existing position against offering wage-and-hour coverage.

"It is a growing exposure for employers," but it actually suggests the need for more activity "on the damage-control side, rather than presenting an opportunity for victory," she said, explaining that most actions resolve in settlements.

"The best thing an employer can do is to be proactive and conduct an audit of its own practices with regard to wage-and-hour payments and employee classifications," she said. "If they do get sued, they will wind up looking at their practices, and in the meantime, the defense costs are very high. The settlements have been wide ranging, but they tend to be high as well."

Mr. Taffae said his firm has been actively involved in the settlement of three multimillion-dollar claims within the last 18 months. "They all settled for over $1.5 million, and some look to be excess of $2 million," he reported, going on to recommend another form of damage control.

Using the example of a wage-and-hour action in which plaintiffs alleged they weren't allowed to take full meal or rest breaks, he noted that an employee that's been at the company 10 years is owed a lot more than one that's been there for one year.

"We met with the attorneys and the insured" and convinced them to start meeting individually with the employees that had been there the least amount of time, he noted. "If you've been at a company for a year or two, you probably like it. You definitely want the job," he reasoned. In this case, "for a couple of hundred bucks" each, the younger-tenured employees agreed to sign a waiver to help the employer out.

"We substantially cut the class," and the plaintiffs' attorneys, who had so much money involved at that point, were eager to settle, he reported.

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ARE MEDICAL MARIJUANA, SOCIAL MEDIA THE NEXT BIG EPL ISSUES?
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EPL INSURERS

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Also at Executive Perils, Assistant Vice President Damien Magnuson said an insured recently picked up coverage for a wage-and-hour action under a directors and officers liability policy because individual directors were named as defendants.

"That's another good reason for smaller, private companies to buy D&O," he advised. "A lot of times there's coverage there that might be excluded under the traditional EPL policy."

On the carrier side, Sal Pollaro, managing director of management liability product lines for Glen Allen, Va.-based Markel Corp., revealed that his company, which has been offering a $100,000 defense and indemnity sublimit for small employers (with up to 500 employees) for several years, is set to roll out a new management liability policy for midsize companies that will also have the wage-and-hour sublimit for defense and indemnity.

The product, set to launch in four or five weeks, is going to be a modular policy that addresses D&O, EPL and fiduciary on one form, he said, explaining that insureds can buy any of the lines independently or blend them in any combination.

"We're focusing on organizations up to $750 million in revenue," he said. Equating that to employee counts, he said it's likely somewhere in the 2,500-to-3,000 range.

While Markel and HCC's AVEMCO are frequently cited as the only two insurers offering defense and indemnity sublimits for wage-and-hour claims, *NU* has confirmed that both U.S. Liability Insurance and Scottsdale (through Flanders, N.J.-based E-Risk Services) are also providing this coverage.

"I think you'll start to see yet more offer a level of indemnity protection," said David Bradford, executive vice president of Advisen, noting that one past deterrent to offering coverage—the idea that they might be in the position of covering employers' deliberate wage-law violations—is now raised less frequently by insurers. "There are probably many more cases of negligence than had been assumed in the past," he said.

Christine Murray, vice president in charge of EPL and D&O at United States Liability Insurance Group in Wayne, Pa., said the distinctions between exempt and non-exempt employee status "are very hazy for most employers," especially those in the carrier's target market of accounts with up to 500 employees.

Many United States Liability insureds have less than 100 employees, and they don't have full-blown human resources departments to help them sort through the complicated exemption rules, she said.

For no additional premium, United States Liability provides a $100,000 wage-and-hour sublimit via endorsement for both defense and loss (settlement or judgment) for all classes that they write in all states except California and Florida. "Most applicants are eligible unless they have had prior wage-and-hour claim activity," she said.

WHO'S OFFERING WAGE-AND-HOUR?

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She said the company has seen a lot of wage-and-hour claims activity—under the endorsement and prior to offering it in mid-2007. "The issue previously was that we would see these claims, and most were brought [together] with a discrimination or wrongful termination claim." Because the EPLI policy is duty to defend with 100 percent allocation of defense costs, "we were already providing the defense." (**Editor's Note:** Under a duty-to-defend policy, the carrier has the right and duty to defend a claim, even if most of the allegations are without merit.)

"Now we are covering wage-and-hour claims where there is no other covered wrongful act," she said.

BROKER ADVICE

Citing the duty-to-defend nature of the policy, brokers continue to wrestle with the question of whether defense-only sublimits provide real value to customers.

"In theory, if you can get a duty-to-defend policy without an absolute wage-and-hour exclusion, and the wage-and-hour claim comes in with a covered [discrimination] claim, you could have defense costs up to the limit of liability," Mr. Taffae said, suggesting that by purchasing a defense-only sublimit, buyers may actually reduce the available defense cost payout by the carrier.

EPLI policies "have to be reviewed in the aggregate," Mr. Taffae advised, noting that some policies granting wage-and-hour sublimits have 100 percent "hammer" clauses or very restrictive coverage grants for sexual harassment claims. (**Editor's Note:** Hammer clauses relate to insureds' options during settlement discussions, dictating how much, if anything, an insurer will pay over the first proposed settlement. See *NU*, Dec. 8, 2008, page 12 for details.)

"We see a lot of people lock into this wage-and-hour issue, and we think they're missing the big picture," he said, noting that $100,000—a typical sublimit value—might actually be a reasonable retention for a sizable insured.

Mr. Taffae and Mr. Magnuson also urged caution in deciphering the language of defense-and-indemnity coverage offerings, suggesting one undesirable interpretation for suits alleging both wage-and-hour violations and some type of discrimination as well.

The wording says "any claim that involves wage-and-hour is sublimited," Mr. Taffae said. "So you think you're getting defense and settlement up to $100,000 for the wage-and-hour [matter], but what you're also doing is capping the whole claim at $100,000," he said. That means "you've got an aggregate of $100,000 for both allegations" under Mr. Taffae's reading of that language.

Mr. Magnuson said the endorsements generally aren't written very well. "Is that intentional on the carrier's part? I don't know," he said. "But when a claim comes in that is several million dollars, whether it was intentional or not, the claims department is probably going to use that argument."

Giving a carrier's perspective, Markel's Mr. Pollaro said that while policy construction varies by market, "generally speaking, the intent should be that wage-and-hour is specific and separate from any other allegation."

"If there's discrimination with wage-and-hour, and there's liability for a wage-and-hour component, most forms should address that aspect [with the sublimit]. But if there's discrimination liability attached to that, I believe most forms are written without a sublimit for that," he said.

"You should have your wage-and-hour sublimit, and then anything else attached to the policy," he added. NU