Insurance Coverage For Sexual Harassment In The Workplace

Ed E. Duncan

There is a very great likelihood that your client's current insurance won't cover sexual harassment claims. The answer? Employment Practices Liability Insurance.

IN RECENT YEARS the number of sexual harassment claims in the workplace has increased at a dizzying pace. A recent article notes that sexual harassment claims have increased nearly 50 percent from 1992 to 2001. Steven T. Catlett and Michael J. Gray, *Employment Insurance Is Complex*, 26 Nat'l L. J., B10 (Jan. 13, 2003). According to another source, EEOC statistics reveal that sexual harassment claims doubled between 1991 and 1997. Joan Dolinsky and Barbara O'Donnell, *Employment Practices Liability Coverage*, 31 Brief 48 (Fall 2001). These figures are borne out by Insurance Services Office, Inc. ("ISO"), a company which provides

Ed E. Duncan is a partner with Tucker Ellis & West LLP, in Cleveland, Ohio.

standardized insurance policies for the industry. In a press release issued on August 19, 1997, ISO announced that the number of lawsuits filed for sexual harassment more than doubled from 6,000 in 1990 to more than 15,500 in 1995.

The explosive growth of these claims can be traced both to the expansion of available federal and state remedies and to the widespread publicity generated by various high-profile sexual harassment claims. Early examples of the latter include the charges leveled by Anita Hill against now Supreme Court Justice Clarence Thomas during his televised confirmation hearings in the early '90s and charges made by Paula Jones against former President Bill Clinton later in the decade. *See, e.g., Joseph P. Monteleone, Employment Claims: A Primer For The Insurance Lawyer and Claims Professional*, 652 PLI/Lit 343 (Apr. 2001); Carolyn H. Rosenberg and Duane F. Sigelko, *Employment Practices Liability Insurance: Ten Considerations Before You Buy (or Renew) Coverage*, 5 Andrews Sex. Harassment Litig. Rep. 3 (Mar. 1999).

Not too long ago, another high profile sexual harassment claim garnered significant media attention. Bill O'Reilly, the popular host of the Fox Television show, *The O'Reilly Factor*, together with News Corporation, Fox News Channel, Twentieth Century Fox Film Corporation and Westwood One, Inc., were sued by a female producer for an unspecified sum because of alleged workplace sexual harassment taking place both in person and by phone. While the suit was settled shortly after being filed, the widely reported, graphic allegations were readily available online for all to see. The terms of the settlement are confidential but this has not prevented media pundits from speculating that the plaintiff received anywhere from a few to several million dollars. Whether the claim was meritorious or not, certainly it will further heighten employees' awareness of their rights in this area.

Faced with escalating claims, beleaguered employers and their risk managers initially turned to their existing insurance programs for coverage. Increasingly, though, they found such programs to be inadequate, either because they provided incomplete coverage or none at all.

At the same time, recognizing the demand for a specialized policy which would provide coverage for employment-related claims, the insurance industry developed a new product: the Employment Practices Liability Insurance ("EPLI") policy. It has been reported that while only 10 percent of employers carried EPLI in 1999, the estimate is that "within a few years" up to 70 percent of employers will purchase some form of that coverage. Steven T. Catlett and Michael J. Gray, supra. A recent estimate places the employment-practices liability insurance market at around $1.3 billion. And a recent article states that the employment-practices liability insurance market is projected to grow to $7 billion "in the next few years." Michael A. Kaufman and Philip R. Voluck, *Watch Your Step*, 104 Best's Review 77, 2003 WL 9872357 (Oct. 1, 2003).

While some employers have continued to rely upon traditional policies to provide coverage for sexual harassment claims, many others have purchased EPLI. In practice, how much coverage do traditional policies provide for workplace sexual harassment claims? How much coverage do EPLI policies provide? Employers, insurers, and counsel for both should know the answers to these questions.

THE SEXUAL HARASSMENT CAUSE OF ACTION • Title VII of the Civil Rights Act of 1964 forms the basis for a federal cause of action for workplace sexual harassment. This cause of action is also recognized under various state statutes. *See, e.g.,* New York State Human Rights Law–N.Y. Exec. Law §290 et seq.; Ohio Rev. Code Ann. §4112.02(A). In ad-

dition, it is enshrined in the common law of some states. *See, e.g., Kerans v. Porter Paint Company*, 575 N.E.2d 428, 435 (Ohio 1991) and *Delaney v. Skyline Lodge, Inc.*, 642 N.E.2d 395, 399 (Ohio Ct. App. 1994), *cert. denied,* 513 U.S. 1191 (1995).

Forms Of Harassment

Under Title VII, as interpreted by the courts, sexual harassment comes in two forms: "quid pro quo" harassment and "hostile work environment" harassment:

- Quid pro quo harassment takes place when harassment is directly linked to the grant or denial of a tangible economic benefit, such as when a supervisor ties a job or job benefit to an employee's submission to unwanted sexual advances;
- By contrast, hostile work environment harassment occurs when the employee is subjected to a sexually hostile working environment which is so pervasive or severe as to alter the conditions of employment and create an abusive working environment.

In addition, an employee who resigns under such circumstances may establish a constructive discharge (and entitlement to the damages allowable for same) by showing that the abusive working environment became so intolerable that quitting was an appropriate response. *Pennsylvania State Police v. Suders*, ___ U.S. ___, 124 S.Ct. 2342, 2347, 2354, n. 8 (2004).

Remedies

The remedies available under Title VII were greatly expanded by the enactment of the Civil Rights Act of 1991. That Act amended Title VII to permit awards of compensatory and punitive damages, whereas before only injunctive relief and limited backpay awards had been available under Title VII. The 1991 Act also permitted jury trials in cases when intentional discrimination is alleged on the basis of race, color, sex, religion, national origin, or disability.

Title IX

In addition to Title VII, Title IX of the Educational Amendments of 1972 provides a specialized avenue of recovery for sexual harassment committed by an educational institution receiving Title IX funds, irrespective of whether the harassment is employment-related. The plaintiff in such an action must establish that he or she was subjected to quid pro quo sexual harassment or to a sexually hostile environment; that the situation was brought to the attention of an official at the educational institution receiving Title IX funds who had "authority to take corrective action" to remedy the harassment; and that the institution's response to the harassment amounted to "deliberate indifference." *Gebser v. Lago Vista Independent School District*, 524 U.S. 274 (1998); *Morse v. Regents of the University of Colorado*, 154 F.3d 1124, 1127-1128 (10th Cir. 1998).

Thus, under Title IX, a student may bring a sexual harassment claim against a college as a result of sexual harassment engaged in by a basketball coach. *Morrison v. Northern Essex Community College*, 780 N.E.2d 132 (Mass. App. Ct. 2002). As is discussed below, under such circumstances, assuming there are no applicable exclusions, the college may be entitled to coverage under some EPLI policies because the claim of sexual harassment arises from conduct directed by an employee (in *Morrison,* the coach) against a non-employee (in that case, a student).

COVERAGE UNDER COMMERCIAL GENERAL LIABILITY ("CGL") POLICIES • CGL policies provide coverage for "bodily injury" or "property damage" arising out of an "occurrence," which is defined, as an "accident." The majority rule is that mental anguish or emotion-

al distress unaccompanied by a physical injury does not constitute "bodily injury." *See, e.g., Allstate Insurance Company v. Diamant*, 518 N.E.2d 1154, 1156 (Mass. 1988). Under this definition, therefore, the vast majority of sexual harassment claims do not allege "bodily injury." Similarly, it is unlikely that most sexual harassment claims allege an "accident," which is generally defined as an unexpected or unforeseen event. *Owens-Illinois, Inc. v. Aetna Casualty & Surety Company*, 990 F.2d 865, 872 (6th Cir. 1993) (Ohio law); *Tate v. Government Employees Insurance Company*, 997 F.2d 1433, 1436 (11th Cir. 1993) (Alabama law).

Likely Exclusions

Further, CGL policies invariably contain an exclusion for expected or intended injuries, and it is reasonable to conclude that a person engaging in sexual harassment expects or intends that his or her actions will result in injury. Indeed, the courts will often presume as much. *See, e.g., Serecky v. National Grange Mutual Insurance,* 857 A.2d 775 (Vt. 2004) (collecting cases); *but see, Meadowbrook, Inc. v. Tower Insurance Company, Inc.*, 543 N.W.2d 418, 424 (Minn. Ct. App. 1996), *rev'd on other grounds*, 559 N.W. 2d 411 (Minn. 1997) (intent to injure cannot be inferred from conduct creating hostile work environment, as opposed to conduct amounting to quid pro quo sexual harassment).

Willful And Malicious Acts

Moreover, some CGL policies contain an exclusion for "willful and malicious acts" of the insured which is applicable to the bodily injury coverage. In accordance with this exclusion, a sexual harassment claim otherwise covered by the policy would probably be excluded. *State Farm Fire & Casualty Company v. Burkhardt*, 96 F.Supp.2d 1343, 1350 (M.D. Ala. 2000).

Employer's Liability Exclusion

Another exclusion which is likely applicable is the "employer's liability exclusion" found in most CGL policies. That exclusion bars coverage for bodily injury to an employee arising out of and in the course of employment by the insured or while the employee is performing duties related to the conduct of the insured's business. This exclusion would probably apply to a sexual harassment claim even if it were held that the plaintiff employee suffered "bodily injury" caused by an "occurrence," and the expected or intended injury exclusion did not apply. *Agricultural Insurance Company v. Focus Homes, Inc.,* 212 F.3d 407, 410-411 (8th Cir. 2000) (Minnesota law).

Personal Injury Coverage

In addition to coverage for "bodily injury" and "property damage," however, most CGL policies provide coverage for "personal injury." "Personal injury" includes claims stemming from false arrest, detention or imprisonment; malicious prosecution; and wrongful eviction. It also includes certain libel or slander claims and oral or written publication of material that violates a person's right of privacy. Unlike claims for bodily injury and property damage, there is no requirement that a "personal injury" arise out of an "occurrence." Therefore, the complaint need not allege an "accident." Also, neither the expected or intended injury exclusion nor the employer's liability exclusion ordinarily applies to the personal injury coverage.

Consequently, a claim of workplace sexual harassment, for instance, arising out of slanderous sexual remarks may qualify as a "personal injury" and not be barred even though it does not allege an "occurrence" and even though it does allege an expected or intended injury.

The Employment-Related Practices Exclusion

Nevertheless, the claim may still run afoul of the employment-related practices ("ERP") exclusion, which is found in most CGL policies and is similar to the employer's liability exclusion. Unlike the latter exclusion, however, the ERP exclusion is not limited to bodily injury claims. Instead, it applies to bodily injury, property damage, or personal injury arising out of employment-related practices in general and harassment in particular. *Miller v. McClure*, 742 A.2d 564, 569-570 (N.J. Super. App. Div. 1998), *aff'd,* 745 A.2d 1162 (N.J. 1999). Therefore, this exclusion bars coverage for workplace sexual harassment claims which would otherwise be covered under a policy's personal injury provisions.

However, the ERP exclusion was held not to apply when the court found that allegedly defamatory statements including "lewd and offensive comments about sexual acts," although made in the workplace, were not made in the context of employment and did not relate to employment performance. *American Alliance Insurance Company v. 1212 Restaurant Group, L.L.C.*, 794 N.E.2d 892, 900-901 (Ill. App. Ct. 2003). Similarly, the fact that a defamatory statement "arose out of" the insured's business (i.e., it was made by a supervisor to an employee) does not necessarily mean it was employment-related within the meaning of the exclusion, so long as the statement was not made in the context of employment and was not related to work performance. *Golden Eagle Insurance Corporation v. Rocky Cola Café, Inc.*, 114 Cal. Rptr.2d 16, 20-23 (Cal. Ct. App. 2001). By contrast, when the alleged defamation occurred after the employee was terminated, that fact does not, without more, remove it from the reach of the ERP exclusion. *American Alliance Insurance Company v. 1212 Restaurant Group, L.L.C.*, supra.

Claims Against Individual Employees

Note also that even if the employing entity successfully obtains coverage under a CGL policy, claims against a supervisor may not be covered. This is true because many CGL policies contain a provision stating that no employee is an insured for bodily injury or personal injury to a co-employee while in the course and scope of his or her employment. *See, e.g., Miller v. McClure*, supra, 326 N.J. Super. Ct. at 566-67, 742 A.2d at 569. It may be argued that an employee is not acting within the course and scope of employment when he or she engages in sexual harassment and that for this reason, the exclusion does not apply. However, if successful, that argument will defeat coverage because of another provision in the policy, namely, the clause in most CGL policies stating that employees are only insureds for acts within the course and scope of employment.

COVERAGE UNDER WORKERS' COMPENSATION AND EMPLOYER'S LIABILITY POLICIES • Part One of the standard Workers' Compensation and Employer's Liability policy applies to claims for benefits made under state workers' compensation statutes. It does not apply to an employee's civil suit for damages. *See, e.g., La Jolla Beach & Tennis Club v. Industrial Indemnity Company*, 884 P.2d 1048 (Cal. 1994). Part Two provides coverage for claims of bodily injury by accident or bodily injury by disease. Therefore, the same arguments which militate against coverage under the CGL policy (bodily injury must be caused by an occurrence, i.e., accident) also militate against coverage under Part Two.

Likely Exclusion

Moreover, the standard version of the widely-used National Council on Compensation Insurance ("NCCI") workers' compensation and employer's liability policy contains an ex-

clusion similar to the ERP exclusion found in CGL policies. Among other things, the NCCI exclusion bars coverage for damages arising out of harassment or any personnel practices, policies, acts or omissions. Thus, one court has held that claims of sexual harassment, negligent hiring and retention, and battery are all barred by this exclusion since they are all "interwoven with, and arise out of, the asserted sexual harassment." *TIG Insurance Company v. Sweet Factory, Inc.*, 748 So.2d 337, 339 (Fla. Dist. Ct. App. 1999). Further, it has been held that the exclusion applies whether the liability of the employer is direct or vicarious. *Midwestern Insurance Alliance, Inc. v. Coffman*, 7 S.W.3d 393, 396 (Ky. Ct. App. 1999).

COVERAGE UNDER DIRECTORS' AND OFFICERS' ("D&O") LIABILITY INSURANCE • Under most D&O policies the corporation's directors and officers are covered for their wrongful acts, and the corporation is reimbursed for indemnifying them. Most of these policies exclude coverage for personal injury or bodily injury.

Disadvantages Of Combining D&O And EPLI

While EPLI extensions to D&O policies are available, there are some disadvantages to combining the two policies. For instance, the D&O endorsement may be subject to a number of limitations such as the:

- Absence of coverage for the corporate entity;
- Lack of coverage for non-officer employees;
- Absence of coverage for claims by officers against other officers and directors; and
- Lack of coverage for emotional distress and mental anguish.

Although some of these restrictions can be eliminated with proper endorsements, the relatively large retention, common to most D&O policies (but perhaps too large for many EPLI policies), may remain the same. Also, there is a risk of exhausting the D&O limits with EPLI claims. *See, generally*, Joseph P. Monteleone, *Employment Claims: A Primer For The Insurance Lawyer And Claims Professional*, supra, at 365-369.

Moreover, stand-alone EPLI policies generally offer broader coverage than that provided by D&O endorsements, as well as risk management and loss prevention services not offered when the EPLI endorsement is added to the D&O policy. *See, generally*, Robert A. Bregman, Key *Coverage Options Under Employment Practices Liability Policies*, (International Risk Management Institute, Mar. 2000) available at www.irmi.com/Insights/Article/2000/Bregman03.aspx.

Some Advantages Over Stand-Alone Policy

There are also some advantages to adding an EPLI endorsement to a D&O policy. These include the convenience of having one less policy to deal with and lower cost since D&O insurers generally charge only an additional 10 percent premium for an EPLI endorsement. *Id.*

Combining Policies May No Longer Be An Option

The question whether to purchase a stand-alone policy or a D&O (or other fiduciary) policy with an EPLI endorsement may become academic. According to one source, the "blending" of EPLI with other policies is fast fading away in favor of stand-alone policies. Gary S. Mogel, *National Underwriter Property & Casualty—Risk & Benefits Management Edition*, 2003 WL 69822001 (June 9, 2003).

COVERAGE UNDER HOMEOWNERS AND PERSONAL LIABILITY UMBRELLA POLICIES • Homeowners and Personal Liability Umbrella policies almost universally contain a business pursuits exclusion. This ex-

clusion is meant, as the name suggests, to apply to claims arising out of (or in some cases, caused by) the insured's business activities. Supervisors who are named as defendants in sexual harassment claims should determine whether they are covered for sexual harassment claims, because the business pursuits exclusion may not apply. The court in one case held that the business pursuits exclusion was inapplicable because it applies only to sexual harassment claims which are actionable because of the employment relationship. According to the court, claims which were not dependent on the employment relationship, i.e., those which would be actionable even if the claimant and supervisor were not co-employees, such as unconsented touching of the employee's intimate parts, for example, did not come within the business pursuits exclusion. *Miller v. McClure,* supra, 742 A.2d at 571-572.

However, unlike the above case, the policy at issue may not contain an exclusion for expected or intended injuries and it may provide coverage for mental anguish when, for example, coverage is sought under the "personal injury" coverage of a personal liability umbrella policy. In such a case, it has been held that if, as an element of the claim, an employment relationship is not legally required, the damage is not "caused by" a business pursuit and the exclusion does not apply. *State Farm Fire & Casualty Company v. Burkhardt*, supra, 96 F. Supp. 2d at 1347-1350 (collecting cases).

COVERAGE UNDER COMMERCIAL UMBRELLA POLICIES AND PROFESSIONAL LIABILITY POLICIES • Although commercial umbrella policies generally contain some additional coverage beyond that provided by the underlying policy, many of these individualized policies also reproduce the same coverage provided by the underlying policy, including the same exclusions. For instance, an employment practices exclusion may bar coverage under the umbrella policy for the identical reasons such coverage is barred under the underlying policy. *See, e.g., Agricultural Insurance Company v. Focus Homes, Inc*., supra, 212 F.3d at 411-412.

It has been held that there is no coverage for a sexual harassment claim under a professional liability policy because the complaint did not allege injuries arising out of professional malpractice and because the policy contained an employer's liability exclusion barring coverage for injuries occurring in the course of employment. *Id.* at 412-413.

COVERAGE AVAILABLE UNDER THE EPLI POLICY • EPLI came into existence in the early '80s. At that time NAS Insurance Services, through Lloyd's of London, introduced an Employer's Legal Expense Reimbursement Policy, which afforded coverage for defense costs for various employment-related claims. The first EPLI policy providing coverage for defense and indemnity became available in the early '90s and afforded coverage solely for wrongful termination claims. As more insurers entered the market, coverage was broadened somewhat to provide protection against claims for employment law judgments, bonds, post-judgment interest and back pay. Most policies, however, excluded coverage for punitive damages and intentional acts.

Scope Of Coverage

Gradually coverage was broadened further to include coverage for:

- Wrongful termination;
- Discrimination;
- Harassment;
- Defamation;
- Negligent hiring; and
- Punitive damages as permitted by state law.

Many policies now also provide coverage for claims of discrimination and harassment made against an employer by third parties, such as customers and vendors. *See, generally*, Joan Gabel, et al. *Evolving Conflict Between Standards For Employment Discrimination Liability And The Delegation Of That Liability: Does Employment Practices Liability Insurance Offer Appropriate Risk Transference?* 4 U. Pa. J. Lab. & Emp. L. 1 (2001); Joseph P. Monteleone *Employment Claims: A Primer For The Insurance Lawyer And Claims Professional*, supra.

Less Desirable Exposure Classes

While EPLI is now widely available (in 2001 it was estimated that more than half of Fortune 500 companies had purchased EPLI coverage), some exposure classes are less desirable and, therefore, more expensive and more difficult to place than others. Some of the more difficult classes include:

- Dealerships (auto, motorcycle or boat);
- Collection agencies;
- Temporary agencies;
- Governmental agencies;
- General contractors;
- Property managers; and
- (Yes) law firms.

Larry G. France, *Employment Practices Liability Insurance*, Rough Notes 80, 2004 WL 62092450 (June 1, 2004), also available at www.roughnotes.com/rnmagazine/06cdindex04.htm.

Claims-Made (And Reported)

Unlike the CGL policy, there is no standard EPLI policy form, although most share a number of common provisions. For instance, EPLI policies are written on a claims-made rather an occurrence basis, which means that only those claims made against the insured during the policy period are covered. Some policies also require that the claim be reported to the insurer during the policy period. Others require that the claim be reported within a specified period of time (typically 30 or 60 days) after the policy expires.

What Constitutes A "Claim"?

An administrative charge against the insured filed with the EEOC or a state agency should be considered a "claim" and timely reported to the insurer whose policy is in effect when that claim is made. This is so because by the time a lawsuit stemming from the same facts is filed, the policy and its reporting period may have expired. Depending upon the facts and policy language, a court may hold that both proceedings should be deemed to be a single claim. In that case, if notice to the insurer is delayed until suit is filed, there may be no coverage for either the administrative charge or the lawsuit. *Pantropic Power Products v. Fireman's Fund Insurance Company*, 141 F. Supp. 2d 1366, 1371-72 (S.D. Fla. 2001), *aff'd without op.*, 34 Fed. Appx. 968 (11th Cir. 2002).

Coverage For Prior Acts

Claims-made coverage gives rise to two questions:

- What about wrongful acts which take place before the policy begins but which result in a claim during the policy period?
- What about wrongful acts that take place during the policy period but which result in a claim after the policy ends?

Many EPLI policies contain prior acts coverage, which means that wrongful acts taking place before the policy begins will be covered so long as the resulting claim is made during the policy period and reported in accordance with the policy terms. The prior acts coverage, however, may be subject to a retroactive date, meaning there is coverage if the prior act takes place

after the retroactive date but not if it takes place before that date. The retroactive date may coincide with the effective date of the policy or an earlier date may be negotiated at the time the policy is purchased.

Extended Reporting Period

Wrongful acts taking place during the policy period which result in a claim after the policy has ended will be covered if the claim is made (and reported to the insurer) during an "extended reporting period" purchased by the insured either before the policy ends or within such later period as may be required by the policy. For an additional premium, extended reporting periods may be purchased generally for a period up to three years (and sometimes longer) after the policy ends. Some policies may automatically extend the reporting period for a short time at no additional charge. The standard ISO form is an example of such a policy. It extends the reporting period for 30 days at no charge.

Defense Costs Typically Within Policy Limits

Another characteristic typically shared by most EPLI policies is that defense costs are within policy limits and therefore reduce those limits. Obviously, this is important if an employer contemplates purchasing a policy with relatively modest limits. In that case, when there is protracted litigation, significant defense costs can greatly reduce or even eliminate the policy limits available to pay any settlement or judgment. For this reason, some EPLI policies are now available with defense costs outside limits.

"No Duty To Defend" Option

Some EPLI policies may be written with no duty to defend. Those policies require that the insured manage its defense and retain counsel and that the insurer reimburse the insured for the cost of defense and any settlement or judgment. Only sophisticated insureds should opt for this policy.

Selection of Defense Counsel/Deductible And Co-Pay

When a defense is provided, most EPLI policies permit the insurer to select defense counsel, but this is sometimes open to negotiation, particularly when there is a large deductible or self-insured retention, in which case the insured, in essence, will be paying for counsel with its own funds. (Incidentally, most EPLI policies do contain a deductible and some contain a co-pay feature requiring the insured to pay a portion of any settlement or judgment, usually five or 10 percent).

The selection of defense counsel has been a source of controversy. Insurers typically prefer to appoint counsel on their regular defense panels because of their familiarity with the insurers' practices and procedures and because of their willingness to handle employment-related cases at the same hourly rate as other cases. By contrast, insureds often prefer to have claims against them handled by their regular employment law counsel because of their familiarity with the law and with the insureds' operations. Insurers have eliminated some of the controversy by adding counsel with expertise in employment law to their regular panel counsel. When insureds remain dissatisfied with panel counsel or when insurers have been unable or unwilling to attract to their regular panels counsel with employment law expertise, some insurers have been willing to permit their insureds to engage their own employment counsel at a negotiated rate acceptable to both parties.

When the insured insists on using its own counsel and when a negotiated rate cannot be agreed upon, one approach is to permit the insured to use its own counsel if the insured agrees to pay the difference between the highest rate the insurer is willing to pay and the lowest

rate the insured's counsel is willing to accept. This is an option which is not discussed often enough.

Consent To Settle Provision/"Hammer Clause"

Another source of controversy is the consent to settle provision found in most EPLI policies. Typically, this provision states that the insurer has a right to settle a claim in any manner it deems proper, but the company will not settle any claim without the insured's consent. This is a desirable provision from the standpoint of employers because, at times, of course they may want to resist a lawsuit, despite its costs, so as not to encourage similar claims in the future. However, the consent to settle provision is generally modified by what is known in the industry as a "hammer" clause. The hammer clause states that if the insured refuses to consent to a settlement recommended by the company, the company's liability shall not exceed the amount for which the claim could have been settled but for the insured's refusal. For obvious reasons, this is a desirable provision from the standpoint of the insurer.

"Soft Hammer"

Some policies now contain a so-called soft hammer clause. Such clauses call for the insurer and insured to share any costs exceeding the amount for which the case could have been settled but for the insured's refusal. The insured's participation may range from 25-50 percent. This clause is a recognition by insurers that at times it is in the mutual interest of the insurer and insured to continue to litigate a case which could have been settled at a favorable cost and that they should both share the risk of an unfavorable outcome.

Coverage For Third-Party Claims

EPLI is intended to provide coverage for claims made by employees (and, sometimes, applicants for employment). Consequently, some policies do not provide coverage for claims of discrimination or harassment made by third parties such as vendors or customers of employers. Other policies do provide such coverage, either as part of the basic policy language or as an endorsement for an additional premium. Certain insureds are more susceptible to third-party sexual harassment claims than others. Included in this category are businesses whose employees have regular contact with the public, such as:

- Restaurants;
- Retail stores;
- Airlines;
- Car rental companies; and
- Other service industries.

By contrast, manufacturers may have less need for such coverage.

Title IX Claims

As mentioned, claims that an employee of an educational institution sexually harassed a student may subject the educational institution to liability under Title IX if the educational institution fails to take corrective action upon receipt of actual notice. In that case, the educational institution would be covered under an EPLI policy providing coverage for an employee's harassment of a third party/non-employee. By contrast, the claim would not be covered under a policy providing coverage solely for claims made by employees. Care should be taken, however, to make sure that when providing coverage for claims by third parties, the policy does not at the same time bar coverage for Title IX claims under a common provision excluding coverage for violation of various federal and state statutes. The language in some of these ex-

clusions is broad enough to bar coverage for the violation of any statute, excluding Title VII and related statutes.

Claims By Nontraditional Employees

When the policy provides coverage solely for claims by "employees," independent contractors, leased workers and even temporary employees may not qualify as "employees." This depends upon the definition of "employee" in the policy. Similarly, such individuals may not be insureds for the same reason. However, endorsements are often available to broaden the definition of "employee" to include these persons.

Punitive Damages Claims

Many EPLI policies now provide coverage for punitive damages where permitted by law. To reduce their exposure, some carriers provide coverage for punitive damages only with a separate lower limit applicable to such coverage. A number of jurisdictions which prohibit insurance for punitive damages as against public policy permit such insurance when the liability is vicarious. See 2 Barry R. Ostrager and Thomas R. Newman, *Handbook on Insurance Coverage Disputes* §14.06 (Aspen, 12th Ed. 2002) (providing chart containing state-by-state survey of insurability of punitive damages). In this connection, the Supreme Court has held that an employer may be vicariously liable for punitive damages even in the absence of egregious conduct on the employer's part. *Kolstad v. American Dental Association*, 527 U.S. 526 (1999).

Intentional Injury Claims

It is against the public policy of most states to provide coverage for intentionally caused injuries. 7 *Couch on Insurance* 3d §101:22 (West Group 3rd ed. 1997). In line with this public policy, some EPLI policies contain exclusions eliminating coverage for dishonest, fraudulent, criminal, or malicious acts. A few, however, exclude coverage for *intentional* acts. Since most employment-related claims involve intentional (as opposed to negligent) conduct, not unlike the standard "expected or intended injury" exclusion in most CGL policies, "intentional act" exclusions in EPLI policies will likely be construed to bar coverage only when the *injury* (not the act that produced it) is intended. Otherwise, there is a risk that the policies will be held to provide illusory coverage.

California Insurance Code Section 533

California presents a special case. California Insurance Code section 533 provides that "[a]n insurer is not liable for a loss caused by the wilful act of the insured...." Under California law, a "wilful act" includes one performed with knowledge that damage is highly probable or substantially certain to occur, and it includes a wrongful act in which the harm is inherent in the act itself. *Shell Oil Company v. Winterthur Swiss Insurance Company*, 15 Cal. Rptr.2d 815, 832 (Cal. Ct. App. 1993). In California, applying this definition, sexual harassment has been held to constitute a "wilful act" under section 533. *Coit Drapery Cleaners, Inc. v. Sequoia Insurance Company*, 18 Cal. Rptr.2d 692, 697-98 (1993). Therefore, in that state, an insurer probably does not owe a duty to indemnify an insured who personally engages in sexual harassment. Nor does the insurer have a duty to indemnify the employer entity when the sexual harassment was "so widespread, well-known, and so ratified by the corporation as to constitute intentional corporate policy." *Id.* at 701.

Nevertheless, when the liability of the insured is merely vicarious, section 533 does not apply and, even when the liability is direct, there may be a duty to defend. Why? Because unlike an agreement to indemnify, an agreement to defend against a claim of a willful tort does not encourage willful conduct. *Downey*

Venture v. LMI Insurance Company, 78 Cal. Rptr. 2d 142, 160 (Cal. Ct. App. 1998). Thus, when there is an express agreement to provide a defense for sexual harassment, creating a reasonable expectation that a defense will be provided, section 533 applies to the duty to indemnify but it does not apply to the duty to defend. *Id*.

Separate Retention For Class Actions

Finally, an increase in the number of class action employment-related claims, particularly among large insureds, has given rise to "split retentions" in some EPLI policies, i.e., one (larger) retention for class actions and another for non-class actions.

Key ISO Provisions

The ISO policy:

- Is written on a claims-made basis;
- Does not provide coverage for claims by third parties;
- Contains an automatic extended reporting period of 30 days, which is provided at no additional cost, but an extended reporting period is available for up to three years; and
- Contains a standard consent-to-settle clause, and defense expenses are included within the policy limits.

However, ISO offers another form which provides separate limits for defense and indemnity. Pursuant to this form, defense payments reduce the defense limit but have no impact on the indemnity limit.

"Criminal, Fraudulent, Or Malicious Acts" Exclusion

While the ISO policy excludes coverage for "criminal, fraudulent, or malicious acts," the insurer must defend claims alleging such acts until it is determined that the insured's actions were in fact criminal, fraudulent, or malicious. This provision is potentially very valuable, since it can be more costly to defend a sexual harassment claim than to indemnify.

Contractual Liability Exclusion

The policy contains a contractual liability exclusion. In a construction setting, for instance, this means that a subcontractor's EPLI insurer will not provide coverage to a subcontractor who has agreed to hold a general contractor harmless because of sexual harassment on the part of a subcontractor's employee, unless the subcontractor would have been liable for such acts in the absence of the hold harmless agreement.

Under the ISO Form, the definition of "employee" includes "leased workers" and "temporary workers" but not independent contractors or job applicants.

Choice Of Counsel

Finally, the policy contemplates a development which occurs all too frequently, namely a conflict between insured and insurer. In some jurisdictions, when a conflict arises, the insurer must pay for separate counsel to defend along with counsel originally retained by the insurer. In that case, or when separate counsel is retained by mutual agreement, the policy requires both lawyers to maintain records pertinent to defense expenses for use in determining allocation of any defense expenses for which the insured may be solely responsible, including defense of any allegation not covered by the policy. When the insurer must defend the entire action because the Complaint alleges both covered or potentially covered claims, as well as claims which are clearly not covered, some jurisdictions permit insurers to recover the cost of defending the latter claims if such cost can be properly allocated, and if the insurer has properly reserved its rights to seek recovery. *See, e.g., Buss v. Superior Court*, 939 P2d. 766 (1997).

CONCLUSION • Only in rare instances do non-EPLI policies provide coverage for workplace sexual harassment claims. There is no better proof of this than those cases in which the courts have denied coverage for such claims under other policies, while pointing to the availability of EPLI that specifically covers sexual harassment claims. *Truck Insurance Exchange v. Gagnon*, 33 P.3d 901, 906 (N.M. Ct.App. 2001); *American Motorists Insurance Company v. L-C-A Sales Company*, 713 A.2d 1007, 1014 (N.J. 1998). Indeed, one court has pointed to the existence of EPLI—which was offered to the insured but declined—as further support for the notion that the parties would not reasonably expect coverage for employment-based actions under a D&O policy. *Miller v. ACE USA*, 261 F.Supp.2d 1130, 1137-1138 (D. Minn. 2003). Therefore, it seems prudent for most employers to consider some form of EPLI coverage. Further, employers whose employees have regular contact with the public should strongly consider purchasing a policy that provides coverage for third-party claims.

PRACTICE CHECKLIST FOR
Insurance Coverage For Sexual Harassment In The Workplace

Most forms of insurance won't cover sexual harassment claims, but Employment Practices Liability Insurance ("EPLI") will. But to get the best protection for your client, you need to know how these policies work.

- EPLI policies are written on a claims-made-and-reported basis, rather than an occurrence basis. This means that the employer has to make a claim quickly, usually as soon as an administrative claim (EEOC, state agency) is filed. It may be a mistake to wait until a lawsuit is filed.
- Some policies will provide endorsements to cover prior acts (acts which preceded the issuance of the policy), or for an extended reporting period.
- EPLI policies usually provide that defense costs are included in the coverage limits, and therefore reduce the amount of coverage by the cost of defense on a claim.
- Some EPLI policies don't require the insurer to defend, and permit the insured to manage its own defense, which the insurer will pay for. This is an option only for the most sophisticated insureds (such as law firms).
- Most EPLI policies give the insurer the right to select defense counsel. But some permit the insured to make the choice, particularly if there is a large deductible or co-pay.
- Most EPLI policies give the insurer the right to settle the case as it deems proper, but only with the insured's consent, and contain a "hammer clause." This clause typically states that the insurer will not be liable for any amount in excess of what it would have settled the case for had the insured not withheld consent. Some policies have "soft hammer" clauses that require the insured and the insurer to share the amount exceeding what the insurer would have settled the case for.
- EPLI policies are intended to cover claims made by employees. Depending on the policy language, harassment claims made by third parties (vendors, customers, and so on) might not be covered. Similarly, the policies might not cover claims by independent contractors, leased workers, and even temporary employees. It is crucial to ask about these things.
- In jurisdictions where it is permitted, the EPLI policy may cover punitive damage awards.