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Mediating employment cases when insurance is in play

CONCEPTS AND PRINCIPLES OF EMPLOYMENT PRACTICES LIABILITY INSURANCE (EPLI) AND THEIR EFFECT ON MEDIATION

A frequent reprise: "there's no insurance." Have you ever wondered what this *really* means? Have you felt that you've run into a brick wall and wonder if there's any way under or around it? Have you wondered whether it's because you've agreed to an early (pre-filing or pre-discovery) mediation or whether the reprise might change as the lawsuit evolves? Have you wished you could verify the "no insurance" status?

This article attempts to shed light on issues surrounding these questions, as it explores the role of insurance in mediating employment cases while offering some practice pointers. It is *not* a primer on basic insurance coverage concepts and principles.

Types of insurance policies

There are multiple types of policies that potentially cover wrongful acts alleged in the employment lawsuit. Each policy type is unique for its definitions, coverages and exclusions. Notwithstanding the fact that nothing about coverage can be certain without reviewing the specific policy in play, seeking all policies should be a familiar refrain. Aside from Employment Practices Liability Insurance (EPLI), policies within which employment-related wrongful acts may be covered include: Commercial General Liability (CGL), Directors and Officers Liability (D&O), Errors & Omissions (E&O), Employers' Liability (EL), Employee Benefits Liability (EBL), Homeowners Liability or Workers' Compensation Insurance.

• ***Practice Pointer***

Plaintiff's counsel should be expansive when requesting insurance policies: "Any and all insurance policies which provide or potentially will provide coverage, including but not limited to: CGL, D&O, E&O, EL, EBL, Homeowners Liability, Workers' Compensation, excess, umbrella or any other type of insurance coverage."

EPLI history

Historically, non-EPLI policies excluded employment-related coverage. Within the last 25 years, EPLI has come into existence to fill this gap in coverage. Coverage can be in the form of an endorsement to a CGL policy or a stand-alone policy. In the opinion of one California EPLI broker, the EPLI market explosion in California has resulted in increased loss payouts and increased deductibles for insureds. This phenomenon, opined the broker, ultimately could make this market uninsurable. To whit, whereas $10,000 used to be a typical deductible for the EPLI product, it has increased today to $25,000, $30,000 or $50,000.

Types of claims EPLI covers

EPLI policies vary widely in their scope of coverage as well as terms and conditions.

Some policies may be very narrow, covering only wrongful termination. Others may include discrimination, harassment,

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retaliation, employment-related torts (e.g., misrepresentation, negligent supervision, training or evaluation, wrongful discipline, wrongful deprivation of a career opportunity, such as demotion or failure to promote) and claims under statutes such as Title VII, Equal Pay Act, Americans with Disabilities Act, Family Medical Leave Act and their state counterparts.

Typical exclusions include claims arising from or brought under statutes such as ERISA, NLRA, WARN and COBRA. Unemployment insurance benefits, labor disputes or negotiations (unless related to retaliation), breach of express written contract and misclassification are excluded. Some policies may exclude administrative complaints and some may cover them, seeing them as conditions precedent to the filing of a lawsuit. These days, EPLI policies exclude indemnity for wage-and-hour claims and frequently the cost of defense as well. Other exclusions typically include punitive damages and fines, whereas emotional distress damages associated with a covered loss are included. Again, only by reviewing the specific policy terms will the answer to whether a particular claim is covered become clearer.

• ***Practice Pointer***

If wage-and-hour claims are included in the EPLI policy, plaintiff's counsel should consider whether inclusion of the wage-and-hour claim will impact the case presentation in a negative way. If the gravamen of the case is violation of wage-and-hour law, the insurer will not be fooled by a feeble attempt to trigger coverage by including a throw-away claim for discrimination. On the other hand, a strong discrimination case may suffer by including the wage-and-hour claim, thus risking the possibility that the insurer may view the wage-and-hour claim as the driving force in the case. Consideration should be given to excluding it.

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• ***Practice Pointer***

Not all states prohibit insurance coverage for punitive damages. And unlike California, where a finding of malice, oppression or fraud is necessary to support a punitive-damages award, other states may permit punitive damages for conduct that would not justify a punitive award under California law, such as gross negligence or reckless conduct. In the case of a national policy where state law might govern, punitive damages not available in California may be permissible.

Duty to defend

A *duty to defend* obligates the insurer to provide competent counsel and pay costs (costs defined as including attorney's fees) for the defense of covered claims. This duty, up to the stated policy limits, includes: (a) claims *potentially* covered and (b) claims that would be covered if the factual allegations were true, even if they are in fact, groundless, false or fraudulent. A *duty to indemnify* obligates the insurer to pay settlements or judgments against the insured. Whereas the definitions appear to be straightforward, their application is not. Some EPLI policies offer only defense coverage whereas others offer both defense and indemnity.

Covered and non-covered claims

Once the duty to defend attaches, California generally requires an insurer to defend the entire lawsuit, including claims that are not potentially within the scope of coverage. But an insurer can reserve its rights to seek reimbursement for the cost of defending non-covered claims. Different policy forms may purport to limit the insurer's defense obligation to defending only potentially covered claims, but this argument has not yet been tested in California.

• ***Practice Pointer***

It is important to understand the difference between the insurer's *duty to defend* and the *duty to indemnify*, and the effect of the presence of both covered and non-covered claims in the lawsuit. As noted, discrimination and wage-and-hour claims are combined often in a lawsuit and wage-and-hour claims are not covered by EPLI insurance. Plaintiff's counsel may not appreciate that the insurer's indemnity (and therefore settlement) obligation pertains only to *covered* claims and may assume the insurer will defend and indemnify *all* claims. In this scenario, the mediator must point out that a barrier to settlement may have been created by inclusion of both covered and non-covered claims in the lawsuit. The insurer may assess the matter as primarily a wage-and-hour claim rather than a discrimination case that is covered under the EPLI policy, thus discharging its *duty to indemnify* in a very nominal way.

Claims made or occurrence coverage – Why it matters

Most EPLI policies are "*claims made and reported*" which require the *reporting* of wrongful conduct while the policy is in force, or during the *extended reporting period* (sometimes called a *tail),* if purchased. An "*occurrence*" policy provides coverage for injury, stemming from wrongful conduct, occurring within the policy period, irrespective of when the claim is reported.

• ***Practice Pointer***

Since most EPLI policies are written on a claims-made and reported basis, the insured is going to want to report to the insurer quickly to avoid a denial of coverage due to late reporting. Plaintiff's counsel should nudge the insured in the direction of reporting by including the following in its demand letter: "Please submit this to your carrier or insurance company to determine if appropriate coverage is available."

What triggers insured's duty to provide notice of the claim (tender) to insurer?

The policy itself will define circumstances in which the insured must inform the insurer that damages are being sought for wrongful conduct. The circumstances include the filing of a lawsuit or administrative complaint, the receipt of a demand letter or any circumstances that may give rise to a claim. Defense counsel has a responsibility to ask the insured about insurance. Sometimes a smaller employer may not know if insurance coverage has been purchased and may need to go on a hunting expedition within the business operations, including reaching out to the insurance broker who sold the policy, to get answers to whether there is available insurance.

After receiving a tender from the insured, what is the insurer's obligation?

A very complicated analysis occurs in determining whether coverage exists under a particular EPLI policy. Here's a taste: Is the alleged perpetrator covered by the policy? Is the employer or entity a named insured? Do any of the declarations, endorsements or exclusions suggest coverage does not exist for the wrongful conduct? Was the insured lax in paying premiums resulting in a policy cancellation? Did the insured make misrepresentations during the application process which led to rescission of the insurance policy?

Insurer's next move

Insurer will notify the insured of its decision regarding the presence or absence of insurance coverage. The most frequent response by the insurer, however, will be an agreement to defend the insured under a "*reservation of rights*." A *reservation of rights* means that uncertainty exists as to the insured's entitlement to coverage, be it a duty to defend only or a duty to defend and indemnify. By issuing a "*reservation of rights*" the insurer preserves its right to contest coverage at a later date when more is known about the claims.

• ***Practice Pointer***

Plaintiff's counsel should remember that as the litigation proceeds, a stronger argument may emerge that coverage exists. If this occurs, plaintiff's counsel should be proactive in his or her communication with defense counsel and press for the insurer to revisit the coverage issue.

What does "no insurance" mean?

A defense counsel's statement of "no insurance" is susceptible of multiple

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meanings: (a) insured did not purchase EPLI; (b) non-EPLI policies do not provide coverage for insured's claims; (c) insured is covered by EPLI but none of the causes of action pled in plaintiff's complaint (or suggested in counsel's demand letter) come within the parameters of *potential* (need not be actual) coverage; (d) insured failed to properly tender (e.g., insufficient information was provided); insured's tender was untimely (failed to tender claim within the active period of the policy or the *extended reported acts* period or (e) the conduct falls within Workers' Compensation.

• ***Practice Pointer***

Frequently defense counsel's statement of "no insurance" has a colloquial meaning, i.e., "we'll never get there." At the time of the negotiation and purchase of EPLI, the insured can elect to retain a certain amount of risk called a *self-insured retention* (SIR). The obligation for the insurer to make contributions to defense costs kicks in only after the SIR is exhausted. The "we'll never get there" comment may mean there is an applicable insurance policy in place, but the value of the case will never exceed the insured's SIR.

Obtaining insurance-coverage information

In the case of early mediation, before a lawsuit has been filed, it is more difficult, though not impossible, to obtain insurance information. From the insurer's perspective, the resistance to providing information before a lawsuit has been filed stems from concerns that: (a) plaintiff's counsel is not privy to the insurance coverage analysis and by turning over the policy too early, may assume there is coverage when there isn't; (b) policy limits will be communicated and this may fuel plaintiff's lawsuit; (c) allegations will be tailored to conform to the policy coverages and (d) the insured's application for insurance, made a part of the insurance contract, would raise confidentiality and privacy issues if disclosed.

After litigation has commenced, Civil Code of Procedure, section 2017.210 and the employment interrogatories set forth permissible information that can be obtained regarding insurance, including the policy number, kind of coverage, policy limits for each coverage type, whether the insured is self-insured and whether any reservation of rights or controversy or coverage dispute exists between the insured and the insurer.

• ***Practice Pointer***

Obtaining insurance information before a lawsuit is filed may be a futile effort. On the other hand, efforts to engage in early settlement discussions or mediation may lead to defense counsel's willingness to disclose whether insurance is available, especially if a policy limits demand is contemplated or has been made. One should always ask.

Policy limits and beyond: Opening the policy

This means the insurer is exposed to liability in excess of the limits of the insurance policy. How does this occur? Plaintiff makes a policy-limits demand during negotiations or mediation. The demand is rejected. A trial ensues. A verdict is returned for plaintiff in a sum in excess of the policy limits. The insured sues the insurer (or the insured assigns its rights against the insurer to the plaintiff who sues the insurer). A judge or jury concludes the insurer breached its duty of good faith and fair dealing to the insured, i.e., exercised *bad faith* in its rejection of plaintiff's policy-limits demand. The insurer is responsible for the entire judgment, even if beyond the policy limits.

Bad-faith test

The ultimate question at trial is "would a *reasonable insurer* have paid the policy limits knowing what it knew (or should have known) at the time the demand was made?" An unjustified refusal to pay the policy limits, as *a reasonable insurer* would do, which may leave the insured in financial ruin, constitutes bad faith.

Making a legally sound policy-limits demand

A decision to make a policy-limits demand should not be a casual or impulsive negotiation move. Both the content and timing of the demand are critical to its success. The demand should set forth all information, the absence of which would provide defenses to the insurer, if a bad-faith trial were to ensue.

A well-drafted policy-limits demand will do the following: (a) make the case that liability is clear, and damages will exceed the policy limits, by providing all pertinent information; (b) make a showing that the unequivocal demand covers all potential claims by all claimants against all insureds; (c) state that plaintiff will be responsible for all outstanding liens; (d) include a reasonable deadline for response to the demand; (e) be reasonable with respect to the insurer's request for additional time to complete its investigation; (f) state how a request for additional time to conduct an investigation will be handled and by what criteria plaintiff will grant or deny an extension request and (g) request that the insured be informed of plaintiff's policy-limits demand.

What constitutes a reasonable policy-limits demand?

Some math is illustrative of the answer. Simply stated, if the policy limit is $50,000, the insured has a 50 percent chance of prevailing and the demand to settle the case is no more than $25,000, the demand is deemed reasonable. With the same facts, if plaintiff is demanding policy limits to settle the case, i.e., $50,000, the demand will be deemed unreasonable.

Settlement considerations in mediation: Burning limits policies

EPLI policies are "*burning limits*" or "*self-consuming*" policies, meaning that all defense costs and settlement monies come out of the same pool of money. Given this, plaintiffs' counsel may employ different litigation strategies. One approach is for plaintiff's counsel to be conservative insofar as discovery and motion practice, knowing that defense costs diminish the monies available for indemnity. Another strategy is to not

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refrain from discovery and motion practice, knowing that as soon as the insured's SIR is spent, insurance monies will be available.

• ***Practice Pointer***

As plaintiff's counsel frames the initial demand and makes negotiation moves during mediation, it is helpful to know what part of the EPLI policy has been consumed by defense costs and attorney's fees. As negotiations unfold, some defense counsel may disclose or hint at the amount of available funds remaining on the policy whereas some may not. Plaintiff's counsel should estimate what remains on the policy based on the activity in the case and the typically lower than market hourly rate for insurance defense counsel.

Insured's consent to a settlement

At first blush, given the oft-seen acrimony and discord between the plaintiff and the insured, it might appear that the insured could thwart a settlement. The "*Hammer Clause*" in an EPLI policy protects against this. It requires the insured to consent to a settlement, which must not be "unreasonably withheld." Depending on the specific policy, the "*Hammer Clause*" might relieve the insurer of payment of defense costs or a settlement beyond that for which the case could have been settled, but for the insured's refusal to consent. Other policies provide that any settlement and defense costs, beyond that for which the case could have settled at an earlier point in time, will be shared by the insured and insurer in a proportionate allocation. Some policies permit settlement without the insured's consent. Although governed by the policy terms, the resolution of this issue appears to be dynamic and negotiable.

• ***Practice Pointer***

Sometimes plaintiff and counsel may wonder what the delay is in the defense room. The delay may be related to an ongoing dialogue circling around the insured's belief that there was no wrongdoing and/or concern that settlement of the case might create an onslaught of future lawsuits. The insurer sees liability exposure. The fact that most insurers want to reach a consensus with the insured keeps the insurer from adopting a "that's your problem — we want to settle this case!" position. The hammer clause keeps the insured in line. Striking a balance around this important issue can be time-consuming, but ultimately may be the make or break of a settlement.

Understanding the insurer's mindset

The facts should be presented in a straightforward fashion, omitting hyperbole or embellishment. The insurer wants to make a hard core dollar evaluation, based on real economic damages and a nebulous amount for non-economic damages. The same case may command top dollar in one case and a lesser amount in another. The "X factor" is the identity of and reputation of plaintiff's lawyer. If plaintiff is seeking only the maximum dollar on his or her best day in court, a jury may need to speak.

• ***Practice Pointer***

Do not exaggerate the loss. If the loss is nominal, but attorney's fees loom large, say so and explain the legal issues that will be brought to bear.

Become a co-conspirator with the adjuster

Since the adjuster is the conduit between plaintiff and the insurer, it will help to become his or her ally, not harasser, and work collaboratively to identify obstacles the adjuster faces and brainstorm workarounds. The adjuster will appreciate being provided with a very thorough written presentation of the case two to four weeks before the mediation. This will give the adjuster ample time for the various levels of authority to weigh in on the case and for reserves to be set. Withholding critical information from the written analysis and springing it on the adjuster in mediation will not serve plaintiff well. Why? The surprise information will not have been vetted and it will not be taken at face value. Moreover, although it's 5:00 pm or 6:00 p.m. on the West Coast, it's the evening hours on the East Coast and a New York carrier will not be inclined to increase reserves, after hours, on a moment's notice.

• ***Practice Pointer***

Consider pre-qualifying the dispute before the mediation occurs. Has there been a preliminary discussion of money in advance of the mediation? Has the insurer done its due diligence in setting reserves? Is *real* authority planning to attend the mediation and if not, will this prevent a meaningful mediation from occurring? If the response is "not your business," plaintiff's counsel's reply could be: "just checking because until these things have occurred, mediation would be premature. We want everyone on your side of the table who has an interest in the case to know we're not just testing the waters." This type of discussion will yield far more benefit than becoming hostile, dismissing the adjuster as being incompetent or not having "real" authority or taking issue with the entire insurance industry.

Showcasing plaintiff during the mediation

If plaintiff makes a good impression, plaintiff's counsel should consider orchestrating a presentation that puts plaintiff in the center of the stage. If plaintiff will not play well to a jury, reduced interaction between plaintiff and the adjuster is best. Some adjusters insist on meeting plaintiff before offering settlement dollars.

• ***Practice Pointer***

Remember, adjusters live and breathe these cases – after this one, the adjuster will face plenty more sitting on his or her desk. Plaintiff's counsel should avoid a cookie-cutter approach to mediation, even if the adjuster wishes to proceed in a formulaic manner. If plaintiff will speak, be certain the presentation is entertaining and is successful in segregating this case from all the others in the adjuster's office.

Don't forget the insured

Understand the respective roles of the insured employer and the insurer. Unlike in years past, before EPLI times,

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employers played a primary role in the mediation negotiations. Today, employers may feel that they are being marginalized during the mediation. Whereas employment mediation is not novel for the insurer, it may be a new experience, and quite an upsetting one at that, for the insured.

• ***Practice Pointer***

Plaintiff's counsel may want to seek a few minutes of face time with the insured. By reassuring the insured that the goal is not to put the insured out of business, by demonstrating an understanding that litigation is very disruptive to the insured's business, by showing appreciation for the fact that the insured may feel very negative about the plaintiff and by emphasizing that there's a strong desire to resolve the case quickly and fairly, a human factor is added that may be missing. These efforts may even help the defense counsel obtain the insured's consent to settle.

Mediating when a coverage dispute is looming

Mediating both the coverage and liability cases at the same time can be advantageous. The nature of the dispute will dictate the feasibility of this. In a duty to defend dispute, the insured will be responsible for plaintiff's damages and the mediation need not be postponed pending the resolution of this type of dispute. If the dispute is over the duty to indemnify, parties may insist on knowing the amount of loss before entering into mediation.

• ***Practice Pointer***

This indemnification coverage uncertainty could be used by the mediator to push all parties toward settlement. Knowing of the indemnity dispute, plaintiff's counsel may be receptive to a lower settlement paid out sooner. The presence of the third-party case may incentivize the insurer to contribute a greater amount to a settlement versus battling the indemnification issue with the insured. On the other hand, the insurer may offer less money to settle the case, seeking a discount on its contribution because of the indemnity question. The insured's offer may be paltry, given the indemnification uncertainty. By folding coverage counsel into the mediation, the coverage decision is able to be adjusted in real time, and this could lead to settlement.

Conclusion

Hopefully this article leaves the advocate feeling that the brick wall erected around EPLI is now a porous one, that early mediation does not have to be an insurmountable hurdle and that the "no coverage" mantra may change during the pendency of the lawsuit. Ultimately, by appreciating the insurance industry world and the needs of those who operate within it, and being willing to adjust attitude and practice, the mediation experience can be more fruitful, and the likelihood of settlement of an employment case, enhanced. At the very least, the advocate may understand that insurance professionals are not just "fill in the blank," but that they have a job to do and are functioning within and according to the insurance industry's norms.

Author's note:

I would like to extend my appreciation to individuals who offered their insights into the subject matter of this article, including insurance defense counsel, defense counsel, EPLI brokers and my mediator colleagues. Resources relied upon include: Chin, Cathcart, Exelrod & Wiseman, Cal. Practice Guide*: Employment Litigation (The Rutter Group 2016) ¶¶ 3:1 to 3:835, pp. 3-1 to 3-82; Friedman, Litigating Employment Discrimination Cases (James Publishing Revision 9, 11/14), volume 2, §§ 12:01 to 12:255, pp. 12-1 to 12-186; Advising California Employers and Employees: (Cont.Ed.Bar 2017) Coverage for Employment Claims, Part VII, chap 19, §§ 19.1 to 19.24, pp. 2-25.*

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