A CHECKLIST FOR INSURANCE COVERAGE IN THE EMPLOYMENT LITIGATION CONTEXT

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A CHECKLIST FOR INSURANCE COVERAGE IN THE EMPLOYMENT LITIGATION CONTEXT

LARRY M. GOLUB*

INTRODUCTION

The area of employment litigation actually involves a variety of topics, ranging from wrongful termination, to discrimination, to sexual harassment, to claims under the relatively uncharted waters of the Americans with Disabilities Act. There are various types of insurance coverage that may be triggered in a lawsuit raising employment-related claims. From an insurance standpoint, and primarily from the position of the employer, it is essential to quickly and comprehensively obtain all insurance information, analyze it, tender the claim to the appropriate insurance carrier(s), and otherwise remain attuned to the insurance coverage issues as they arise throughout the course of the litigation. This Article will address some of these issues, alerting the reader to those topics and strategies that may arise in the typical employment claim. This Article will not address substantive legal issues that arise in coverage litigation between the employer and its insurer(s), since these matters are analyzed by other contributions to this Symposium.

For purposes of this Article, we will assume that the employer has just received service of a complaint raising employment claims, such as for wrongful termination and discrimination. This Article provides a checklist for the employer dealing with potential coverage issues. Although this Article will address certain strategies and topics with respect to employment claims in general, it should not be considered as an exhaustive discussion of that broader topic. Rather, the focus will be on employment claims as they relate to insurance coverage issues.

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I. IMMEDIATELY OBTAIN ALL INSURANCE POLICIES COVERING THE EMPLOYER

From an insurance coverage perspective, the first thing an employer must do when it learns that it has been sued by an employee is to amass any and all potentially applicable insurance policies that may provide insurance coverage for the claim. Employers should recognize that the insurer’s obligation may be triggered not only by a formal lawsuit but also by a demand for arbitration or even by a claim filed with the Equal Employment Opportunity Commission (“EEOC”) or some comparable state agency. The person at the employer who is responsible for obtaining and maintaining insurance coverage should consider all potentially applicable forms of insurance policies, many which are discussed in greater detail in other contributions to this Symposium. This Article provides only a brief discussion of the different types of policies that may afford coverage.

A. General Liability Policies

When one thinks of the insurance policy which the typical business purchases, the first policy that usually comes to mind is the general liability policy. This is the basic policy THAT businesses purchase to cover run-of-the-mill tort claims against the business. Such policies generally do not cover claims arising out of breach of contract. The types of coverage provided under general liability policies include claims alleging “bodily injury” and “property damage,” as those two terms are defined under the policy, and usually also provide coverage for a variety of torts, commonly referred to as “personal injury” coverage and “advertising injury” coverage. While virtually all general liability policies now provide express exclusions for employment-related claims, some of them do so only with respect to claims for bodily injury and property damage and not necessarily with respect to claims for personal injury or advertising injury.  

Under those coverages, many policies do provide protection for injury arising out of libel, slander, defamation, violation of the right of privacy, false imprisonment, detention or arrest, and discrimination.

Furthermore, while most businesses may have some form of

1. See, e.g., David Kleis, Inc. v. Superior Court, 44 Cal. Rptr. 2d 181, 187-88 (Cal. Ct. App. 1995) (exclusions may apply to coverage A (bodily injury coverage) but not to coverage B (personal injury coverage)).
the standard ISO general liability form, there are many nonstandard policies on the market, and the coverage under those policies may be broader (or narrower) than under the standard ISO policy form. In addition, the exclusions that may be applicable may be broader or narrower. An insurer may also issue a special endorsement or rider to a policy to specifically provide coverage for claims of discrimination and harassment, often done by expanding the definition of the personal injury coverage.

In the event an employee is sued along with the employer, another source that should be considered for that defendant employee is the liability portion of the employee's homeowner's insurance policy, which tracks to a great degree a business's general liability policy. It should be remembered, however, that there may be various applicable exclusions to a homeowner's policy, such as claims arising out of the "business pursuits" of the insured.

B. Excess or Umbrella Policies

In many cases, an employer's umbrella or excess coverage might provide protection for employment-related claims even if the primary policy below it does not cover such claims. Excess and umbrella policies tend to be quite diverse from each other, and there is really no one standard form. Accordingly, it is critical for an employer to review these coverages to determine whether there might be a potential for insurance protection available.

C. Workers' Compensation Policies

In some instances, workers' compensation policies may afford potential coverage to employers for employment-related claims. The typical workers' compensation policy is divided into two parts: one part (usually denoted Coverage A) covering workers' compensation benefits and the other part serving as a "gap-filler" for those claims against an employer not subject to the exclusivity of the workers' compensation laws. This second part is usually designated as Coverage B, or the employer's liability coverage. In appropriate cases, this coverage may provide for both a defense and indemnity for claims against an employer for injuries to employees.3

2. Insurance Services Office, or ISO, is the organization that prepares standardized insurance forms and makes them available to insurers throughout the country. See Montrose Chem. Corp. v. Admiral Ins. Co., 10 Cal. 4th 645, 671 n.13, 897 P.2d 1, 14 n.13 (1995).
Recently, at least two decisions issued by the California Court of Appeal found insurance coverage under Coverage A of a workers' compensation policy.4 The California Supreme Court, however, accepted review of both of those cases and recently issued its decision, concluding that Coverage A of the standard workers' compensation policy does not give rise to a duty to defend an employee's civil suit for damages, and that a civil suit for damages does not present a potential judgment within the indemnity provisions of the policy because workers' compensation benefits can never be awarded in a civil suit. Not only did this reverse the intermediate appellate decision in that case, but the supreme court also specifically disapproved the intermediate appellate decision in the other case to the extent that it was inconsistent with the supreme court's holding.5

Despite this determination by the California Supreme Court concerning Coverage A, under some workers' compensation policies there still may be a potential for coverage under Coverage B, and there is always the question as to whether a jurisdiction other than California would rule the same way as the California Supreme Court. It should be mentioned, however, that over the course of the past ten years, workers' compensation insurers have added specific exclusions to their policies to preclude employment-related claims. A typical policy exclusion provides that the insurance does not cover damages arising out of the discharge of, coercion of, or discrimination against any employee in violation of law.

D. Directors and Officers Liability Policies

It is possible that, depending upon the policy form, a directors and officers ("D&O") liability policy could provide coverage for employment-related claims. Generally, however, such a policy will contain specific exclusions for claims arising out of bodily injury and property damage as well as defamation and invasion of privacy. It may also contain exclusions for claims of wrongful termination and discrimination. Finally, it should be noted that D&O policies

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the employer's liability part of workers' compensation policy); but see Transamerica Ins. Co. v. Superior Court, 35 Cal. Rptr. 2d 259 (Cal. Ct. App. 1994) (no duty to defend sex discrimination/wrongful termination claim under employer's liability part of policy).
only cover claims made against the directors and officers, not claims made directly against a corporation. Accordingly, if the employee does not name a director or officer in his or her action, the D&O policy would not be triggered.

E. Errors and Omissions Policies

Although an employer's errors and omissions coverage, i.e., its malpractice policy, may be an unlikely source of potential insurance coverage, it should also be examined if there is any possible theory to fall within the scope of that coverage. Like D&O policies, errors and omissions policies generally contain exclusions for bodily injury and property damage, which are the types of damages that normally would be covered under an employer's general liability coverage.

F. Employment Practices Liability Policies

As discussed in other contributions to this Symposium, while insurers have fought to restrict the availability of insurance coverage for employment-related claims under traditional types of insurance policies in the past few years, some insurers simultaneously have begun offering policies intended to cover these precise claims. There are currently a variety of employment practices policies on the market, which can be purchased as either stand-alone policies or as an endorsement to another liability policy. These policies vary widely as to the scope of coverage as well as their terms and conditions. Some policies provide only reimbursement of defense costs with no indemnity, while others do provide indemnity coverage as well as defense coverage. Some policies require co-payments by the insured, and many have sizable deductibles. Some policies may cover only wrongful termination claims, while others may cover wrongful termination claims as well as claims for discrimination, sexual harassment, and claims under the Americans with Disabilities Act. Many of these policies specifically provide coverage for claims made with the EEOC or comparable state or local agencies. If an employer has such a policy, it should be carefully reviewed to determine precisely the scope and extent of coverage.

II. Analyze the Coverage Under the Respective Policies

Once the various potentially applicable insurance policies are located, the employer should analyze whether those policies in fact provide a potential for coverage, which in turn may at least provide
the employer with coverage for its defense costs for the employee's claim. The analysis process involves two basic steps. The first is to verify that you have the applicable policy in terms of the alleged wrongful acts or damage, and the second is to interpret the actual coverage under the policy.

A. Occurrence Versus Claims-Made Coverage

It is first critical to determine whether the liability policy is of the "occurrence" type or the "claims-made" type. Depending upon which policy is at issue, the potential claim may fall within the employer's current policy or one issued several years earlier.

An occurrence-based policy generally provides coverage only if the actual damage, such as emotional distress alleged by plaintiff, occurs during the policy period. Alternatively, occurrence-based policies may provide coverage only if the acts or omissions that are at issue occur during the policy period, such as in an occurrence-based malpractice policy. This also is the case with respect to the advertising and personal injury coverage under most general liability policies. For example, it is the act of libeling or slandering the employee that must occur during the policy period, rather than any damage that results therefrom. Accordingly, if the termination occurred on August 1, 1995, it is the occurrence-based policy in effect on that date which might apply, even if the lawsuit is not filed until 1997.

In contrast to occurrence-based policies, many policies today are written on a claims-made basis, under which coverage is triggered only if the claim is first asserted against the insured during the policy period. This is the case in most malpractice policies issued today, and it is also the case with many, if not all, of the new employment practices policies that specifically provide coverage for employment-related claims. Although there is often a contested issue as to when a claim is first made against an insured, often the employer will be aware of the claim well before a lawsuit is filed, as in the case of an administrative proceeding before the EEOC or the comparable state agency is commenced. Alternatively, a demand letter from the employee's lawyer may constitute first notice of a claim being made against the employer. Therefore, even if the termination/discrimination occurred in 1995, it might not be until 1997 that the claim is first made against the insured, and it would be that year's policy that would potentially be applicable.
B. Follow the Six Basic Steps of Analysis

In order to analyze coverage under an insurance policy properly, one should review the policy by following the specific steps discussed below, in the order in which they are discussed. The coverage analysis should begin with the declarations page(s) and proceed with the insuring clause(s), the definitions, the exclusions, the conditions, and finally, the endorsements.

1. The Declarations Page

The first place to begin the analysis of the policy is the declarations page or pages. The reason this is the first step is that, usually, one can determine whether or not one is reviewing the correct policy from the basic information contained in the declarations. It should be noted that an insurance policy may have several declarations pages, one for each type of coverage provided under a policy. For example, a business may purchase a commercial package insurance policy, containing not only its general liability coverage, but also its first-party property coverage, employee benefits coverage, and its crime coverage. Each of these coverages may have their own declarations page(s).

By reviewing the declarations, the following items generally can be determined: (1) The identity of the insured, (2) the applicable policy period, (3) the type of coverage provided by the policy, (4) whether the policy is issued on a claims-made basis, and (5) the policy limits, deductibles and restrictions.

2. The Insuring Clause

The next step is to conduct a detailed analysis of the policy. This begins with the insuring clause, which sets out the scope and parameters of the insurance coverage provided. If the claim does not fall within the insuring clause, then presumably a review of the conditions and exclusions will not be necessary, i.e., the claim will not be covered. The three basic components of most insuring clauses are whether there is a claim against "the insured," whether there is a claim for "damages" as required under the policy, and whether the type of "activity" alleged triggers coverage under the policy.

In order to determine if the insured is the proper insured, it is often necessary to review the definition of the terms "insured" or "persons insured." It is under this step of the analysis that an employer will determine not only whether it is covered, but also
whether its employees, partners, officers and directors are covered. With respect to the damages qualification, under a general liability policy this determination depends upon whether there is a claim for bodily injury, property damage, advertising injury, or personal injury, as those terms are defined. Under an employment practices policy, the term "damages" may be joined by the phrase "by reason of any 'claim,'" which in turn may be defined as alleging discrimination on the basis of race, religion, age, sex, national origin, or physical handicap or alleging wrongful termination of the employee by the insured. Finally, the activity qualification defines the type of activity that triggers coverage under the policy, such as the phrase "caused by an occurrence" as set forth in the standard general liability policy. As just noted for the employment practices policy, the damages qualification may be joined with the activity qualification.

3. The Definitions

Many of the most critical terms used in an insurance policy are defined in the policy itself. For ease of reference, they are generally printed in boldface type, in italics, or in quotes. The policy is to be read and interpreted pursuant to these definitions, and any policy definitions will prevail over what may otherwise be the plain meaning of a term. For example, what one might otherwise think is a "personal injury" claim falls under the definition of "bodily injury" in a general liability policy. Conversely, the phrase "personal injury" has its own special meaning under this type of coverage and is defined in terms of specific tort offenses, such as false imprisonment, defamation, and invasion of privacy.

4. The Exclusions

After conducting the prior three steps, one should then examine the various exclusions that are contained in virtually all insurance policies. It is here where the policy limits the scope of the coverage provided by the insuring clauses. As indicated previously, many liability policies now contain specific exclusions for employment-related claims, although the exclusions must be examined carefully to determine whether they in fact preclude coverage under all of the various insuring clauses. For example, some general liability policies only exclude employment-related claims for bodily injury and property damage claims and not for advertising
It should be remembered that in the insurance world, an exclusion under one type of policy is often an invitation to purchase coverage under another type of policy. With respect to employment-related claims, the gap in coverage an employer might encounter in its general liability policy may be filled by the purchase of such employment-related coverage under an employment practices policy, designed specifically to provide coverage for these types of employment-related claims.

5. The Conditions

An insurance policy will also contain a section entitled "Conditions," and these also must be examined to ascertain the availability of coverage under the policy. While conditions do not define the coverage afforded under the policy, they often can dramatically affect what coverage is provided. Further, if the insured breaches a condition, it may render part or all of a policy unenforceable under the law. While there are a variety of conditions, some of the most important conditions include the insured's obligation to give timely notice of a claim to the insurer and to cooperate with the insurer in defending and settling the claim. The conditions may also provide that the insured may not settle a claim, make any voluntary payment, or otherwise assume any obligation without the insurance company's prior written consent. Additional conditions may address how a policy is to be canceled, confirm the insurer's subrogation rights, describe in detail the claim notification process, provide for arbitration and discuss whether appeals are covered under the policy. Finally, most liability policies contain an "other insurance" clause, by which the policy may seek to establish priorities for coverage liability when there is other valid and collectable insurance available to the insured.

6. Endorsements or Riders

For the most part, the preceding steps all have involved an analysis of the basic insurance policy form. In addition, many insurance policies contain various endorsements or riders that modify the basic coverage provided under the policy. In some instances, these endorsements may alter the insuring clauses, remove certain exclusions or matters contained in the conditions, or add additional

exclusions. Endorsements may be included in the policy when originally issued, or they may be added after the policy has been executed. One cannot complete a coverage analysis of a policy unless one has reviewed all of the endorsements to make sure that the coverage previously analyzed has not somehow been modified.

III. INTERPRET THE POLICY PROVISIONS

In conducting the analysis just mentioned, often it is necessary to interpret the policy provisions. This may involve not only reviewing the definitions in the policy itself but also referring to case law or various insurance treatises that have addressed the same or similar provisions in other policies. The following points should be noted in the interpretation process.

A. Construe the Policy as an Ordinary Contract

An insurance policy is a contract between the insured and the insurer, and it is generally to be interpreted according to the same principles that apply to all contracts. Just as special rules of interpretation have been developed over time in order to construe general contracts (i.e., what was the mutual intent of the parties at the time of contracting), these rules would also apply to insurance policies.

Although insurance policies, as just indicated, should generally be construed as any other contract, special rules have developed in case law over time to assist in the interpretation of policies alleged to contain unclear and ambiguous terms. Case law throughout the jurisdictions frequently is confused in this area, and depending upon what jurisdiction one is in, one must carefully review the jurisdiction's decisions on how to interpret insurance policies.

B. The California Rules

In California, the supreme court recently clarified the special principles concerning insurance contracts. In Bank of the West v. Superior Court, the court adopted a three-step approach. The court, while advising that insurance policies are still contracts to be interpreted according to the ordinary rules of contract interpretation, noted that "the fundamental goal of contractual interpretation is to give effect to the mutual intention of the parties" at the time of

contracting. The supreme court set forth the following order of analysis:

(1) "If the contractual language is clear and explicit, it governs."  

(2) The disputed language must be reviewed in context, and with regard to its intended function in the policy, "if the terms of the promise are in any respect ambiguous or uncertain, it must be interpreted in the sense in which the promisor, [i.e., the insurer] believed, at the time of making it, that the promisee understood it." This basically means giving effect to the "objectively reasonable expectations of the insured."  

(3) Finally, if the first two steps of this process do not resolve the asserted ambiguity, the court will resolve the ambiguity against the insurer.  

While these general rules will apply to the interpretation of any term in an insurance policy, it must also be remembered that insuring clauses are grants of coverage and are generally construed broadly in favor of coverage, while exclusions and other provisions denying coverage are to be interpreted narrowly against the insurer so as to preserve coverage.  

C. Ambiguity

As just indicated, virtually all jurisdictions will ultimately conclude that an ambiguity in an insurance policy will be construed against the insurer; this rule is generally known as the "contra-insurer" rule. In some cases, however, this rule might not be applied if the insured is a sophisticated corporation and was jointly involved with the insurer in the drafting of the provision at issue. In such a case, the insurance policy is not the "contract of adhesion" it is often claimed to be, and the insured may be just as responsible as the insurer for the existence of an ambiguous policy term. Cases throughout the country have refused to apply the contra-insurer rule where the insured is a sophisticated entity and was involved in the drafting of the provision at issue.  

8. Bank of the West, 2 Cal. 4th at 1264, 833 P.2d at 552.  
9. Id.  
10. Id. at 1264-65, 833 P.2d at 552.  
11. Id.  
12. Id.  
D. Refer to Any Applicable Statutes

There is one other avenue to consider with respect to the interpretation of insurance contracts; whether there are any applicable statutes that affect the interpretation of the policy. Depending upon the jurisdiction, certain statutes may be triggered with respect to the individual claim and may affect whether the policy may provide coverage for the claim. All applicable statutes are considered part of a liability insurance policy even if the policy makes no mention of them. The theory behind this principle is that public policy prohibits an insurer from enlarging, circumventing, defeating, or modifying the law simply by including unlawful provisions in an insurance policy. It should be noted, however, that a statutorily-mandated term in an insurance policy is not strictly construed against the insurer, in contrast to the strict construction applied to language drafted by the insurer itself.

Different jurisdictions may have various statutes that must be considered in the interpretation of insurance policy. In California, Insurance Code section 533 must often be considered when the claims against the insured are based on alleged intentional acts. Section 533 provides as follows: “An insurer is not liable for a loss caused by the willful act of the insured; but he is not exonerated by the negligence of the insured, or of the insured’s agents or others.” Section 533 is a part of every insurance contract under

had substantial bargaining power); Fireman's Fund Ins. Co. v. Fibreboard Corp., 227 Cal. Rptr. 2d 203, 206 (Cal. Ct. App. 1986) (court refused to apply the contra-insurer rule because the terms of the policy had been negotiated between the insurer and a specialized insurance broker who represented the insured); McNeilab, Inc. v. North River Ins. Co., 645 F. Supp. 525, 545-47 (D.N.J. 1986) (court refused to apply the contra-insurer rule because both the insured and the insurer were large companies who were advised by competent counsel during negotiation of the insurance contract); Northbrook Excess and Surplus Ins. Co. v. Procter & Gamble Co., 924 F.2d 633, 639 (7th Cir. 1991) (no contra-insurer rule where significant portions of the language in the policy were “customized” at the insistence of the insured).

17. Id. There is another related provision under California law, Cal. Civ. Code § 1668 (West 1993), which provides that “[a]ll contracts which have for their object, directly or indirectly, to exempt any one from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law.” Section 1668, like Insurance Code section 533, embodies California’s intent to prohibit insurance coverage for willful torts and statutory violations. Both statutes are read into every insurance contract and function as the equivalent of an exclusion in the policy. State Farm Fire & Casualty Co. v. Baer, 745 F. Supp. 595, 598 (N.D. Cal. 1990) (no coverage for wrongful death claim arising out of insured’s providing decedent with an illegal drug), aff’d, 956 F.2d 275 (9th Cir. 1992).
California law and is the equivalent of an additional exclusion. It should be mentioned, however, that section 533 precludes only indemnification of willful conduct and not the defense of an action in which such conduct is alleged.

In the employment context, section 533 has been relied upon to deny coverage for employment-related claims. For example, in *B&E Convalescent Center v. State Compensation Insurance Fund,* the insured employer was sued by a terminated employee for wrongful termination based on allegations that the termination violated national labor laws and California's anti-discrimination statutes. Although the policy had no exclusion restricting coverage for the insured's willful or intentional acts, the court held that Insurance Code section 533 was sufficient to preclude coverage as the claim against the insured was in violation of public policy. Similarly, in *Coit Drapery Cleaners, Inc. v. Sequoia Insurance Co.*, the court found no coverage for the employer with respect to repeated and unwanted sexual remarks and advances, including a sexual assault, by the president, who was also the chairman and a major stockholder of the insured employer. Among other reasons, the court held that the insured's acts of sexual harassment and wrongful termination for failure to grant sexual favors were intentional acts for which insurance coverage was precluded pursuant to Insurance Code section 533. Most recently, in *Save Mart Supermarkets v. Underwriters at Lloyds' London,* the court considered whether section 533 would preclude insurance coverage for employment discrimination claims as alleged in that case. Finding that the relevant claims were discrimination alleging disparate impact rather than disparate treatment, the court found the claims alleged only unintentional discrimination (for which the plaintiff does not need to establish that the insured intentionally committed a wrongful act), and that section 533 was inapplicable.

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21. Id. at 910.
23. Id.
24. Id. at 697-98.
26. Id. at 606-07.
E. Choice of Law Concerns

One last factor that should be considered in interpreting an insurance policy is which state's laws are to be used in the interpretation process. Since insurance policies often have contacts with several jurisdictions, it is critical to consider whether a choice of law or conflict of laws analysis must be undertaken. As an example, assume the insurance policy was issued by an insurer located in New York to an employer at its home office in Illinois, but the alleged wrongful termination/discrimination claim arose at the employer's regional office in Arizona. In that circumstance, one might need to consider which state's laws apply with respect to the interpretation of that policy. This analysis can be quite complicated, and it is discussed in depth in another contribution to the Symposium.\textsuperscript{27} At this point, it is sufficient to stress that when interpreting and analyzing insurance coverage for employment-related claims, it is important to conduct a choice of law analysis.

IV. Tender to All Potentially Applicable Insurers

Once an employer determines that coverage is potentially available under one or more of its liability policies, the claim should immediately be tendered to those insurers who issued the policy or policies. Even if there might ultimately not be coverage (for example, in California, Insurance Code section 533 might apply to the claim to preclude indemnification for intentional conduct), the insured employer might be afforded at least a duty of defense, which in many circumstances may be even more valuable than a duty of indemnification.

In tendering the claim to the insurer, the employer or its attorney should send a general and simple tender letter, which merely encloses the complaint or administrative notification, advises when the complaint or notice was served on the employer, references the policy number issued by the insurer and requests a defense of the action under such policy. At this early stage of the process, it is not appropriate for the insured to advise the insurer why the claim is covered; it is the insurer's job to accept coverage or advise the insured why there is no coverage.

In the event the insurer denies coverage for the claim and refuses to reconsider the matter further, the insured might want to

consider bringing a coverage action against the insurer in order to obtain the defense and indemnity, assuming, of course, that there is some basis for coverage. Alternatively, the insurer, generally in those instances in which it has accepted the defense under a reservation of rights, may consider bringing a declaratory relief action against the insured. Detailed discussions of the strategy relating to declaratory judgment actions are presented in other contributions to this Symposium. It is important to note here, however, that when the primary basis for the reservation of rights is the alleged intentional conduct of the insured, quick determination pursuant to a declaratory relief claim often is stayed pending the conclusion of the underlying case. The primary reason for such a stay is to eliminate the risk of inconsistent factual determinations that could prejudice the insured in the underlying action when the coverage question involves the same facts to be litigated in the underlying action.28

V. CONSIDER WHO THE DEFENDANTS ARE IN THE ACTION

From an insurance coverage standpoint, it is important to consider who is specifically named as a defendant in the employee’s action. In the event that both the employer and one or more employees are named, this may create other coverage issues that the employer must address.

A. Is the Employee Covered?

Generally, an employer’s general liability policy also provides coverage for its employees, officers, directors and partners. For example, the standard definition of “who is an insured” under a general liability policy provides that a corporate insured includes the corporation’s executive officers, directors, and its employees, but only with respect to their duties as officers or directors or for acts within the scope of their employment. Accordingly, if the employee has acted outside the scope of his or her employment, there may be an issue as to whether the employee is covered. However, in the employment-related context, at least for duty-to-defend purposes, this issue will not be determinative.

B. **Is the Employer Covered?**

Generally, an employer is covered for liabilities, especially those arising under a respondeat superior theory, although there may be an issue when the employer is found to have acted intentionally in unlawfully discriminating against or harassing the plaintiff. It should be noted, as mentioned above, that with respect to D&O policies, the insureds are the directors and officers and not the corporation. In that instance the employer would *not* be covered as an insured, although under the corporate reimbursement portion of the policy the insurer would be obligated to reimburse the corporation for amounts that it is lawfully permitted or required to expend in indemnifying its directors and officers.

C. **Can Counsel Represent Both the Employer and the Employee?**

This issue often arises in employment-related claims, and in some circumstances it may be necessary for the insurer to retain not one, but two or more attorneys to defend the action. This would be the case if there is a conflict of interest between the defendant employer and the defendant employee(s), and no waiver of the potential conflict of interest can be obtained. The circumstances in which this may occur is where the employer has since terminated the offending defendant employee and may, for strategic and liability reasons, want to distance itself from that employee. In such a case, separate counsel would appear to be mandatory.

D. **Should Counsel Represent Both the Employer and Employee?**

Assuming that the defendant employer's and defendant employee's interests are aligned, the issue arises as to whether, in this circumstance, counsel *should* represent both parties. This, of course, requires a judgment call and speculation as to how the case will proceed. In order to maintain a unified front, and if both the employer and employee believe they acted properly, joint representation would probably be effective, assuming all the proper waivers were obtained. As a practical matter, since the employer is generally obligated to indemnify the employee under statutory law, especially in those instances in which the employer ratified, condoned, or was aware of the defendant employee's actions, joint representation is most likely appropriate.
VI. IMMEDIATELY CONDUCT AN INTERNAL FACTUAL INVESTIGATION

From the employer's perspective, once it has been named in an employment-related action or administrative claim, it should immediately commence an internal factual investigation as to the merits of the claim. The following are basic components of such an investigation:

A. COLLECT THE DOCUMENTATION

Obtain, review, and analyze the employee's personnel file, as well as the personnel files of any implicated employees. The files should be obtained not only at the local level, but also at any departmental, district, regional, or home office levels. The employer should immediately gather together any of its written policies applying to the plaintiff, such as employee handbooks, employee benefits books, employee safety manuals, and so on.

B. INTERVIEW THE WITNESSES

The employer should interview all relevant witnesses immediately with respect to the employment of the plaintiff and obtain declarations under penalty of perjury from such witnesses. These witnesses should include the plaintiff's former supervisors, co-employees, and others who may have knowledge as to the plaintiff's employment-related claims. It should be recognized that employment loyalty is fluid, that today's employee may be tomorrow's plaintiff, and it is for this reason that declarations under penalty of perjury are necessary to preserve the "objective" testimony of the relevant witnesses. In the event that an insurer will be defending an employer, the employer should disclose all investigations performed by the employer to the insurer and to counsel retained for the employer by the insurer. However, disclosure might not be advisable concerning coverage issues in the event the insurer has issued, or the employer expects the insurer to issue, a reservation of rights letter.

C. CONDUCT EX PARTE DISCOVERY IMMEDIATELY

Even before formal discovery commences, an employer may consider conducting any sort of ex parte discovery that may properly be conducted. For example, Freedom of Information Act requests, including similar requests under state law, should be pursued when they concern the plaintiff. It is possible, for example,
to obtain documents that the plaintiff has submitted to administrative agencies under such statutes.

D. The Employee Can Also Conduct Informal Discovery

The employee may also wish to pursue such *ex parte* discovery routes prior to initiating formal discovery, which may prove useful in drafting the complaint against the employer. This could include manual or computer searches of corporate documents and filings, such as those maintained by Dun & Bradstreet, Secretary of State or Department of Corporations offices, local county or city agencies, and other court actions involving the employer.

In addition to the Freedom of Information Act and related state procedures, the employee or the employee's counsel, should also try to interview other terminated employees or former employees of the employer. Note that professional responsibility rules dictate whom may be contacted by the employee's attorney; for example, a plaintiff employee is forbidden to interview employees in the employer's "control group." Nonetheless, a fertile source of information for the employee may come from such former employees, especially those who have been fired.

VII. Pleading Issues

The pleadings filed in an employment-related case are critical to the insurance coverage issues, since it is generally the pleadings (as well as facts the insurer learns from other sources) that determine whether there is a potential for coverage and accordingly a duty of defense owed to the insured. Plaintiff's counsel, in drafting the complaint, should be sensitive to insurance coverage issues involved in employment-related claims and, if appropriate, draft the complaint to trigger at least a defense obligation under the various insurance policies that the employer might maintain. As it turns out, the employer, if it obtains insurance coverage, would generally appreciate such drafting. The following sections address a few of the issues raised in this area.

A. The Complaint

Adding a claim for negligence, rather than only alleging claims in terms of intentional conduct, may assist in obtaining insurance coverage, or at least a duty of defense under an employer's liability

policy. It should also be recognized that this may trigger a reservation of rights letter, although this may not be too problematic, since the insurer would at least be defending the action and will be confronted with the issue of whether to pay or contribute to any settlement demand. In particular, the plaintiff’s lawyers might consider whether it is appropriate to add one of the “personal injury” torts (from the general liability coverage) such as libel, slander, false imprisonment or detention, invasion of privacy, or discrimination.

Should the complaint be filed in state or federal court? Generally, state court is more favorable to employees, as are state court juries. If possible, an employer may attempt to remove the action to federal court since the federal court summary judgment standard tends to favor defendants, the plaintiff must obtain a unanimous verdict, and the jury pools are generally more favorable for defendants than in state court. If appropriate, and if the employer and plaintiff employee are diverse as concerns jurisdiction, the plaintiff employee might consider naming other nondiverse employees of the employer as defendants who could defeat diversity jurisdiction to prevent removal based upon diversity jurisdiction.

B. Response to the Complaint

The first thing the employer should consider in response to the complaint is whether the case can be removed to federal court by raising the issues discussed above. In determining how to respond to the complaint, the employer should consider whether to file a demurrer or a motion to dismiss, instead of answering the complaint. The advantage of such a motion would be to narrow the scope of the lawsuit and the claims alleged against the employer. From an insurance coverage standpoint, however, it is also necessary to consider whether such motion, if successful, will destroy any potential insurance coverage. For example, assume the employee has alleged a slander claim, and there is a clear statute of limitations problem on the face of the complaint with respect to that claim. Assume further that it is solely the slander claim by which the insurance company has agreed to provide a defense to the employer. Disposing of the slander claim at the outset may very well trigger the insurance carrier to issue a denial with respect to the continued defense of the lawsuit. Similar considerations would apply with respect to a motion for summary judgment or summary adjudication of issues that an employer may consider filing once the case is underway.
C. Should the Employer File a Counterclaim Against the Employee?

One issue that employers sometimes face in employment-related cases is whether to file a counterclaim against the plaintiff. Generally, such a counterclaim is not advisable, unless the plaintiff employee is truly a bad actor, such as when the employee has been caught lying or stealing, is a sexual harasser, or has tape-recorded statements unlawfully. In such situations, the use of such a counterclaim may be effective in obtaining an early resolution of the litigation. From an insurance coverage standpoint, an employer should be careful in pursuing a counterclaim, as an insurer may contend that a counterclaim is actually for affirmative relief, rather than for defensive purposes, and might otherwise not be covered under the policy. At the very least, this could result in a dispute between the employer and the insurer as to the allocation of attorney's fees between affirmative relief and "defense" costs.

VIII. Discovery

Generally, discovery proceeds in employment litigation cases as in all other litigation: the first task is to obtain the documents and propound written interrogatories and requests for admissions and then conduct depositions. In an employment-related case, however, there are a few special discovery rules to follow.

A. For Employers

The employer should schedule and take the plaintiff employee's deposition as soon as possible even before documents have been requested in a formal production request. Generally, it is critical to do this as soon as possible so that the employee does not have the opportunity to review the employer's documents and depose management employees of the employer. In many instances, the employee will have little documentation to support his or her allegations and may not have shown much documentation at all to his or her attorney. Getting the employee to commit to certain things without the benefit of seeing the employer's documentation can be an important strategy.

Additionally, the employer should immediately issue subpoenas to prior employers of the employee, who generally are listed on the resume or application submitted by the plaintiff employee at the time of hiring. One of the reasons to obtain such information, from the employer's standpoint, is to support a defense based upon
"after-acquired evidence."  

In appropriate cases, an employer should consider moving for a protective order to safeguard any privileged communications that a prospective witness may possess. This would often arise in the context of a former employee or supervisor over whom the employer and its attorney may no longer have control.

B. For the Employee

It is important for the plaintiff's lawyer to ensure that document requests to the employer are as broad as possible and that the requests seek documentation at all levels of the employer's operation, be it at the local, regional, district, or home office levels. All of these levels of the corporation may have relevant documentation concerning the various employment-related claims that may be asserted.

It is also useful to depose the decision makers at the employer immediately, as this generally puts pressure on the employer to either settle the case or at least take it seriously. An employee should be aware of the argument that a plaintiff may not immediately be able to depose the "apex" of the corporation, especially in those cases where the designated deponent has had no first-hand contact or knowledge of the plaintiff employee.  

30. The after-acquired evidence defense has recently been the subject of intense litigation throughout the country. In some jurisdictions, employers have been able to use the defense to preclude claims by employees when they have discovered that the employee made material misrepresentations on his or her employment application, and if the employer had known that, it would not have hired the employee in the first place. It should be recognized, however, that the after-acquired evidence defense has been restricted in a recent decision by the United States Supreme Court. McKennon v. Nashville Banner Publishing Co., 115 S. Ct. 879 (1995). In McKennon, the Court concluded that while the after-acquired evidence defense did not provide a complete bar to the plaintiff employee's claims, it did restrict any claim for back pay after the date the evidence was uncovered. Id. at 886. McKennon, however, considered the issue only under federal law, and various jurisdictions may take different positions on the viability of the defense. Under California law, several decisions have restricted the employer's use of the after-acquired evidence defense. See, e.g., EEOC v. Farmers Bros. Co., 31 F.3d 891, 901 (9th Cir. 1994) ("It would be inequitable to hold that after-acquired evidence of misrepresentations in a job application should preclude an otherwise successful plaintiff from recovering damages."); Conlin v. Mission Foods Corp., 850 F. Supp. 856 (N.D. Cal. 1994); Cooper v. Rykoff-Sexton, Inc., 29 Cal. Rptr. 2d 642 (Cal. Ct. App. 1994).

31. See Liberty Mut. Ins. Co. v. Superior Court, 13 Cal. Rptr. 2d 363 (Cal. Ct. App. 1992). The court granted a protective order with respect to plaintiff's attempt to depose an officer at the highest level of the defendant's corporate management, concluding that "it amounts to an abuse of discretion to withhold a protective order when a plaintiff seeks to depose a corporate president or corporate officer at the apex of the
IX. Settlement

More so than in other types of tort cases, the availability of insurance coverage may be greater at the time of early settlement negotiations than if the case goes to trial. Generally, in employment-related cases there are always issues of intentional conduct, which would trigger either a policy exclusion or a violation of some statute such as California's Insurance Code section 533. An employer's termination of an employee in violation of public policy or claims of sexual harassment where the employer itself had knowledge of the wrongful conduct will be indemnified once a jury verdict has resolved these questions of fact.

If a case settles prior to trial, these issues will never be fully resolved, and the only way the insurance carrier could ultimately resolve these issues would be to retry the entire underlying case, which insurers are not prone to do. As a practical matter, settlement not only might preserve potential insurance coverage, it might also avoid bad publicity for the employer, substantial uninsured defense costs, and the inability to keep the resolution of the case confidential.

X. Trial

As mentioned in the preceding section, the jury's ultimate verdict generally will dictate whether the insurer will have an obligation to indemnify the claim. This would be true except for those employment practices policies that provide only reimbursement of defense costs and do not provide any indemnification for the employer. As this Article has emphasized, to the degree the employer is found liable for intentional, wrongful, and perhaps even unlawful conduct, the chances of obtaining insurance indemnification appear slight. Additionally, once the underlying case is resolved, the insurer then may file a declaratory relief action to contest its obligation to indemnify the insured or may also seek to reactivate a previously-stayed declaratory relief action now that the liability of the insured is fully known.

CONCLUSION

Securing insurance coverage for employment-related claims raises a number of complex issues that affect the pleading, discovery, and settlement negotiations in the underlying litigation as well as how the employer deals with its insurers. This Article has sketched a checklist for an employer to follow to ensure that its interests in obtaining insurance coverage and successfully defending the employment claim can both be maximized. As with most areas of the law, insurance coverage in the employment litigation context presents a challenge that continues to change as employment law and insurance law both evolve.