



Insurance for employment disputes: Know what's covered before negotiating

BY JJ JOHNSTON

Employers rely on their risk management teams to evaluate and acquire insurance coverage, but unless they know the key features of their policies, they may be left holding the bag during settlement negotiations.

Consider a typical employment dispute: Plaintiff has asserted a claim for wrongful termination and retaliation; the employer hopes to resolve the matter expeditiously in mediation. The final settlement should be covered by its Employment Practices Liability Insurance (EPLI). Correct?

Oops! As negotiations begin, the employer realizes that it may be the one paying some or all of any final settlement. It had mistakenly assumed that its policy would cover these types of damages even though a careful reading of that policy, as well as notice from the insurer, should have alerted it to policy exclusions and lack of indemnity coverage.

Suddenly, everything has changed. Negotiations are stalled as the defense considers how to manage payment of potentially significant damages. Ultimately, with the mediator's help, the parties are

able to resolve their dispute through strategic allocation of damages.

If the employer had understood the limits of its EPLI policy before entering mediation, it could have planned its negotiating strategy in advance, and the mediation would have proceeded without hiccups.

Employment insurance

Employment disputes can involve various types of insurance coverage, including Directors and Officers (D&O) insurance, Commercial General Liability (CGL) insurance, and workers' compensation coverage. However, most employment disputes that go to mediation are covered by EPLI.

EPLI policies are designed to cover claims related to wrongful termination, discrimination, harassment, retaliation, and other workplace violations. Such policies often cover defense costs as well as settlements or judg-

ments, but many contain significant exclusions and limitations, and these can directly impact mediation negotiations.

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EPLI features

EPLI policies provide important protection for companies with employees, but they are not a one-size-fits-all proposition. Key features will determine the scope of coverage when claims are asserted by employees.

Claims-made basis: Most EPLI policies operate on a claims-made basis, meaning that coverage is triggered only if the plaintiff's claim is made during the policy period. If a claim is filed after coverage has lapsed, even if the alleged wrongful act occurred during the policy

period, the insurer may deny coverage, leaving the company responsible for the entire settlement amount.

Self-insured retention: Employers typically have a self-insured retention (SIR) or deductible that must be paid before the insurer contributes to defense or settlement costs. This should be factored into the equation when employers are negotiating settlement.

Exclusions: Some common EPLI exclusions are: wage and hour violations (including unpaid overtime and meal/rest break claims); PAGA penalties, which insurers typically refuse to cover; workers' compensation and other employment benefits; and intentional misconduct, which insurers may cite to deny coverage in harassment or retaliation cases. An employer who fails to take these exclusions into account could be in for a rude awakening during mediation. When an employment claim is subject

to an exclusion, parties in the mediation may need to consider creative solutions.

Duty to defend vs. Duty to indemnify

A critical aspect of EPLI coverage is the distinction between an insurer's duty to defend and its duty to indemnify the policyholder. This difference can play a pivotal role in mediation, influencing the insurer's willingness to participate in settlement discussions.

Duty to defend

The duty to defend is broader than the duty to indemnify. It obligates an insurer to provide a defense whenever there is a potential for coverage, even if some claims in the lawsuit ultimately fall outside the policy.

In *Gray v. Zurich Insurance Co.* ((1966) 65 Cal. 2d 263, 275), the California Supreme Court held that an insurer must defend any suit in which there is a potential for coverage, even if some claims in the lawsuit are ultimately not covered. An insurer can only avoid this obligation when "the third party complaint can by no conceivable theory raise a single issue which could bring it within the policy coverage." (*Montrose Chem. Corp. of Calif. v. Superior Court* (1993) 6 Cal.4th 287, 300.)

Duty to indemnify

The duty to indemnify is narrower and applies only if the final resolution of the case establishes that the claim falls within the policy's coverage. In *Buss v. Superior Court* ((1997) 16

Cal. 4th 35, 46), the California Supreme Court emphasized that while an insurer must defend the entire lawsuit if at least one claim is potentially covered, the insurer is only obligated to indemnify claims that fall squarely within the policy's coverage.

This distinction frequently creates challenges in mediation, as insurers may be hesitant to contribute to settlement discussions if they believe there is no duty to indemnify. In some cases, an insurer will offer a partial settlement contribution under a reservation of rights, reserving the ability to later deny coverage after all issues have been addressed.

Insurer's reservation of rights

When an insurer defends under a reservation of rights, it provides a defense to the insured but reserves the right to later deny coverage for some or all claims. This scenario often arises when there are potential coverage issues or exclusions that may apply to the claims asserted.

In California, the landmark case of *San Diego Navy Federal Credit Union v. Cumis Insurance Society, Inc.* ((1984) 162 Cal.App.3d 358) addressed the conflict of interest that arises when an insurer defends under a reservation of rights. The court held that, in such situations, the insured is entitled to independent counsel, commonly referred to as "Cumis counsel," paid for by the insurer. This ensures that the insured's defense is not com-

promised by the insurer's potential coverage defenses.

The *Cumis* decision led to the enactment of California Civil Code Section 2860, which codifies the right to independent counsel when there is a conflict of interest between the insurer and the insured. However, the assertion of a reservation of rights does not automatically entitle the insured to *Cumis* counsel.

Section 2860 clarifies that the right to independent counsel arises only when the conflict is significant enough that the insurer-appointed defense counsel could control the outcome of coverage issues. Courts have held that a mere potential for conflict is insufficient; the conflict must be real and must impact defense strategy. (See *Gafcon, Inc. v. Ponsor & Associates* (2002) 98 Cal. App. 4th 1388, 1421, *Dynamic Concepts, Inc. v. Truck Ins. Exchange* (1998) 61 Cal. App. 4th 999, 1007.)

Mediation dynamics

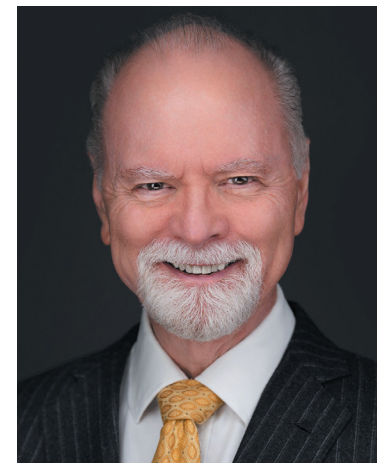
Whenever independent counsel becomes involved in mediation of an employment dispute, the dynamics change. Independent counsel can increase insurer defense costs and thus influence an insurer's willingness to settle.

Independent counsel - whose allegiance is solely to the insured - may adopt defense strategies at odds with the insurer's strategies, and this can also affect the course of settlement negotiations. Disputes over who ultimately controls settlement negotiations

- the insurer, the insured, or independent counsel - may create stalemates during negotiations.

Conclusion

The goal of any employment mediation should be to fairly compensate the plaintiff without forcing the employer into bankruptcy. When employers understand the limits of their EPLI policies, they can map out smart negotiating strategies. Mediators can help parties arrive at workable settlements that meet their objectives.



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