EPLiC™

Employment Practices Liability Consultant

"Your quarterly guide to exposures, coverage, and loss control"

Avoiding a Litany of Compliance Exposures in the Hiring Process

By Don Phin, Esq.

The greatest risk an employer faces is hiring the wrong employee or, conversely, not hiring the right one. This article will argue that the small risks inherent in an "active," comprehensive hiring approach pale in comparison to the risks that are created when an employer fails to thoroughly evaluate potential employees before making the decision to hire them.

As the chart below indicates, there will be vastly different outcomes between hiring the right employee and hiring the wrong one.

What Can Go Wrong?

A lot can go wrong when you hire the wrong employee.

The Wrong Employee Is:	The Wrong Employee Will:
Underqualified	Create negative energies
Close-minded	Harass or discriminate against coemployees
Prone to error	Turn off customers or vendors
Habitually absent, late, or lazy	Quit at the drop of a hat
Untrustworthy	Sue your company
Addicted	Cause your company to be sued by a third party
Violent	Create bad press
Unethical	Use up every available day of sick leave Steal company trade secrets or other confidential information Take business opportunities for his or her own
Unhealthy	File for unemployment or workers compensation

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Coming Up

- Preemployment Testing and the Ford Motor Company Discrimination Lawsuit
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From the Editors ...

Welcome to the Winter 2008 edition of *EPLiC*. In each issue, we strive to supply our readers with practical and effective strategies and tools aimed at lowering your company's or your clients' exposures to employment-related claims. We also provide insights and ideas on how to buy the most expansive, cost-effective employment practices liability insurance coverage possible.

According to many attorneys, the more a company engages in preemployment testing, fit-for-duty physical exams, and background screening, the more vulnerable it is to allegations of discrimination, privacy violation, and potential workers compensation retaliation claims. In this quarter's lead article, "Avoiding a Litany of Compliance Exposures in the Hiring Process," *EPLiC* coeditor Don Phin debunks the myth that employers face substantial exposure from such activities. Don explains how a number of key hiring tools can be used legally and effectively in ways that further minimize these already-minor compliance exposures.

In "What Are You Doing To Protect Your Company Against Wage and Hour Lawsuits?" San Francisco attorney Katherine Catlos points out that from a financial standpoint, wage and hour claims have become the most costly employment-related exposure to businesses—far exceeding the pure dollar cost of discrimination claims. She describes new programs that have recently become available that provide coverage—up to $250,000—for defending such claims. Her article concludes by providing a checklist of steps that employers can take to minimize the threat posed by wage and hour litigation.

Next, an article by Mark Lies II shows that workplace harassment is not always of a sexual nature. In "Corralling the Workplace Bully," he explains the characteristics of this exposure, analyzes the liabilities to which it can subject employers, and provides remedies for minimizing its effects.

In "EPLI Policy Exclusions: It's Not What They Exclude, It's What They Except," *EPLiC* coeditor Bob Bregman examines 10 standard exclusions and shows why the exact wording of employment practices liability insurance policy exclusions makes a significant difference in the degree of substantive coverage the policies actually provide.

Please let us know what you think about these articles, as well as advising us of additional topics you would like to see addressed in future issues. Your comments are welcomed and we are anxious to publish them in the next issue of *EPLiC*.

May all of your risks
be profitable,

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What Can Go Right?

In contrast, a lot can go right when you hire the right employee.

The Right Employee Is:	The Right Employee Will:
Highly qualified	Create positive energies
Anxious to learn	Empower coemployees
Responsible, punctual, and attentive	Work to add value and attempt to advance within the company
Trustworthy	Create profitability
Focused	Work as a team member
Healthy	Act respectfully and responsibly
Ethical	Keep company trade secrets confidential
Loyal	Create new business opportunities for the company
Innovative	Work in a safe and healthful manner, lowering your insurance costs

The bottom line: hire the right employees! They are well worth the time, effort, and expense. This article will demonstrate how to minimize the hazards that are sometimes created during the employee evaluation process.

Hiring and Compliance: The Great Paradox

Ironically, the greater the effort an employer makes to hire the right employees, the greater its compliance exposure. For example, one of the things I preach is prehire physicals (otherwise known as "fit-for-duty exams"). The potential exposures created by such exams, as we'll discuss below, are allegations of privacy invasion, possible workers compensation retaliation, and Americans with Disabilities Act (ADA) violations. So, if a company requires these exams, it may properly avoid "hiring" a workers comp claim but, in the process, exposes itself to this litany of other claims. Figure 1 outlines the types of risks associated with the hiring process.

Figure 1
Risks Associated with the Hiring Process

Hiring Activity	Potential Claim Allegation/Potential Outcome
Online recruitment	Discrimination, privacy breach
Interviewing	Discrimination, breach of contract, misrepresentation, privacy, ADA, workers comp
Skill testing	Discrimination, ADA
Character assessment	Discrimination, privacy, ADA
Background checks	Discrimination, privacy, Fair Credit Reporting Act (FCRA), immigration law violations
Fit-for-duty exams	Discrimination, privacy, ADA, workers comp
Not doing the above	Hiring thieves, frauds, illegal drug-users, whiners, losers, and claimants

Choosing Your Risks

Optimal risk management is about choosing your risks. As Walter Olson, author of *The Excuse Factory* (published by The Free Press, New York, NY, copyright 1997), stated, "There is no such thing as the Golden Shores of legal compliance." The legal risks associated with these

hiring activities, while they do exist, are minimal, compared to the risk of hiring the wrong employee. Indeed, the most successful employers have consciously chosen to assume a handful of relatively small compliance risks, in return for avoiding the much greater downside associated with hiring the wrong employee.

Unfortunately, I find too many lawyers telling their employer-clients to do just the opposite. Instead of assuming small compliance risks, they advise their clients not to engage in an "active" hiring process—but only because they heard of an aberrant, once-in-a-blue-moon case in which an employer was sued and the claimant received a significant settlement or jury award.

Providing References: How So-Called Risk Avoidance Can Prove Costly

A classic example of this syndrome involves the giving of references. Because of a relatively few unscrupulous employers who have been sued for slandering competent former employees when providing references, lawyers now advise businesses to not give references at all. But let me ask you this: which disserves the business community more, the 1-in-10,000 slander claim by a former employee or the fact that employers simply don't communicate with each other any longer? In exchange for avoiding the rare slander claim, companies have abdicated their right to exchange the kind of honest, first-hand evaluations of former employees, the kind that can truly assist in making optimal hiring decisions, or even more important, avoiding the employee who creates havoc.

Consider the situation several years ago when a nurse at a New Jersey hospital was found to have administered fatal overdoses of medication to more than 30 patients. Previous employers had dismissed the nurse under suspicion of serious misconduct. But they were reluctant to elaborate on the numerous complaints and problems surrounding his tenure when the New Jersey hospital attempted to obtain references. In this case, the cost of so-called risk avoidance was staggering.

Skill Testing

As I often remind employers in workshops, "Half the employees out there are above average and half are below average. Which half do you have?" I will preach to anyone who will listen about the importance of skill testing.

The Risks of Not Doing Skill Testing

Let me provide you with the same example I give my workshop participants. It illustrates the importance of skill testing.

Just prior to ending my litigation practice, a woman walked into my office wanting to sue the law firm that had fired her. To make a long story short, she was an experienced litigation secretary who had worked for a partner at a competing firm for 15 years and no longer wished to stay there. She put it out to the grapevine that she was looking for greener pastures. At the same time, a litigation partner at another law firm had recently lost his legal secretary on short notice. He too, put word out to the grapevine and that was how they met. He interviewed her. She was likeable, obviously knew what she was doing, and was hired on the spot. Unfortunately for both parties, within 3 months, the relationship was over. She was let go for not being as productive as the previous litigation secretary.

The Importance of Defining the Critical Skill Set

I started off my interview by asking her this question: "What level of skill was required for you to be successful at your job?" Her answer was, "I know my job." But she wasn't getting my point. Legal secretaries have three fundamental functions. They type, probably as much as 60 percent to 80 percent of their day. The rest of their time is spent dealing with procedural matters and client management. So, she could have been skill tested on her: (1) typing speed, (2) substantive knowledge of litigation procedures, and (3) client administrative protocols. When I asked what her typing speed was, she indicated that it was 80 words per minute. Unfortunately, typing speed was never discussed during the hiring process. As it turns out, I contacted her predecessor in the job, who typed roughly 100 words per minute—but her boss didn't know that.

The lesson is this: *That legal secretary was literally set up for failure on day one* because the attorney wasn't crystal clear about the specific skill set that was required to be successful. From his

perspective, he was trying to duplicate the skill set of his previous legal secretary. Yet because he hadn't defined it, nobody knew about it!

Over the long haul, there is a big difference in productivity between someone who types 100 words per minute and one who types 80 words per minute—and we haven't even begun discussing the substantive knowledge or client management requirements of the job. So, consistent with the theme of this article, there is a huge risk exposure for firms that do not engage in skill testing of prospective employees. And the risk is usually not from the hiring side; it's from the termination side, where the dollars and emotions are far greater.

Skill Testing and Compliance Risks

The risk with any testing approach is that it may create a disparate impact on one group of applicants. For example, an IQ requirement may have a disparate impact on blacks. A company would then have to identify a legitimate business reason for allowing that disparate impact to continue. Unfortunately, in most instances, a common-sense argument won't work. As a result, many employers will unnecessarily shy away from skill testing to avoid having to make a business justification case. But all I can say is that in 25 years of representing both employees and employers, I have never once had to handle such a case. In reality, the reported number of claims asserting disparate impact discrimination is small, and even when such claims are successful, the resulting damages are certainly not severe. Again, I believe the greater risk is not doing skill testing, especially when weighed against the minute potential of a disparate impact claim.

Character Assessments

These tools are not called "personality tests"—because you can't fail your personality! According to the book, *Blink,* by Malcolm Gladwell (published by Little, Brown and Company, New York, NY, copyright 2005), there are approximately 2,500 different character assessment tools in the marketplace, such as DISC, Profiles International, Kolbe, McQuaig, Caliper, and so on. This means that, of course, the best one is the one *you* use. It is appropriate for me to mention that for many years I have recommended IRMI's character assessment program, ZERORISK HR, to my clients. It is an excellent tool.

The Importance of Personality Testing

Let me give you an example of how important these tools are. Customer service representative, also known as account manager, is one of the most common positions in the insurance world. The key challenge inherent in this job is that it requires what I consider a "split personality." Half the day, customer service reps work on data management, a "left brain" activity. The other half of the day, they build customer relationships, which is primarily a "right brain" activity. The problem is people are either dominant on their left or their right side of their brain. If it were my insurance agency, I would assess all of the CSRs and have those folks who are very good at data management perform that aspect of the job 80 percent of the day and those who excel at customer service management would work in that area for at least 80 percent of the day. Using this approach would increase both their passion for the work as well as their productivity. To do otherwise is an attempt to jam round pegs into square holes—simply because that is what the CSR's job description calls for. Marcus Buckingham wrote about how ridiculous this mindset is in *First Break All the Rules* (coauthored by Curt Coffman, published by Simon & Schuster, New York, NY, copyright 1999 by The Gallup Organization).

Another example: if you are hiring a chief financial officer for your company, you would want somebody who enjoys paying a great deal of attention to detail. But unless you assess for this character trait, how could you be certain if a candidate possessed it? I don't know about you, but I don't want a CFO with a low attention to detail managing *my* books! But of course, there is the risk side, which again, is relatively minor. The risk side associated with a character assessment tool is that it, too, can have a disparate impact on job applicants.

Uniform Guidelines for Employee Selection Procedures

Both skill testing and personality assessment tools are subject to uniform guidelines. Specifically, the Equal Employment Opportunity Commission's Uniform Guidelines on Employee Selection Procedures, 29 CFR Part 1607[1], provide a framework to help ensure that a test used as part of the hiring, evaluation, or promotion process will be employed in a nondiscriminatory manner.

It is important to note that the Uniform Guidelines address all parts of a selection procedure, including resume reviews, interviews, and assessments. The goal of the guidelines is to prevent unnecessary discrimination against protected groups.

The Four-Fifths Rule

Adverse or disparate impact occurs when a selection process results in a substantial difference in the selection rates for different racial, gender, or age groups. The EEOC's Uniform Guidelines on Employee Selection Procedures (designed in 1978) require the use of the "four-fifths rule." It provides that a "selection rate for any race … which is less than four-fifths (or 80 percent) of the rate for the group with the highest rate will generally be regarded by the [EEOC] as evidence of adverse impact…."

When adverse impact is present, the Uniform Guidelines require employers to validate the use of each component of their selection process, including interviews, assessments, and all other methods, and to verify that each component is job-related and cannot reasonably be replaced by another procedure that produces less adverse impact.

The Upside—and Downside—of Skill Testing and Personality Assessments

When skill tests and personality assessments are applied properly, they actually *reduce* your legal risk, since they add objectivity to the selection process. This is because the results of skill tests and personality assessments are normally expressed in a precise, quantified manner by means of a specific score or percentile ranking. Conversely, careless use of assessment tools is just as risky as are untrained interviewers. The key is to implement any assessment tool or skill test in a thoughtful manner and to verify that all aspects of these tests/assessments bear a *direct relationship* to the actual skill set required for the job in question.

Evaluating and Monitoring the Assessment/ Skill Testing Process

If a test or assessment has adverse impact, you should validate that the assessment is job-related, using a job analysis, evaluation of alternate methods of measuring the same thing that have less adverse impact, and verification that the assessment is applied in a way that minimizes the amount of adverse impact. This might, for example, involve reducing or even eliminating a specific cutoff score for a certain job. The best way to ensure that you are not violating the Uniform Guidelines is to conduct a proper job analysis and use it to choose each component of your selection process. Then, monitor the process for adverse impact and make adjustments as required.

"Hard" vs. "Soft" Job Requirements

As stated by what, in my opinion, is the best skill testing Web site on the market, BrainBench.com, "no matter what method you use to test someone, the key question that must be answered is: *'What key attributes are required for high performance and are difficult to teach once the person is on the job?'"* For instance, the job of "New Business Sales Representative" obviously requires an extroverted, outgoing personality. But even after taking all of the best available courses, those imparting the latest, most effective "techniques" of the sales process, an introvert is still not likely to succeed in such a position. In many jobs, certain individuals can simply never "learn" their way to successful job performance.

As BrainBench.com further states, "For some jobs, the critical attributes are obvious. For example, a medical doctor must have a degree and a license to practice medicine. A lawyer must be licensed to practice law. A data entry clerk should be able to type at a certain number of words per minute. For other jobs, however, the

key elements are less obvious. For example, what are the most important attributes to look for when hiring a security guard or a sales person?"

The EEOC Fact Sheet

The EEOC recently issued a new fact sheet on the application of federal antidiscrimination laws to employment tests and selection procedures for workers and applicants. The fact sheet describes commonly used tests in the modern workplace, including cognitive tests, personality tests, medical examinations, credit checks, and criminal background checks. It further sets forth "best practices" for employers to follow when using employment tests and other screening procedures, including the following.

- Determining the selection procedure with the least adverse impact on a protected group of employees;
- Updating test specifications or selection procedures to conform to changes in job requirements; and
- Ensuring that managers understand the test procedure's effectiveness and limitations, appropriate administration, and scoring.

The new fact sheet may be found at the EEOC's Web site, http://www.eeoc.gov/policy/docs/factemployment_procedures.html.

Trends in Testing-Related Discrimination EEOC Charges

The percentage of discrimination charges raising allegations of disparate impact employment testing and exclusions based on criminal background checks, credit reports, and other selection procedures has been increasing since fiscal year 2003. However, according to a December 2007 EEOC press release, the absolute number of such charges is still small. In fiscal year 2003 there were 26 such charges, and in fiscal year 2006 the number had risen to 141. (http://eeoc.gov/press/12-3-07.html)

Testing and Privacy Issues

I have also seen some people argue that assessments violate their rights to privacy. The most well known case in this area is *Soroka v. Dayton Hudson Corp.,* 235 Cal. F. App. 3d 654 (1991), in which a California appellate court found that the compelling interest test determines whether a psychological test violates an applicant's right to privacy. In this case, Target department stores were using a blend of tests to help in hiring security officers. Among other things, the tests contained questions concerning the applicant's sexual, religious, and moral preferences. Because Dayton Hudson was unable to show that the tests directly measured the specific characteristics required by a qualified security officer, the court determined that these intrusions invaded the applicants' privacy. If a company is foolish enough to take such an approach, it shouldn't be surprised when it gets sued. But that is the only privacy case I have seen successfully litigated in my 25 years of practice. Again, the problem was not that Target used testing, but that *the test it used bore no relationship to the skill set required for the job.*

Privacy Expectations Vary

A number of privacy cases decided across the country over the last several years have made it very clear that the "expectation of privacy" is at its lowest during the application stage. Conversely, courts appear to place a higher burden on employers who use assessment tools when making promotion or downsizing decisions, conditions under which the affected worker is already employed. It is also evident that the manner in which a test is presented and how its results are communicated go a long way in creating the perception of whether it was fair or whether the test invaded a person's privacy.

Criminal and Credit Background Checks

The Fair Credit Reporting Act (FCRA) governs the use of third-party agencies that conduct criminal and credit background checks.

Criminal Background Checks: Reporting Limitations

Both federal and state laws limit the scope of inquiry into an applicant's criminal background. For example, an employment application might ask if you have "ever" been arrested. On the

other hand, the FCRA prohibits a consumer reporting agency from reporting an arrest that took place more than 7 years ago. *But it does not say that the employer cannot ask the question.*

According to a Federal Trade Commission (FTC) attorney, in a letter dated December 10, 1998, in response to an inquiry regarding the length of time a consumer reporting agency may report "adverse" items of information under Section 605(a) of the FCRA:

> Except for records of criminal convictions, which may now be reported without any time limitation, Section 605 of the FCRA prohibits consumer reporting agencies from providing adverse information that is more than seven years old (ten years in the case of bankruptcies) for employment purposes where the annual salary is less than $75,000. There are no restrictions upon reporting adverse information for jobs involving salaries of more than $75,000.

State employment laws may limit the questions an employer includes on a job application. For example, in California an application may ask "job related questions about convictions, except those convictions which have been sealed, or expunged, or statutorily eradicated," but applications cannot ask "general questions regarding an arrest." (http://www.dfeh.ca.gov/Publications/publications.aspx?showPub=9)

When Applicant Authorization and Notification Are Required

Under the FCRA, the employer must obtain the applicant's written authorization before the background check is conducted. The authorization must be on a document separate from all other documents, such as an employment application. In California, at the time an employer obtains permission for a background check, the applicant or employee should also be told that he or she may request a copy of the report. The FCRA, in contrast, says the applicant is entitled to a copy of the report if a pre-adverse notice is given (i.e., if the report indicates an arrest or conviction).

Under federal law, if the employer uses information from the consumer report for an "adverse action," that is, denying the applicant a job, terminating the employee, rescinding a job offer, or denying a promotion, it must take the following steps, which are explained further in the Federal Trade Commission's Web site, http://www.ftc.gov/bcp/conline/pubs/buspubs/credempl.htm, and give the applicant a "pre-adverse action disclosure." This includes a copy of the report and an explanation of the consumer's rights under the FCRA.

After the adverse action is taken, the individual must be given an "adverse action notice." This document must contain the name, address, and phone number of the employment screening company, a statement that this company did not make the adverse decision, rather that the employer did, and a notice that the individual has the right to dispute the accuracy or completeness of any of the information in the report.

Credit Background Checks

The EEOC has been urging companies to proceed cautiously when utilizing credit checks in their employment screening decisions. Credit checks have a potential for discrimination under Title VII, unless, of course, there is a legitimate business necessity.

Research done in 2004 by the Texas Department of Insurance has been cited extensively in this area. The research focused on 2 million individuals and found that "… Blacks have an average credit score roughly 10% to 35% worse than the credit scores for Whites; Hispanics have an average credit score that is 5% to 25% worse than those for Whites." (http://www.tdi.state.tx.us/reports/documents/creditrpt04.pdf) Given these discrepancies, the potential for adverse impact discrimination is substantial. The message: employers should proceed cautiously when using credit scores in making hiring decisions.

Be Sure You Can Justify any Disparate Impact

The business justification case gets really interesting. In researching this article, I found no empirical studies linking credit scores to job performance or other risk factors. As stated earlier, common sense is not enough to defeat a disparate impact argument. Only data can do so.

Once the plaintiff "demonstrates that a respondent uses a particular employment practice that causes a disparate impact on the basis of race," the burden of proof shifts to the defendant to "demonstrate that the challenged practice is job-related for the position in question and consistent with business necessity." This standard was codified into Title VII but originated from *Griggs v. Duke Power Co.,* 401 U.S. 424 (1971), which rejected two job requirements because "neither … is shown to bear a demonstrable relationship to successful performance of the jobs for which it was used. Both were adopted … without meaningful study of their relationship to job-performance ability."

As part of a May 16, 2007, EEOC meeting on Employment Testing and Screening, plaintiff attorney Adam T. Klein provided a well-researched 10-page statement that outlined the argument for severely restricting credit and criminal background checks. That statement can be (and should be) read in full at http://www.eeoc.gov/abouteeoc/meetings/5-16-07/klein.html.

All I can say after reading Mr. Klein's statement is that his opinions would probably be very different if he had operated a business and was forced to pay a large out-of-pocket settlement or judgment to an employee who he would never have hired had a criminal background or credit check been conducted.

Preemployment Physicals and Job Accommodation Issues

Wouldn't it be great if employers could obtain any information they want about a job applicant's medical background, workers compensation claims history, drug use, sick leave use, disabilities, and any other possible "challenges" that could warn us of a poor hire or potential claim? In a well-publicized case, one employer who was hyper-concerned about risky hires surreptitiously took DNA hair samples, to assess a propensity for health problems (or worse). Of course, when the applicants found out, the company was quickly hit with a lawsuit and agency sanctions. Whether business owners and managers like it or not, the EEOC has made it very clear that employers are limited in the scope of allowable inquiries before making a conditional job offer. Even then, privacy and myriad other laws come into play.

The General Rule Regarding Prehire Health Inquiries

The general rule is this: the Americans with Disabilities Act (ADA) allows on an application prehire inquiries into the ability to perform a particular job (e.g., can you lift this 30-pound mail sack with or without an accommodation?). On the other hand, it prohibits any preoffer inquiries about a generalized disability (e.g., have you ever been injured while lifting?). However, after making a conditional job offer, an employer can ask almost anything. You can ask about the employee's workers compensation history, sick leave usage, medical challenges, addictions, you name it.

Focus on the Ability To Perform a Specific Job, Not on a Specific Disability

Information that may be requested on application forms or in interviews includes questions to determine whether an applicant can perform specific job functions. But the questions should focus on the applicant's ability to perform the specific job in question, not on a disability. For example: an employer could attach a job description to the application form, with information about specific job functions. Or, the employer may describe the functions of the job. This will make it possible to ask whether the applicant can perform these functions. It also will give an applicant with a disability requisite information to request an accommodation required to perform a specific task. The applicant could also be asked:

- Are you able to perform these tasks with or without an accommodation?

If the applicant indicates that he or she can perform the tasks with an accommodation, he or she may be asked:

- How would you perform the tasks, and with what accommodation(s)?

The interviewer may describe or demonstrate the specific functions and tasks required by the job and ask whether an applicant can

perform these functions with or without a reasonable accommodation.

Questions Regarding Attendance

Questions regarding attendance must also be handled properly. Information concerning previous work attendance records may be obtained on the application form, during the interview, or in reference checks. But the questions should not refer to "illness" or "disability."

The interviewer may provide information on the employer's regular work hours, leave of absence policies, and any special attendance needs of the job, and ask if the applicant can meet these requirements (provided that the requirements actually do apply to employees in a particular job).

For example: "Our regular work hours are 9 a.m. to 5 p.m., 5 days weekly, but we expect employees in this job to work overtime, evenings, and weekends for 6 weeks during the Christmas season and on certain other holidays. New employees get 1 week of vacation, 7 sick leave days, and may take no more than 5 days of unpaid leave per year. Can you meet these requirements?"

When Can a Fit-for-Duty Exam Be Administered?

After making a conditional job offer and before an individual starts work, an employer may conduct a medical examination or ask health-related questions, provided that all candidates who receive a conditional job offer in the same job category are required to take the same examination and/or respond to the same inquiries. For example:

- An employer may condition a job offer on the satisfactory result of a postoffer medical examination or medical inquiry if this is required of all entering employees in the same job category. A postoffer examination or inquiry does not have to be "job-related" and "consistent with business necessity." Questions may also be asked about previous injuries and workers compensation claims.
- If an individual is not hired because a postoffer medical examination or inquiry reveals a disability, the reason(s) for not hiring must be job-related and necessary for the business. An employer with more than 15 employees also must show that no reasonable accommodation was available that would enable this individual to perform the essential job functions, or that the accommodation would impose an undue financial hardship on the business.
- A postoffer medical examination may disqualify an individual who would pose a "direct threat" to his or her own health or safety, or to the health/safety of others. Such a disqualification must be job-related and consistent with business necessity.
- A postoffer medical examination may not disqualify an individual with a disability who is currently able to perform essential job functions because of speculation that the disability may increase the risk of future injury (e.g., a recovering alcoholic).

If you choose not to hire someone based on his or her medical history, the decision must be directly related to his or her inability to perform the job up to a certain standard or because in doing so, he or she may harm himself, herself, or someone else. Employers with more than 15 employees are required to consider job accommodations. Lastly, you would be wise to have medical inquiries done by a physician and have the physician maintain the underlying medical records.

I recommend that if anyone ever has an accommodation issue he or she contact the Job Accommodation Network at http: www.jan.wvu.edu.

Interviewing

The more questions you ask in an interview, the better the chance of making a great hire. But the more questions you ask, the more you risk asking the wrong question and getting hit with a discrimination or privacy claim. Here are examples of questions that can get an employer in trouble.

- Have you ever filed a workers comp claim?

- I'm curious, what is your age, race, nationality, etc.?
- Do you and your family stay healthy?
- Do you have any kids in school to worry about?
- Do you plan on getting pregnant anytime soon?
- And many, many more.

One way to reduce the chances of asking the wrong question: develop a uniform set of interview questions that will be asked in all interviews. Then, have the questions reviewed by outside employment counsel.

Racial Discrimination

Today's employment laws have their genesis in challenges faced by blacks prior to the early 1960s. The main reason the Civil Rights Act of 1964 was passed was so that blacks could have equal access to employment opportunities. Regrettably, in many places, this challenge remains. I remember giving a workshop to a group of executives in Texas and one attendee stated unapologetically that he consistently favored white applicants over black applicants in making hiring decisions. Although such attitudes are unusual, regrettably, they do still exist.

In addition to blatant racial discrimination, a great deal of unconscious bias exists. Such bias is based on stereotypes and prejudices, often hidden from the conscious mind of the person making a hiring decision. Malcolm Gladwell talked about this phenomenon in his book *Blink,* referred to earlier.

An Inherent Problem for Large Companies

The larger the size of the employer, the greater the company's exposure to racial discrimination claims. In the *Coca-Cola* class action claim, a case discussed in the Winter 2001 issue of *EPLiC,* the plaintiffs argued that the company's hiring practices had disparate impact on blacks. Once the impact is statistically significant—which in a large company is much easier to prove, compared to a smaller organization—the burden shifts to the employer to disprove that discrimination is the cause of the racial disparity.

The larger the size of the employer, the greater the company's exposure to racial discrimination claims.

Fighting this leap in logic is difficult for any employer but is especially so for a huge multinational corporation like Coca-Cola. This difficulty has resulted in significant settlements such as that paid by Coke ($192.5 million), Texaco ($176 million), and Sodexho Marriott ($80 million). Ironically, at the time of the settlement, most observers considered Coke to be one of the most progressive employers in the country! Of course, the plaintiffs' attorneys received about $40 million of the settlement, a far cry from any individual claimant, who would have been lucky to receive a six-figure payment. But that is the state of today's civil justice system.

Sex Discrimination

As with racial discrimination, many of these claims are being driven "underground." As with race discrimination, compared to 20 or 30 years ago, sex discrimination claims now result from less overt, more subtle, and less conscious actions on the part of employers. Such decisions are often based on veiled stereotypes. For example, there is the notion a woman can't make a good forklift operator or that a man can't function effectively as a nurse, and so on. I remember counseling three female attorneys, on separate occasions, each of whom felt she had hit the glass ceiling at her law firm. Substantial pay differentials also remain between males and females who perform comparable jobs.

Of course, employers are very concerned about everyone's productivity. This concern is heightened when one of the employees is a primary caregiver. Since this burden falls largely on women, it too can result in sex discrimination claims.

Moreover, since only females can get pregnant, which necessitates absence from the workplace, pregnancy discrimination represents yet another gender-related exposure to claims.

Age Discrimination

There is a wider generation gap in today's workplace than ever before. This is due to a combination of demographics and technological changes. It's hard to believe today that anyone over the age of 40 is still considered to be an "older worker." I wouldn't be surprised if statistics reveal that we have more "older" workers than younger ones. Having made that observation, a judge in California recently allowed a lawsuit to proceed against Google because somebody was fired for allegedly not fitting in with the company's "youth culture." The same argument can be made in the hiring process. You can expect to see more of these claims.

Reducing Stereotyping Based on Race, Sex, and Age

The fact is, racial, sex, and age discrimination claims can be reduced by using sound hiring practices. For example, many orchestras now do "blind" auditions, in which musicians play behind a screen during the evaluation process. This approach has dramatically increased the percentage of women hired—in the same way that a character assessment tool helps display a person's personality traits—without identifying somebody's age, sex, or skin color. The same goes for skill testing and prehire fit-for-duty exams. Rather than making decisions based on race, sex, age, or any other characteristic unrelated to job performance, employers should strive to incorporate evaluation procedures into their hiring protocols that produce *objective* and *quantifiable* measures of a job candidate's abilities and personality traits.

Online Recruiting

The main issue associated with online recruiting is the question of who is an "applicant" for discrimination purposes. The EEOC guidelines make it clear that simply submitting a resume—in the absence of an actual, advertised job opening—is not enough to reach such a level.

In addition, corporate human resources personnel must keep track of all persons that properly submit an online application for an open job.

The EEOC guidelines make it clear that simply submitting a resume—in the absence of an actual, advertised job opening—is not enough to reach such a level.

While there was once a lot of "noise" generated by real or imagined compliance exposures associated with the online recruiting process, I am not yet aware of any claims that have resulted from it.

Concluding Thoughts

There is no substitute for getting the right person on every seat of the bus. But, ironically, the more active and focused the effort to accomplish this critical goal during the hiring process, the greater a company's compliance exposure. Hopefully, this article has demonstrated that not only are these compliance risks vastly overblown, but that the relatively minor risks that do exist can be largely avoided by following the guidelines I have provided. *EPLiC*

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Sources of Additional Helpful Information

The following online sources provide useful information to help you hire more effectively, while avoiding the compliance minefields discussed in this article.

- EEOC Policy Guidance on the Consideration of Arrest Records
  http://www.eeoc.gov/policy/docs/arrest_records.html
- FTC: Using Consumer Reports: What Employers Need To Know
  http://www.ftc.gov/bcp/conline/pubs/buspubs/credempl.shtm
- EEOC Informal Discussion Letter Regarding Credit Checks
  http://www.eeoc.gov/foia/letters/2005/titlevii_credit_reports.html
- EEOC Testimony of Adam T. Klein, Esq., Regarding Credit Checks and Criminal Background Checks
  http://www.eeoc.gov/abouteeoc/meetings/5-16-07/klein.html
- Privacy Rights Clearinghouse Employment Background Checks: A Job Seeker's Guide
  http://www.privacyrights.org/fs/fs16-bck.htm
- EEOC Informal Discussion Letter Regarding Validity of Testing
  http://www.eeoc.gov/foia/letters/2005/titlevii_ugesp.html
- Nondiscrimination in the Hiring Process: Recruitment; Applications; Preemployment Inquiries; Testing
  http://www.jan.wvu.edu/links/ADAtam1.html#V
- EEOC Uniform Guidelines on Employee Selection Procedures
  http://www.access.gpo.gov/nara/cfr/waisidx_02/29cfr1607_02.html
- Promoting Diversity Means Testing Employment Tests Published by the AFL-CIO
  http://www.workingforamerica.org/documents/PDF/EmploymentTestsFinal8.pdf
- The Association of Test Publishers
  http://www.testpublishers.org/
- DOJ Disability Rights Section Home Page
  http://www.usdoj.gov/crt/drs/drshome.htm
- EEOC Getting Medical Information from Employees
  http://www.eeoc.gov/ada/adahandbook.html#medical
- EEOC Americans with Disabilities Act
  http://www.eeoc.gov/ada/index.html
- EEOC Enforcement Guidance: Preemployment Disability—Related Questions and Medical Examinations
  http://www.eeoc.gov/policy/docs/preemp.html
- Questions and Answers: Enforcement Guidance on Disability-Related Inquiries and Medical Examinations of Employees under the ADA
  http://www.eeoc.gov/policy/docs/qanda-inquiries.html
- Enforcement Guidance: Disability-Related Inquiries and Medical Examinations of Employees under the ADA
  http://www.eeoc.gov/policy/docs/guidance-inquiries.html
- Job Accommodation Network Job Descriptions
  http://www.jan.wvu.edu/media/JobDescriptions.html

What Are You Doing To Protect Your Company Against Wage and Hour Lawsuits?

By Katherine S. Catlos, Esq.

Employers throughout the United States are being bombarded with lawsuits alleging wage and hour violations and the employees are certainly coming out as winners. Recently, Staples paid $38 million—more than $22,000 to each "assistant manager" who allegedly was misclassified as an exempt employee under overtime laws. Starbucks is also in "hot water," having just lost a class certification ruling to 900 "managers" who claim to have been improperly classified as "executives."

There can be no doubt that wage and hour violations are the single largest exposure for employers today, far exceeding that from discrimination claims.

But wage and hour lawsuits are not limited to large employers or even to class actions. Their impact upon smaller companies may be far greater. One employee recovered a six-figure settlement because he meticulously documented the time he spent "on call," as a result of his employer's failure to properly utilize time cards. There can be no doubt that wage and hour violations are the single largest exposure for employers today, far exceeding that from discrimination claims.

The Fair Labor Standards Act

The operative law known as the Fair Labor Standards Act was enacted by Congress in 1938. The FLSA requires most employers in the United States to comply with minimum wage and hour standards. Oftentimes, comparable state laws, such as those in California, apply even more stringent requirements. The FLSA's basic requirements govern the payment of overtime wages, overtime wages for employees working more than 40 hours per workweek, and employment limitations for children, and mandate record keeping by employers.

The issue of who is an "exempt" employee continues to cause employers huge headaches. Basically, there is an overtime exemption for executive, administrative, professional, and outside sales employees under the FLSA and under most state labor codes. To be exempt from eligibility for overtime pay, these employees must meet certain tests regarding job duties and responsibilities and be compensated "on a salary basis" at not less than stated amounts. Such tests, however, are highly confusing and even those paid on a salary basis can sometimes be eligible for overtime pay.

Litigating wage and hour claims is extremely expensive. Oftentimes, the prevailing plaintiffs (both current and former employees) can recover double the actual damages plus attorneys' fees. If an employer is found to have willfully violated FLSA, a 3-year statute of limitations applies, compared to the longer 4-year statute of limitations applicable under California's Business and Professions Code 17200 *et seq*.

Sources of Wage and Hour Litigation

Perhaps the most pervasive—and costly—myth associated with wage and hour claims is that they result only because employers fail to pay overtime to "nonexempt employees." In fact, there are numerous *additional* sources of wage and hour claims. These include the following.

- Misconceptions that if an employer pays someone a salary, he or she is automatically classified as "exempt." Generally speaking, in California, employees are exempt from receiving overtime wages only if they spend more than 50 percent of their time working in "administrative, executive, or professional" capacities, which is primarily

"intellectual, managerial, or creative which requires the exercise of discretion and independent judgment." 8 Cal Code Regs §§ 11070.

- Misclassifying employees as independent contractors and not paying them overtime.
- Not properly paying employees for overtime; i.e., compensation for hours worked in excess of 8 hours in a given day or more than 40 hours in a week.
- Miscalculating the amount of wages owed (i.e., applying the wrong rate, crediting tips, etc.).
- Not paying qualified employees for time they are "on call."
- Allowing employees to work "off the clock" (i.e., not paying for time spent for opening tasks or closing duties, before and after the official workday, or for time spent donning uniforms, attending seminars, etc.).
- Not allowing employees to take meal or rest breaks; notably, state law requires an unpaid 30-minute, uninterrupted meal period whenever the employee works 5 or more hours (with a second meal period for workdays of 10 hours or longer) and a paid 10-minute rest period for each 4 hours of work. This often occurs with the diligent employee who works through his or her lunch period.
- Not paying qualified employees for "on call" time or travel time.
- Not paying employees on a timely basis.
- Not paying all wages due and owing at the time of termination; such delays could result in "waiting time" penalties in that the employee's wages continue to accrue each day he or she is paid late—up to 30 additional days.
- Docking exempt employees' salaries for absences; among many other related claims such as retaliation, etc.

Among other allegations, it is very easy for employees to allege that they were not allowed to take meal or rest breaks. Conversely, it is very difficult for employers to defend against these claims unless they have compiled proper documentation. Unfortunately, employers often have little or no evidence documenting how their employees spend their days. But by the same token, the last thing an employer needs is a costly expert who shadows its employees, only to testify before a worker-friendly jury about how many hours an employee is truly engaged in exempt tasks. Talk about a classic "catch-22" situation!

Insurance Coverage to the Rescue

Given the risks caused by this onerous exposure, employers have been looking to their brokers and insurers to obtain coverage for FSLA / wage and hour claims. In response to this need, creative underwriting professionals, such as Socius Insurance Services, Inc., in San Francisco, California, have developed markets for placing appropriate coverage.

The new product is a boon to employers—especially smaller ones—previously left to defend against this costly litigation without the benefit of insurance.

More specifically, they now offer employment practices liability insurance (EPLI) policies that provide defense coverage for wage and hour claims. Coverage is available as a sublimit to the policy's aggregate limit, in increments of either $100,000 or $250,000. The new product is a boon to employers—especially smaller ones—previously left to defend against this costly litigation without the benefit of insurance.

Additional Benefits

Another advantage afforded by this approach is that the defense coverage for wage and hour claims is written on a first-dollar basis. This means it is not subject to the policy's regular deductible/retention, which is often substantial.

Nor do payments for defending wage and hour claims reduce the policy's annual aggregate that is available for other types of employment-related claims; rather, the policy's wage and hour defense sublimit is a wholly separate amount of coverage.

Despite the absence of an insurer requirement, it is still a good idea for an employer to have experienced counsel periodically examine its exposure.

Lastly, under these policies, there is typically no requirement that the insured undergo an audit to evaluate the extent of its wage and hour exposure. Rather, insurers will agree to provide the coverage solely on the basis of the insured's answers to questions on the application that pertain to its wage and hour compliance program. (Despite the absence of an insurer requirement, it is still a good idea for an employer to have experienced counsel periodically examine its exposure.)

Steps To Reduce the Exposure to Wage and Hour Claims

Although insurance coverage can reduce much of the risk posed by wage and hour claims, it is not a panacea. Accordingly, employers should also take the following steps to minimize their liability exposure under federal and state wage and hour laws.

- Audit internal wage and hour practices with the assistance of experienced employment law counsel to ensure wage and hour laws are being followed.
- Create accurate job descriptions for all personnel, ensuring that the duties described for nonexempt and exempt staff are correct.
- Classify independent contractors, nonexempt, and exempt employees properly.
- Keep accurate and written time records for nonexempt employees' hours worked, including documentation regarding meal periods taken, signed off on by *both* the employer and employee.
- Require nonexempt staff to clock in and out at the beginning and at the end of the day, as well as for meal periods.
- Prohibit nonexempt employees from eating lunch at their desks or at their designated work areas; doing so could result in the employee arguing that they were required to be "on duty" during their lunch break.
- Pay for all "hours worked."
- Pay terminated employees all wages due and owing at the time of termination; or within 72 hours, to an employee who has resigned.
- Periodically review wage and hour policies to ensure compliance with constantly changing laws.
- Train supervisors and managers on FLSA and state wage and hour laws.
- And of course purchase EPL insurance that includes coverage for defending wage and hour claims.

Concluding Thoughts

By taking these steps, employers can shift the tide in the wage and hour litigation bonanza. In fact, implementing these precautionary measures could very well result in lower premiums for EPL coverage and hopefully prevent wage and hour lawsuits altogether. *EPLiC*

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Corralling the Workplace Bully

By Mark A. Lies II

As most employers are aware, the employer has a duty to protect its employees against all forms of harassment at the workplace (including harassment based upon sex, race, age, religion, national origin, disability, etc.) under existing federal and state employment laws. Moreover, such harassment is frequently a breeding ground for workplace violence. And when the victim (or a relative) finally reacts to the conduct (which often results in physical acts or threatening conduct toward the harasser), the employer must have a policy that prohibits such forms of conduct.

Fortunately, many employers have responded to these challenges by adopting and enforcing antiharassment and workplace violence prevention policies. Such policies are required to prohibit the kind of egregious conduct that the law defines as "severe or pervasive" and that creates a "hostile work environment" for the victim and for other employees who may witness such conduct.

What Is "Bullying"?

Unfortunately, while the employer's policies may help to identify and eradicate the high-profile forms of sexual and other harassment for which there is clearly recognized legal liability, there is also a vast undercurrent of slightly less but still objectionable conduct that pervades the workplace and can have a crippling effect on employee morale, productivity, and the overall workplace culture of mutual respect. This phenomenon is known as "bullying."

While growing up, nearly all of us either experienced directly or witnessed bullying by fellow students and sometimes by teachers, conduct that can have lifetime impact on students. In fact, state law requires many school districts to conduct training and to protect students against all forms of bullying in the academic setting.

As we all complete our formal education and migrate into a job, this unfortunate aspect of human conduct continues, only this time, the consequences can be far more severe, particularly the loss of a job if the bully is the supervisor or if a coemployee's bullying results in poor attendance due to fear or anxiety, sabotage of the employee's work by the bully, and barrages of insults that may cause depression or lack of confidence in completing required work tasks.

Particular Behaviors

Many commentators have focused on attempting to define "bullying," which is generally considered to involve one person harassing another and is characterized by a pattern of deliberate, hurtful, and menacing behaviors. It can have two aspects:

> *Physical*—making intimidating physical threats, pushing, shoving, invading an individual's personal space, or
>
> *Psychological*—psychological violence that is mostly covert, including joking or initiation rites that may mask sadistic behavior.

Other commentators have attempted to define the "bullying" conduct in terms of certain intentional behaviors, including the following.

- Staring or glaring in a hostile manner
- Treating another in a rude, demeaning, or disrespectful manner
- Interfering or sabotaging work activities
- Shunning or otherwise giving someone the "silent treatment"
- Failing to give, or giving little, professional feedback on performance
- Failure to provide praise when warranted
- Withholding of critical information necessary for work performance

- Lying or misrepresentation regarding workplace assignments, events, or opportunities
- Preventing or impeding an individual from expressing himself or herself.

While this list of behaviors is not all-inclusive, what is known is that bullying is a type of behavior that intimidates, humiliates, or undermines a person and that is repeated over time. And, importantly, the bully can be a supervisor or coemployee.

Legal Liability

Thus far, the employment-related antiharassment laws have focused on conduct that is more high-profile, typically characterized as "severe or pervasive." Unfortunately, this has the effect of allowing conduct characterized as bullying to go undetected or unpunished. Nonetheless, the consequences to the victim may be just as devastating, including mental or emotional injury, which may result in workers compensation liability if there is competent evidence to support the claim, as well as lost work time and Family and Medical Leave Act (FMLA) absence if the employee requires treatment for a "serious health condition" such as depression, severe emotional distress, or panic disorder.

The decision in the* Raess *case may be a harbinger of claims to come, as numerous states have now proposed "antibullying" statutes for the workplace.

As stated above, an employee who is repeatedly subject to such conduct may also have civil remedies against the coemployee responsible for the conduct. In *Raess, M.D. v. Doescher,* 858 N.E.2d 119 (Ind. App. 2006, Court of Appeals), a medical professional (perfusionist) brought a civil action against a heart surgeon, claiming that his conduct in yelling at the plaintiff, verbally threatening him, and engaging in threatening physical behavior constituted "bullying" under the legal theories of intentional infliction of emotional distress and assault. The plaintiff obtained a jury verdict of $325,000. The appeals court reversed the judgment on December 8, 2006, and remanded the case on evidentiary issues.

The decision in the *Raess* case may be a harbinger of claims to come, as numerous states have now proposed "antibullying" statutes for the workplace, including:

- Connecticut
- Washington
- New York
- New Jersey
- Oklahoma
- Montana
- Hawaii
- Kansas
- Missouri
- Oregon
- Massachusetts
- California

Recommendations

Employers may believe that they already have enough to worry about, given the mandates imposed by existing antiharassment legislation. Nevertheless, it is suggested that employers consider taking additional action, which is not onerous; namely, revising their existing antiharassment and workplace violence prevention policies to specifically include the term "bullying," providing examples of the conduct and prohibiting this behavior.

In addition, employers should consider incorporating the topic of "bullying" into their employee antiharassment and sensitivity training. In this fashion, the employer may be able to eliminate such conduct, before it elevates into behavior that will constitute actionable harassment or workplace violence for which there is statutory liability. This approach will also help to foster a culture of common respect that should ultimately reduce the potential for all forms of employment law liability. *EPLiC*

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EPLI Policy Exclusions: It's Not What They Exclude, It's What They "Except"

By Bob Bregman, CPCU, RPLU, ARM

Just about every employment practices liability insurance (EPLI) policy contains the same standard set of exclusions. But what really matters for the insured is the exact wording of the exclusions. More specifically, the extent to which these standard exclusions "except" and therefore cover certain types of claims and damages varies considerably from insurer to insurer. This article analyzes 10 exclusions found in virtually all EPLI policies and presents favorable versions of these exclusions, which insureds should always seek to have within their form.

Bodily Injury

Liability for claims involving bodily injury is excluded by EPLI policies because such coverage is typically afforded under commercial general liability (CGL) policy forms. Although CGL policies do cover bodily injury, the forms exclude claims caused by employment-related acts and, for this reason, do not cover claims for (1) emotional distress, (2) loss of reputation, (3) mental anguish, or (4) humiliation, all of which are commonly alleged in employment practices liability (EPL) claims.

Exception for "Special" Employment-Related BI Claims

Under most, but not all, versions of this exclusion, there is an exception and thus coverage for claims alleging these special employment-related perils. Representative wording providing such coverage appears in Figure 1.

Liability under Workers Compensation and Similar Laws

Virtually all of the forms exclude coverage for the insured's obligations under workers compensation and similar laws, such as disability and unemployment compensation. This is appropriate since separate coverage is available to cover workers compensation benefits. But what if an employee is injured on the job, files a workers compensation claim, and then, in retaliation for doing so, the company demotes the employee? Then, the employee files a discrimination claim against the employer. Under this scenario, an EPL policy that excluded claims "… arising from or in any way related to claims for workers compensation benefits …" would not cover the employee's discrimination suit.

Exception for Retaliation Claims

Fortunately, most, but not all, of the forms contain exception language that covers claims alleging employer retaliation for filing a workers compensation claim, as in the above scenario. Representative wording of this exclusion appears in Figure 2.

Figure 1
Bodily Injury/Property Damage Exclusion

This insurance shall not apply to, and the Company shall have no duty to defend or pay Defense Expenses for any Claim … for or arising out of bodily injury, sickness, loss of consortium, disease or death of any person; *provided, that this exclusion shall not apply to that portion of a Claim seeking damages for emotional distress, loss of reputation, mental anguish or humiliation.* (Emphasis added.)

Source: Travelers Insurance Company, Employment Practices Liability PLUS+ Policy, EPL-3001 (07/01)

Figure 2
Workers Compensation Law Exclusion

This Policy does not cover any "loss" arising out of any obligation under any workers' compensation, disability benefits or unemployment compensation law, or any similar law.

This exclusion does not, however, apply to any "claim" for "retaliation" or "discrimination" or "inappropriate employment conduct" on account of the filing of a workers' compensation claim or a claim for disability benefits. (Emphasis added.)

Source: Houston Casualty Insurance Company, Employment Practices Liability Insurance Claims-Made Policy Form, EP 0001 (12/01)

Breach of Employment Contracts

Most EPL forms exclude coverage for damages accruing when the insured organization breaches an employment contract. Such exclusions also preclude payment of the severance amounts provided by such contracts. The rationale for the exclusion is that the insured was in control of this exposure when it entered into the employment contract, as well as when it terminated the contract.

Figure 3
Breach of Employment Contracts Exclusion

The Company shall have no duty to pay Damages, *but will pay Defense Expenses* (emphasis added), resulting from any Claim seeking … severance pay, damages or penalties under an express written Employment Agreement, or under any policy or procedure providing for payment in the event of separation from employment; or sums sought solely on the basis of a claim for unpaid services.

Source: Travelers Insurance Company, Employment Practices Liability PLUS+ Policy, EPL-3001 (07/01)

Exception for Defense Costs

Favorable versions of this exclusion provide for coverage of defense costs associated with allegations that the insured organization breached an employment contract. Defense coverage for claims alleging breach of an employment contract is important, especially when such contracts involve executives whose contracts call for substantial sums. Representative wording of this exclusion appears in Figure 3.

Americans with Disabilities Act

Loss arising from an insured's failure to comply with any accommodations or building modifications for the disabled, as required by the Americans with Disabilities Act, is excluded by most EPLI forms. The effect of this exclusion is to preclude coverage if, for example, an insured is required to install handicapped access ramps within its building. Insurers consider this exposure a business risk and therefore exclude it.

Exception for Defense Costs

Suppose, for example, that a disabled employee sued an employer, alleging that the employer failed to make a reasonable accommodation, requiring a building modification (as required by the ADA), so that he could perform his job. Under this scenario, the employer could be liable for making such modifications and would also have to defend the claim. Some, but not all, versions of this exclusion contain exception wording that affirmatively provides coverage for the costs of defending claims alleging violation of the Americans with Disabilities Act, which is, of course, favorable for the insured. Such wording is illustrated in Figure 4.

Figure 4
Americans with Disabilities Act Exclusion

The Company shall have no duty to pay Damages, *but will pay Defense Expenses,* resulting from any Claim seeking:

1. costs and expenses incurred or to be incurred to comply with an order, judgment or award of injunctive or other equitable relief of any kind, or that portion of a settlement encompassing injunctive or other equitable relief, including but not limited to actual or anticipated costs and expenses associated with or arising from an Insured's obligation to provide reasonable accommodation under, or otherwise comply with, the Americans With Disabilities Act or the Rehabilitation Act of 1973, including amendments thereto and regulations thereunder, or any related or similar law or regulation. (Emphasis added.)

Source: Travelers Insurance Company, Employment Practices Liability PLUS+ Policy, EPL-3001 (07/01)

WARN Act Liability

Under the federal Worker Adjustment and Retraining Notification (WARN) Act, employers of 100 or more persons are required to give their workers specific notice periods prior to various types of mass layoffs or plant closings. The majority of policies preclude coverage for claims alleging failure to provide such notice as required by law. The rationale for the exclusion is that if claims result from failure to comply with the requirements of the WARN Act, they are within the control of the insured organization and could presumably have been avoided.

Favorable WARN Act Language

However, a favorable variation of this exclusion is one in which there is an exception and therefore coverage for claims that result—when the insured organization consulted with attorneys and acted in good faith—yet was sued nevertheless, under an allegation of having violated the WARN Act. Such wording is illustrated in Figure 5. Note that such wording not only covers defense expenses but damages, as well.

Figure 5
WARN Act Exclusion

This policy does not cover any Loss arising out of the Workers' Adjustment and Retraining Notification Act, or any amendment thereto, or any similar federal, state or local law. *This exclusion shall not apply if the Named Insured consulted with legal counsel and made a good faith attempt to comply with the law.* (Emphasis added.)

Source: Lloyd's of London (EPL-Exclusive Advantage), Employment Practices Liability Insurance Policy, EPLX-022S (2/1/02)

Nonpecuniary/Injunctive Relief

Most of the policies exclude coverage for nonmonetary damages. Coverage of injunctive relief such as reinstatement of a terminated employee is beyond the intended scope of EPLI forms because insurance policies are contracts to pay money rather than to perform or enforce the performance of services.

Exception for Defense Costs

However, favorable versions of this exclusion, except, and therefore cover, the costs required to defend claims seeking nonpecuniary relief, which can be considerable. Wording of this exclusion is illustrated in Figure 6.

Figure 6
Nonpecuniary Relief Exclusion

The Insurer shall not be liable to make any payment for Loss in connection with any Claim made against the Insureds … based upon, arising from, or in any way related to any request for injunctive relief, declaratory relief, disgorgement, job reinstatement, or any other equitable remedy; *provided that this exclusion shall not apply to Claims Expenses.* (Emphasis added.)

Source: Hartford Insurance Company, Employment Practices Liability Policy, GL 00 R424 00 0498

Insurance Benefits

Nearly all EPLI forms contain exclusions precluding coverage for insurance benefits. The rationale underlying this approach is that obligations to provide employee benefits are business risks and therefore do not fall within the scope of coverage intended by EPL policies. The intent of this exclusion is to also preclude coverage for a risk that could also possibly be covered by fiduciary/employee benefit liability insurance policies. For example, assume that an employee was told by the benefits administrator at a company that his retirement pension would be $2,000 per month. In reality, when he retires, his monthly benefit is only $1,200. If he sues the company for the difference between the promised and the actual benefit amount, this exclusion will preclude coverage, which is appropriate since this type of claim would be covered by a fiduciary liability policy form. On the other hand, this exclusion could also preclude coverage if, as part of a wrongful termination claim, a former employee claims a loss of health insurance resulting from his termination. Absent an exception in this exclusion for loss of benefits as a result of wrongful termination, no coverage would apply.

Exception for Coverage of Benefits as a Part of Claim Settlements

Fortunately, favorable versions of this exclusion, such as the one appearing in Figure 7, "except" from their definitions of "benefits" and therefore cover benefits when they are part of claim settlements or judgments associated with wrongful termination claims.

ERISA Claims

The policies exclude coverage for claims made under the Employee Retirement Income Security Act (ERISA) of 1974 or under any similar benefit laws. The rationale for this exclusion is that coverage of such claims falls within the purview of fiduciary liability insurance policies. But what if an employee makes a claim under his employer's health care benefit plan, and in retaliation, the company terminates him? In turn, the employee files a wrongful termination lawsuit. Under this scenario, an EPL policy that excluded claims "… arising from or in any way related to claims for benefits falling within the purview of ERISA …" would not cover the employee's wrongful termination claim.

Exception for Retaliation Claims

A favorable version of this exclusion that would cover the wrongful termination claim in the above scenario is that some insurers' forms except, and therefore cover, claims brought that allege retaliation as a result of bringing a claim involving benefits subject to ERISA. This favorable version is illustrated in Figure 8.

Figure 7
Benefits Exclusion

No coverage will be available under this Coverage Section for Loss, other than Defense Costs … which constitutes Benefits due or to become due or the equivalent value of such benefits; *provided that this Exclusion (B)(1) shall not apply to any Employment Claim for actual or alleged wrongful termination, dismissal or discharge of employment.* (Emphasis added.)

"Benefits" means perquisites, fringe benefits, deferred compensation or payments (including insurance premiums) in connection with an employee benefit plan and any other payment. Benefits shall not include salary or wages, Stock Benefits or nondeferred cash incentive compensation.

Source: Chubb Group of Insurance Companies, ForeFront Portfolio, Employment Practices Liability Coverage Section, 14-02-3797 (04/01)

Figure 8
ERISA Claims Exclusion

This Policy does not apply to any Claim or portion thereof made against the Insured … for insurance benefits that the claimant may have been entitled to receive pursuant to any state, federal or local law or regulation regarding the continuation of insurance after termination of employment, including but not limited to the Employee Retirement Income Security Act (ERISA) (29 U.S.C. § 1001 *et seq.*), *except as such benefits are prayed for only as items of damage for a Wrongful Employment Practice, and this exclusion shall not apply to an alleged retaliatory discharge for having asserted a claim under ERISA.* (Emphasis added.)

Source: Evanston Insurance Company, Employment Practices Liability Insurance Policy, EP-A-2000 (5/00)

Prior Knowledge of Potential Claims

Nearly all EPLI policies exclude coverage for claims produced by circumstances or incidents that the insured knew, prior to policy inception, had the potential to result in claims. This is appropriate because the purpose of EPLI policies is to cover only fortuitous circumstances about which the insured had no knowledge prior to the inception of the policy, as opposed to incidents for which claim potential was recognized, despite the fact that a formal claim had not yet been made. However, the prior knowledge exclusion, if worded in a manner that is unfavorable for the insured, can be a frequent source of claim denials. Specifically, if a prior knowledge exclusion states that knowledge by an "insured" or "employee" bars coverage, coverage would, for example, be precluded in scenarios where employees, but not management personnel, had knowledge of circumstances that could give rise to a claim. For example, after being terminated, an employee tells a coworker, "I'm going to see my lawyer about this." Following the incident, the coworker does not advise his supervisor. If an investigation by the insurer receiving the claim revealed that an employee was aware of such circumstances, a claim denial could result.

Only Knowledge by Officers, Managers, or HR Department Supervisors Should Be Considered "Prior Knowledge"

Accordingly, a prior knowledge exclusion that precludes coverage only if a supervisory employee, officer, department manager, or HR department manager had knowledge of the circumstances is preferable to one where knowledge of an "employee" would bar coverage. Many, but not all, insurers offer such wording, which is illustrated in Figure 9.

Figure 9
Prior Knowledge of Potential Claims Exclusion

Prior Knowledge. This policy does not cover any Loss arising out of Insured Events or, if purchased, Third Party Insured Events of which any Insured *who is a principal, partner, officer, director, trustee, in-house counsel, Employee(s) within the HR or Risk Management department or Employee(s) with personnel and risk management responsibilities* was aware by actual knowledge of the facts or circumstances of such Insured Events or, if purchased, a Third Party Insured Event prior to the Prior Knowledge Date, as shown in the Declarations. (Emphasis added.)

Source: Beazley Insurance Company, Employment Practices Liability Insurance Policy, BICEP00020405

Contractual Liability

The vast majority of EPLI forms exclude coverage for contractually assumed liability (i.e., an agreement to indemnify or hold a third party harmless). But what about the common situation in which, for example, an insured organization agrees to indemnify an employment agency (that leases workers to the insured organization) for the wrongful acts of the insured's employees committed against the employment agency's employees? Under these circumstances, the insured organization would be liable, *even in the absence of the contract,* to indemnify the employment agency. However, unless the

wording of a contractual liability exclusion excepts, and therefore covers, contracts where liability would attach even in the absence of a contract, the insured would be without coverage.

Exception for Liability in the Absence of Contract

Fortunately, nearly all EPLI policies contain an exception that provides coverage for liability that would have attached in the absence of a contract. Such wording is illustrated in Figure 10.

Figure 10
Contractual Liability Exclusion

Liability Assumed by Contract. This policy does not cover any Loss Amount which the Insured is obligated to pay by reason of the assumption of another's liability for an Insured Event in a contract or agreement.

This exclusion shall not apply to liability for damages because of an Insured Event that the Insured would have had even in the absence of such contract or agreement. (Emphasis added.)

Source: Lexington Insurance Company, Employment Practices Liability Insurance Policy Claims-Made, LEX EPL 03/02

Concluding Thoughts

Although virtually all EPLI policies contain the same set of exclusions, the exact wording of these exclusions is far from identical. For example, although virtually all forms contain favorable exception wording as respects the contractual liability exclusion, at the other end of the spectrum, few policies contain the kind of favorable WARN Act exclusionary wording noted in Figure 5. Accordingly, insureds and their representatives would be wise to review the exclusions in their EPLI policy forms, compare them to the checklist in Figure 11, and verify that their form contains the preferred exception wording, as noted below.

Figure 11
EPLI Exclusion Checklist

Exclusion	Preferred Exception Wording
Bodily Injury	Exception for coverage of claims alleging "emotional distress," "loss of reputation," "mental anguish," and "humiliation"
Workers Compensation	Exception for coverage of retaliation claims
Employment Contracts	Exception for defending claims for breach of employment contracts
Americans with Disabilities Act	Exception for defending ADA claims
WARN Act	Exception providing coverage (defense and damages) if insured consulted an attorney and acted in good faith
Nonpecuniary Relief	Exception for defense costs involving claims for nonpecuniary relief
Insurance Benefits	Exception for coverage when benefits are part of wrongful termination settlements
ERISA	Exception for coverage of retaliation claims
Prior Knowledge	Exception for knowledge by "management," "supervisors," or "HR managers"
Contractual Liability	Exception for liability in the absence of a contract