

Presenting a live 90-minute webinar with interactive Q&A

Wage and Hour Insurance Coverage: Mitigating Risk With EPL, D&O, and Emerging Specialty Wage and Hour Insurance Policies

Evaluating Insurance Options, Negotiating Coverage and Exclusions, Strategically Arguing for Coverage of Claims

WEDNESDAY, AUGUST 17, 2016

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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Washington, D.C.

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Wage & Hour Insurance: Exposures and Traditional Coverage Limitations

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- AV-rated attorney with over 29 years in commercial insurance coverage and defense.
- Principal author of *Employment Practices Liability* (National Underwriter, 2nd Edition 2012) and *Minnesota Insurance Law and Practice* (Thomson West, 2nd Edition 2010).





Increasing Wage & Hour Exposures

Wage & hour claims are a large and growing risk for employers.

The legal exposure can be immense, with large attorney's fees awarded if even one of multiple claims is proven.

Increasing Wage & Hour Exposures

Two worrisome trends:

1. Agencies and courts increasingly finding temporary employees & independent contractors are “employees.”
2. DOL narrowing FLSA exemptions – fewer executive, administrative and professional employees can be paid a salary (12/1/16).



Legal Costs

In addition to these increasing exposures for wage & hour damages, there is large exposure for **attorneys fees**.

Expensive to defend these suits – surprisingly time-consuming.

Also, prevailing employees get **their attorneys fees** as damages!



Risk Management

Two basic forms of risk management, to mitigate immense wage & hour exposures:

1. **Prevention.** Careful compliance efforts to reduce wage & hour exposures.
2. **Liability insurance.** If wage & hour claim is made, seek coverage under EPL, D&O and other liability insurance policies.



EPL Insurance?

The most natural place to look is the company's Employment Practices Liability insurance policy. However, in most cases, EPL insurance is not the answer.

Most EPL policies exclude coverage for both federal and state wage & hour claims.



Wage & Hour Exclusions

Courts broadly construe these exclusions, consistent with plain language. For example, rather than listing every state wage & hour law, policies generally exclude claims for violating the federal FLSA and “similar” state statutes.

These exclusions are broadly construed to include the relevant state wage & hour statute, even if not identical to the federal FLSA. *Employment Practices Liability, Second Edition*, p. 24.



Moral Hazard Issue

A broad reading of EPL wage & hour exclusions is consistent with the **moral-hazard doctrine**, which seeks to avoid coverage when insureds could knowingly precipitate the event insured against.

“Insurance against a violation of an overtime law, whether federal or state, **would enable the employer to refuse to pay overtime and then invoke coverage so that the cost of the overtime would come to rest on to the insurance company.**” *Farmers Auto. Ins. Ass’n v. St. Paul Mercury Ins. Co.*, 482 F.3d 976 (7th Cir. 2007).



“Loss” and “Damage” Trigger

In addition, in the absence of express wage and hour coverage, it is questionable whether such claims would satisfy the EPL “loss” or “damage” trigger.

Repayment of past-due OT is the kind of **restitution claim** that is not normally an insurable damage. It is the repayment of an amount **already due** -- prior to the employer’s alleged wrongful act.



No Restitution Coverage

In a frequently-cited Texas case, the Court explained why **restitution** is conceptually distinct from **damages**: “An insured ... does not sustain a covered loss by restoring to its rightful owners that which the insured, having no right therein, has inadvertently acquired.” *Nortex Oil & Gas Corp. v. Harbor Insurance Co.*, 456 S.W.2d 489, 494 (Tex. Ct. App. 1970).

Level 3 case

More recently, the Seventh Circuit applied this principle to D&O insurance. In [*Level 3 Commc'ns Inc. v. Fed. Ins. Co.*, 272 F.3d 908, 911 \(7th Cir. 2001\)](#), Court found that a claim for restitution is not the same as loss or damage. “An insured incurs **no loss** within the meaning of the insurance contract by being compelled to **return property** that it had stolen, even if a more polite word than ‘stolen’ is used to characterize the claim for the property's return.”



D&O and EPL Limitations

Most D&O policies have the same coverage restrictions as EPL policies. Wage & hour claims are frequently **excluded**. Also, absent a contrary policy provision, a wage & hour claim may not be a “**loss**” under a D&O policy. (As suggested by *Level 3* case.)



Wage & Hour Endorsements

Increasingly, EPL and D&O insurers offer wage & hour endorsements for additional premium. Normally such endorsements are limited in scope:

- Generally have lower **sublimit** than the remainder of the policy. (For example, a \$1,000,000 EPL policy may have a \$100,000 wage and hour sublimit.)
- Also, many endorsements provide **defense-costs-only** coverage, with no indemnity for judgments or settlements.



Wage & Hour Endorsements

Challenge: Even when EPL or D&O wage & hour endorsements available, they generally do not provide significant **indemnity** protection.

Situation may be changing. Kelly Thoerig will be discussing new **stand-alone** policies specifically designed to provide wage & hour coverage.

Wage & Hour Risk Transfer and Solutions



- Primarily responsible for manuscripting EPL and Wage and Hour policies, leading policy and insurer new product reviews, and drafting endorsements.
- Claims advocate for Marsh's FINPRO practice, specializing in complex coverage and claims issues concerning employment practices liability, directors and officers, professional liability, cyber, and fiduciary liability insurance.
- Former practicing insurance coverage attorney.



Wage and Hour Insurance – Coverage Evolution

- **Employment Practices Liability Insurance (EPLI):**
 - Virtually all EPLI policies contain a standard exclusion for alleged violations of Fair Labor Standards Act violations and similar state laws ("FLSA" exclusion)
 - In light of some successful challenges to the FLSA exclusion, the exclusion became much more sweeping to reiterate that EPLI insurers have no intention of covering such claims under an EPL policy.
 - As the EPL market continued to soften, some insurers began to offer defense-costs only sublimits for wage and hour claims with the following GENERAL characteristics:
 - (a) \$100,000 to \$150,000 sublimit of coverage for defense costs
 - (b) For companies with 1,000 employees or less
 - (c) Excludes California and Florida
 - (d) Excludes certain industries, particularly retail and financial institutions
 - (e) May not be available if prior wage and hour claim history
 - However, an EPL policy with sublimited defense costs for wage and hour claims may in some instances *restrict* the defense coverage that may otherwise have been provided under a duty to defend policy.
- **Directors' and Officers' Liability Coverage (D&O):**
 - May provide some limited coverage if a claim names a director or officer and is otherwise covered via definition of Wrongful Act. But, most of these claims do NOT name an individual, just the company, and the company is not insured under a public company D&O policy except for Securities Claims.
 - Given the potential individual liability of directors and officer for wage and hour claims, many D&O insurers now require a broad wage and hour/FLSA exclusion endorsement (not standard – should be avoided if possible).

Wage and Hour Insurance – Coverage Evolution

- Journey to the January 2013 Release of Wage and Hour Insurance
 - EPLI insurers traditionally believed that the risk was uninsurable and would create a moral hazard.
 - For over three years, Marsh conducted extensive research and analysis of data to educate many leading EPL insurers on why this risk can indeed be insured.
 - Marsh also worked with leading wage and hour defense firms to fully understand the exposure so that the policy written would properly address the unique issues associated with these types of claims.
- First W&H policies geared towards large companies
 - Bermuda
 - \$5M minimum retention
 - \$30,000 rate per M
 - Extensive underwriting

Wage and Hour Insurance – Private Litigation Exposure

- Wage and Hour claims, typically brought under the FLSA, were the single largest employment practices-related exposure in 2015.
 - In calendar year 2015, 8,954 FLSA lawsuits were filed – an **11% increase** from the 8,066 lawsuits filed in 2014.
 - The number of filings is only expected to increase over the next few years, with no crest in sight.
 - The Department of Labor (“DOL”) rule regarding the salary and compensation levels needed for so-called “white collar” workers to be “exempt” from overtime pay was recently revised – more than doubling the standard salary level from \$455 per week (\$23,660 annually) to \$913 per week (\$47,476 annually).
 - Note that in 2002, there were only 2,035 FLSA lawsuits filed.
 - The top 10 private settlements in 2015 totaled **\$463.6M** – more than DOUBLE the top 10 total of \$215.3M in 2014.
 - These figures do not include defense costs, state claims, or claims brought by the DOL.



Wage and Hour Insurance – Private Litigation Exposure

Settlements over \$20M (not including defense costs) over the past 24 months included:

| Courier Services | \$225M | Class action of drivers asserting misclassification as independent contractors |
|------------------------------|---------|---|
| Healthcare | \$80M | Class action related to overtime on extended shifts |
| Restaurant | \$56.5M | Class action involving 108,000 workers and the failure to provide adequate meal and rest breaks |
| Financial Institution | \$36M | Class action relating to the misclassification of a category of employees due overtime |
| Grocery | \$30M | Class action challenging the overtime calculation method |
| Logistics | \$28M | Class action involving failure to provide meal and rest breaks |
| Municipality | \$26M | Class action of trash truck drivers alleging meal and rest break violations |
| Retail | \$23M | Class action including 40,000 workers alleging denial of overtime and rest breaks |
| Logistics | \$21M | Class action alleging denial of overtime and minimum wages |

Wage and Hour Insurance – Enforcement Exposure

- Department of Labor Wage and Hour Division (WHD) maintained increased enforcement in 2015, recovering over \$246 million in back wages for more than 240,000 workers (as compared to \$173 million in FY2009).
- Average settlement value by industry ranged from \$2.9 million to \$7.4 million in 2014 / 2015.
- Targeted industries include retail, construction, health care, financial services and staffing agencies.



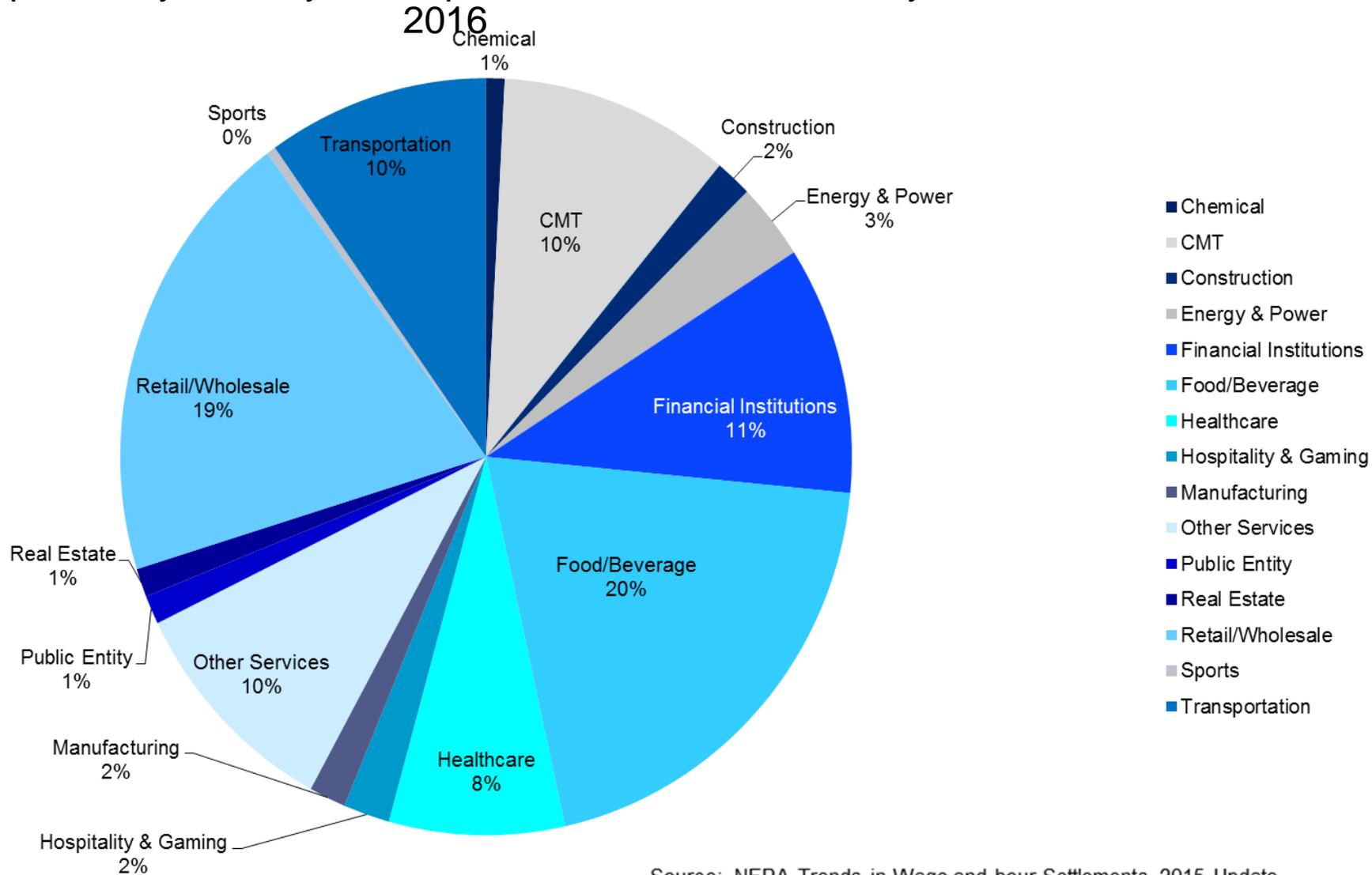
Source: <http://www.dol.gov/whd/statistics/>

Wage and Hour Insurance – Focus on Industry

- Hardest hit industries:
 - Financial services/insurers
 - Retail
 - Food & food services
- In 2014-15, more than half of settlement dollars (57%) were paid to financial services/insurers (21%), retail (19%) and food & food services (17%)
 - Over all years these industries account for ~50% of settlement dollars paid.
- Settlements with defendants in the tech industry were the highest, followed closely by financial services/insurance and food services industries.
- Majority of settlement dollars were paid out in New York and California.

Wage and Hour Insurance – Focus on Industry

Exposure by Industry – Sample Settlements: 2011 – May



Source: NERA Trends in Wage and hour Settlements 2015 Update

Wage and Hour Insurance – What Does it Cover?

Definition of **Claim**

- Includes claims brought by the DOL, as well as employees or independent contractors.

Definition of **Wage and Hour Practices Liability**

- Misclassifying an Employee as an independent contractor, or as exempt rather than non-exempt;
- Miscalculating the overtime rate of pay;
- Failing to pay wages, partially or fully, for shift start or shift end, or other “off-the-clock” activities such as booting and logging on to work computers;
- Failing to pay wages, partially or fully, for “donning and doffing” activities;
- Failing to provide required meal and rest periods;
- Failing to compensate partially or fully for work-related travel times;
- Failing to maintain or keep accurate records relating to wages earned or hours worked

Definition of **Loss**

- Includes wages and liquidated damages, defense costs, plaintiff’s attorney’s fees.
- Some forms also cover civil monetary penalties or statutory penalties.

Wage and Hour Insurance – What Does it Cover?

Selected Exclusions

- Prior knowledge of Claims by Insured's Law, HR or Risk Management departments
- Loss Amounts attributable to criminal violation if established by final adjudication in underlying action (severability will apply)
- Traditional EPL claims
- OSHA, workers comp, unemployment benefits, Workers' Adjustment Retraining and Notification Act ("WARN"), NRLA, etc.
- Bodily Injury
- ERISA & other benefits laws
- Contractual liability

Wage and Hour Insurance – What Does it Cover?

A Numerical Example

- 50 employees improperly classified as exempt from overtime
- Average unpaid overtime of \$8,900 per employee per year (per latest DOL average)
- Three years of back pay as result of willful FLSA violation

Civil Monetary Penalties (CMPs) and Costs:

| | <u>Amount</u> |
|--|-----------------------------|
| • \$8,900 x 50 employees x 3 years = \$1,335,000 x 2 (liquidated damages) | \$2,670,000 |
| • \$1,894 x 72 pay periods x 50 employees (CMPs) | \$6,818,400 |
| • Attorney's fees, administrative costs, defense costs | <u>\$3,000,000+</u> |
| • <i>Total cost of noncompliance</i> | <i>\$12,488,400+</i> |

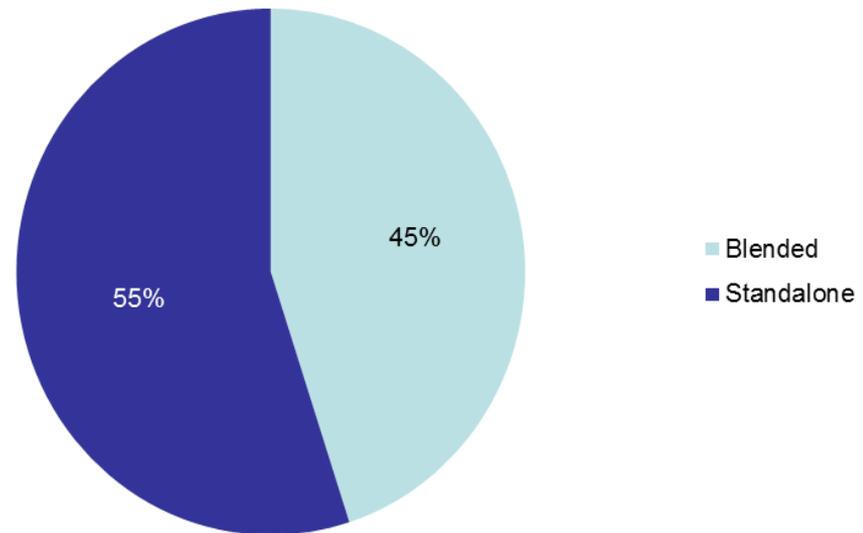
Wage and Hour Insurance – Market Update

- In the last year, the market has seen new entrants from both the U.S. and London, to complement the Bermuda W&H primary products that have been available for the past three+ years.
 - Beazley Syndicate in London formally releases their W&H Insurance policy in September of 2015 – \$5M in capacity / will consider a blend with EPL / will provide as part of excess layer with “drop down” structure over EPL insurance program / retentions as low as \$250,000 (geared to companies with less than 10,000 employees).
 - StartPoint in London considers excess W&H Insurance and also has \$5M in capacity.
 - AIG releases their primary W&H Insurance form in September – the first domestic market to offer a stand-alone policy / \$25M in capacity / minimum retention is \$5M / will consider a blend with EPL insurance.
- XL Bermuda releases a combined EPL and W&H Insurance form in December 2015, providing a streamlined option for clients that want a blended program.
- There is considerable excess capacity available, especially in the Bermuda marketplace.

Wage and Hour Insurance – Market Update

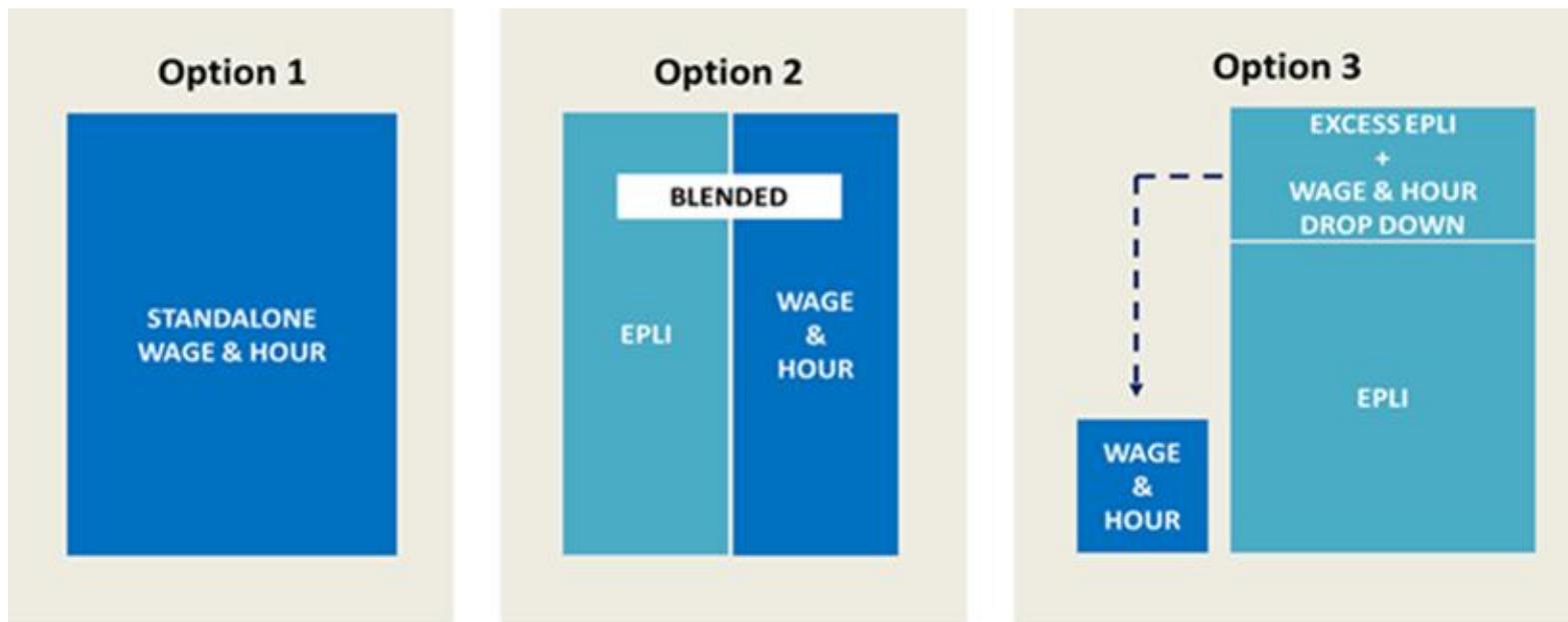
- Submission and quote activity is on the rise, and we saw more companies budget for and purchase W&H insurance in 2015 than in prior years.
 - More companies bound coverage in the first six months of 2016 than in all of 2015.
- Industries represented by placements:
 - More than 25% of Marsh W&H placements to date have been in the retail/wholesale/food and beverage sector.
 - Historically, the most common industries targeted by plaintiffs in W&H claims include financial institutions, retail and food & food services.

Marsh W&H primary placements through July 1, 2016 (Marsh W&H placements are ~30% of all placements)



Wage and Hour Insurance – Market Update

- Looking forward, we expect a continuation of underwriting flexibility in coverage and program structure.
- Underwriters are generally willing to provide primary W&H coverage
 - on a standalone basis,
 - on a blended basis with primary EPL insurance,
 - or in an excess blended layer in an EPL insurance program, with a W&H drop down feature.



Wage and Hour Insurance – Underwriting Process

Initial Underwriting Information Necessary for Non-Binding Indication

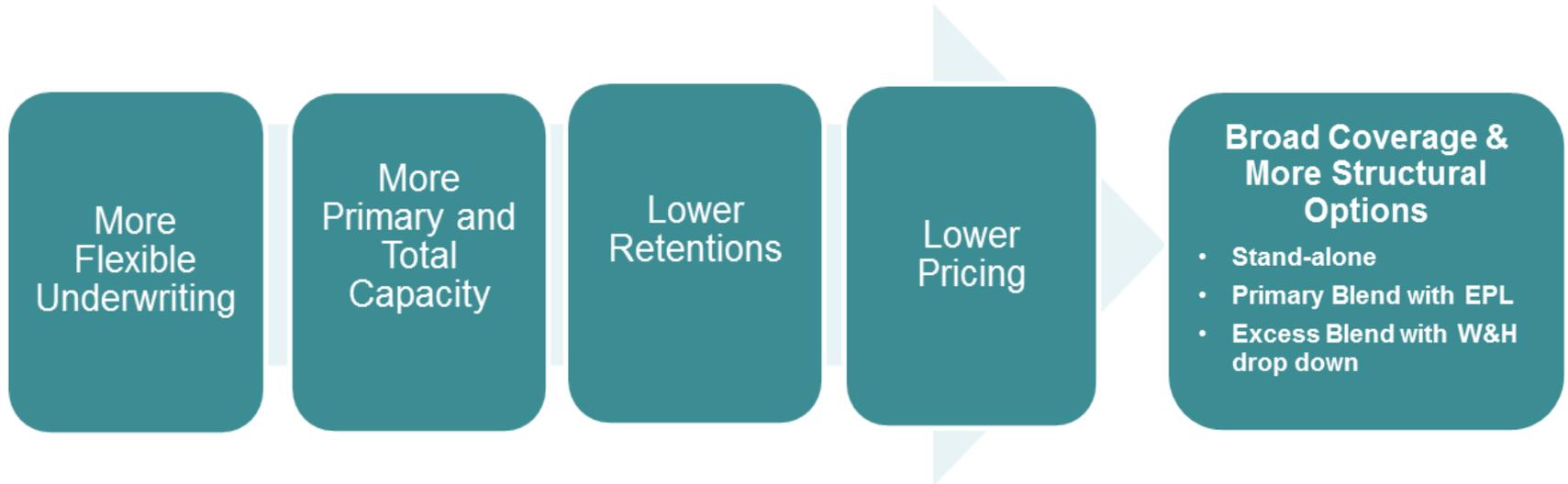
- Detailed headcount information, i.e. breakdown by state of
 - Full-time
 - Part-time
 - Exempt
 - Non-exempt
 - Union
 - Independent Contractors
 - Temporary
 - Leased employees, etc.
- Five (5) year claims summary
- Three (3) year staff turnover % (Beneficial)



Full Underwriting Information

- Application including warranty
- Copy of written company policies relating to wage and hour, employee use of cell phones and blackberries
- Wage and hour compliance documentation and internal training programs
- Copies of wage and hour audits (internal and/or external)
- Job descriptions (including reclassifications)
- Policies relating to IT classifications and exemption status
- Payroll and timekeeping practices, policies and procedures
- Policies relating to independent contractors, consultants and/or temporary workers
- Detailed claims history

Wage and Hour Insurance – Market Update



Thank You!



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Wage & Hour Insurance: Top 5 Questions for Employers

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Question 1: Is Stand-Alone Wage & Hour Policy a Good Fit?

Stand-alone policies avoid all or most of coverage problems previously discussed. (Time will tell.)

Does the **pricing** work for your company? Is the **deductible** too large to be useful?



Question 2: Are All Wage & Hour Endorsements the Same?

No. Virtually every insurer uses its own language. (Low sub-limits, defense cost only, etc.)

Always important to read your policy language. **Especially** true with EPL and D&O policies and endorsements.

Ask your broker for assistance!



Question 3: Is Wage & Hour Endorsement With Low Sublimit a Good Fit?

Many insurers provide wage & hour endorsements to EPL or D&O policies with a lower sublimit, such as **\$100,000**.

Challenge: Most wage & hour claims require more coverage. **Defense** costs often 200K+. **Indemnity** also often 200K+ (since employee's attorney fees are item of damage).



Question 4: Is Wage & Hour Endorsement With Defense-Cost Only Coverage a Good Fit?

Important coverage – defense costs are significant risk.

However, this leaves **indemnity** uncovered – the other half of risk.

Can you afford the **premiums**? Can you afford to **self-insure indemnity**?



Question 5: How Important is Prevention?

Prevention (risk management) is always a good investment, for any legal risks.

Especially important with wage & hour claims. Even if you have coverage, there will be significant gaps.

Get wage & hour audit from an employment attorney or other expert – an excellent investment!