FLSA COVER LIMITED

As Wage & Hour Lawsuits Explode, Carriers Weigh In Against Insurability

BY SUSANNE SCLAFANE

WHILE AN EXPLOSION in wage-and-hour lawsuits may bring more employers to the doors of their employment practices liability insurance carriers, in most cases, those seeking coverage for settlement costs will be out of luck, experts say.

Most carriers remain dead set against providing coverage for settling employee suits in which workers allege violations of federal or state laws governing how they are paid. In addition, while some carriers provide limited coverage for the costs of defending such suits, not everyone agrees the coverage grants are really adding protection for employers.

"The largest number of class actions coming in every carrier's door are FLSA claims," said Lucy Ann Galioto, vice president at AIG's National Union in New York, referring to wage-and-hour actions alleging violations of the Fair Labor Standards Act.

Such actions can deal with issues ranging from missed employee meal breaks to improper classification of employees as exempt from overtime pay, she said.

DEFENSE COSTS HIGH

Costs to defend the cases reach as high as $3 million when brought as collective actions, she said. "Giving a sublimit of $150,000 is not going to do it," she said, suggesting that defense-only sublimits being offered by some carriers are a drop in the bucket in terms of covering these costs.

"I think the way to go is through prevention, education and a buy-in from the [insured] that this is serious," she said. However, she noted that the issue is one that is very difficult for employers to grapple with, especially those with temporary workforces or changing workforces scattered throughout the country.

AIG has one client that hired a person specifically charged with monitoring all its California worksites to make sure all the employees are properly classified and that all are taking rest periods and meal breaks, she said. "I think that [speaks to] the enormity of the problem."

Several experts pointed to Wal-Mart as a high-profile example of an FLSA target that has served as a wakeup call even to much smaller companies that run the risk of being hit with wage-and-hour lawsuits. "All you need is that one employee," Ms. Galioto said, noting that a car wash in New York paid over $700,000 in a wage-and-hour dispute.

At Philadelphia Insurance in Bala Cynwyd, Pa., where smaller companies (averaging 500 employees) tend to populate a book where EPLI is bundled in insurance packages with directors and officers, fiduciary, Internet liability and workplace violence coverages, Brad Lacey, assistant vice president-product manager for the management liability division, illustrated a potential exposure for a social services firm falling in Philadelphia's private and nonprofit company niche.

Group homes for mentally challenged children can have employees on 24-hour shifts, he noted. "If you have some downtime on the shift, or you sleep over because you have a 24-hour shift, are you to be paid for your sleep? That has become an issue," he said.

Mr. Lacey noted that while the FLSA has existed for decades, the government has become more active in enforcing it in recent years. He and other experts agree, however, that the plaintiffs' bar is the biggest driver of a surge in FLSA suits.

"They started to pay attention to it and some cases got through and established

With wage-hour claims exploding and carriers reluctant to give coverage, loss prevention is the answer for employers large and small, carrier says

new case law," Mr. Lacey said. "It's just one of those things where the legal community starts to target it."

Ms. Galioto referred to an article she read in which plaintiffs' lawyers called these cases "low-hanging fruit" because they are easy to file in states that are amenable to collective actions, requiring less work than regular discrimination class actions.

Analyzing workplace class actions for 2007 in a January report, the Chicago law firm Seyfarth Shaw, which defends employment cases, reported that FLSA collective actions pursued in federal court produced more rulings last year than either actions of discrimination or actions under the Employment Retirement Income Security Act (ERISA). While $1.8 billion in ERISA costs dominated a settlement total of $2.7 billion for all 2007 workplace class actions tallied, the law firm reported that settlements of wage-and-hour actions totaled $319.3 million, while discrimination class actions brought $282.1 million in settlements.

"The volume of wage-and-hour litigation continues to increase exponentially," the report said. While the U.S. District Courts for the Southern and Middle Districts of Florida have more wage-and-hour filings than any other federal jurisdiction, the report noted that the most explosive growth is at that state court level, with California, Florida, Illinois, New Jersey, New York, Pennsylvania and Texas leading the way.

"You really don't have to be an expert" to bring these cases, Ms. Galioto said. "You just have to find one person."

She described a situation where a worker visits a plaintiffs' lawyer to complain about some form of discrimination and ends up talking generally about his or her work duties and whether he or she took breaks. The lawyer begins to get a sense "of how compliant or noncompliant that employer is, and pretty soon you have a collective action going."

Neither AIG nor Philadelphia Insurance cover settlement costs for wage-and-hour cases, but Philadelphia does offer a $100,000 sublimit of liability to provide defense costs.

"All carriers are different, but our own underwriting philosophy is that you're really in violation of the law" in these cases, Mr. Lacey said. "If a case comes up, we'll defend you because anybody can be sued for anything. But we're not going to pay if [the employer is] actually guilty of violating the law."

"Our stance right now is we do underwrite for it," Mr. Lacey said. "We want to make sure [insureds] have some written procedures in place [and] that their procedures are reviewed by outside counsel," he said, describing some of the underwriting factors considered.

In addition, the insurer looks at the makeup of the employee base—how many employees are exempt, nonexempt, salaried or not salaried. Type of industry is another factor, he said, noting, for example, that problems are more prevalent in the restaurant industry than for office work.

Like Philadelphia Insurance, most carriers that offer coverage for wage-and-hour claims provide defense-only sublimits, according to Richard Betterley, president of Betterley Risk Consultants in Sterling, Mass., and author of "The Betterley Report." His December 2007 survey of 25 EPLI products (which did not include Philadelphia Insurance) lists 10 with defense-only sublimits, while only two—AVEMCO and Markel—cover settlements also.

FACE OFF

Carriers who don't offer coverage for wage-and-hour suits say:

- They're unwilling to pay if an employer is guilty of violating the law
- It's against public policy to pay earned but unpaid wages

Carriers who do offer coverage for wage-and-hour suits say:

- They're paying for honest mistakes, not intentional law violations
- The public policy argument doesn't wash; EPLI with wage-and-hour coverage is an admitted product in many states

"Generally speaking EPL insurers take the position that [they] do not cover anything related to wage-and-hour, but the reality is not quite so clear," Mr. Betterley said, referring to the 13 remaining insurers.

Describing "the reality" in wage-and-hour claims scenarios, he said there are usually several allegations against the insured. "There's almost always something covered—like discrimination," where an allegation might be that the employer only short-changed one class of employees.

"Therefore a number of carriers have been paying to defend cases that were basi-

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cally wage-and-hour because there were also discrimination allegations," he said.

Those carriers that have come out and said, "We will provide a defense, but we will put a sublimit on," he noted, are not acknowledging that they would have had to provide a defense anyway in the multi-allegation-type situation he described.

"What's changed is now you've got a sublimit on that cost," he said. Without the sublimit, if an insured had a policy with a $1 million limit of liability, and it had a wage-and-hour case where defense was covered because there was also a discrimination allegation, the insurer might have been on the hook for $1 million.

Now, by putting a $250,000 sublimit on wage-and-hour, the insurer may actually be reducing coverage, not increasing it, he said.

"We don't cover it because these are disgorgement claims. Essentially, the employer is keeping something it should have given the employee."

Lucy Ann Galioto, Vice President
AIG National Union

Peter Taffae, managing director of Executive Perils, a Los Angeles-based wholesale brokerage, offered a similar assessment. Noting that the availability of $100,000 defense sublimits is increasing, he observed that "most people look at this as if they're getting an extra one hundred thousand" of coverage.

"That's not the way to look at a sublimit. A sublimit is an exclusion. Without the sublimit, you've got full limits," he said.

Mr. Taffae said the market is currently moving toward $250,000 sublimits. "There's only one market, London, that will give $1 million," he said.

As for carriers that don't offer any coverage, "the time has come where you're just going to have to do it," he said. "A year from now, it's just going to be like third-party," he said, referring to the fact that while carriers were slow to extend EPLI to include coverage for discrimination suits brought by nonemployee third parties, they include this almost universally today.

"No one is going to buy a policy without it. You're at a substantial disadvantage if you don't offer it," he said, adding that carriers are "being smart" to limit coverage to defense only.

Mr. Betterley said that while there's been talk about more carriers providing settlement coverage also, "the more thoughtful EPL product managers don't want any part of [that]—"and they're right because they don't want to be covering some employer's decision to short-change its employees."

While there's always a possibility that a competitive insurance market will force more carriers into providing the settlement coverage, "I see it as a pretty high wall that's going to be tough to breach. From a product improvement standpoint, I think the carriers are just not going to want to go there," Mr. Betterley said.

At AIG, Ms. Galioto said, "We don't cover it because these are disgorgement claims. Essentially, the employer is keeping something it should have given the employee." She added that in a California case, the appellate division has ruled it is against public policy for an insurer "to pay earned but unpaid wages."

At Markel Shand in Deerfield, Ill., which offers a defense and settlement product, EPLI Product Manager Robert Cap said "that's a curious argument on the part of some competitors," referring to the notion that indemnification is against public policy.

"It's an admitted product," he explained, noting that Markel has "the green light in 45 states to offer the coverage."

With defense-only coverage, he said, the insured is "only half protected," adding that once the defense limit is exhausted, the insured is on its own."

"The indemnification component is a nice feature because if there's an opportunity to resolve a case early and short-circuit a class action, we're able to do that," added Mr. Cap, whose company is a market for employers with 500 employees or less.

Acknowledging arguments of other carriers that this is uninsurable "because someone could consciously disregard the need to pay their workers properly," Mr. Cap said Markel's experience has been that the claims are simply "based on mistakes—a misclassification or a fundamental misunderstanding" of an employer's legal compensation obligations to employees.

"In most cases, they're shocked that they made such mistakes," he said. "There's ignorance on the part of employers with respect to the law," he said, referring to the FLSA. "It's a confusing law," he said.

"A lot of employers still don't understand the simple notion that when employees work overtime, they need to be paid at a time-and-a-half rate, unless the state specifies otherwise," he said. "Or they say, 'You worked an hour over your regular schedule. Let me carry that over to the next pay period and I'll pay you there,' which is a violation."

MORE ON THE WAY

Mr. Taffae noted that in early 2004, the Department of Labor (DOL) updated the FLSA by changing the way employers should determine overtime exemptions and raising salary thresholds of exempt employees.

"I think the intent was to decrease the number of DOL actions, but with the publicity of these changes, they rang a bell" for the plaintiffs' bar, substantially increasing the lawyers' interest in wage-and-hour suits, Mr. Taffae said.

Both Mr. Taffae and Mr. Cap said there's never been more claims activity than there is right now, citing a worsening economy as another key factor.

"As people are laid off, they realize their former employers did not pay them overtime or did not pay them properly. You see these claims surfacing," Mr. Cap said.

"Now is not a good time to be an underwriter," Mr. Taffae said.

Still, Mr. Cap said the number of carriers offering FLSA coverage has risen in the last year. "For four years, we were probably the only carrier offering a sublimit of $100,000 on a defense-and-indemnity basis," he said, noting that three competitors jumped in with a similar product in the last 12 months.

Will more enter in future years?

"Personally, I think the Johnny-come-latelies of the world…are going to feel the effects of offering the sublimit at a low price, and with the worsening economy and the increase in FLSA claims, you'll see the opposite take place," he said. "I think you'll find that some carriers that jumped in and said we're willing to do this will pull out." NU