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THE INSURANCE NEWSLETTER

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EPL and Third Party Claims

Employment Practices Liability (EPL) insurance is an important part of any employer's insurance program. As employment laws and regulations become ever more complex, regulators ever more aggressive and employees ever more litigious, it's necessary coverage.

The typical EPL policy will define a laundry list of types of employment related practices and claims it will cover, much like the old "named perils" property policies we used to see instead of the "all risk" policies that are common today. For most reputable insurance companies writing these policies that list of covered EPL named perils has grown longer over the years. Here's the key point, though: these policies are all about employment related risk. They will cover past, present and future employees, including job applicants (potential future employees), but an employment relationship in some form is necessary for coverage to apply.

But suppose you face a claim of discrimination or harassment from someone who is not in an employment relationship with you. Take a few examples:

- Vendors, suppliers, contractors and service people may be in and out of your premises and interacting with your staff and employees on a regular basis;
- The same for customers. Your employees may routinely interact with customers; they may also do work for or make deliveries to customers at their homes or places of business;
- Temporary or leased employees may also be present. In such cases there is an employment relationship, but not with you.

These are all potential third party EPL exposures, usually not covered by an unendorsed EPL policy. Some policies may have an expanded definition of "employee" that will include leased or temporary employees, and some (even fewer) may even go as far as to include independent contractors, but you can't rely on that unless you actually read your policy to see what it covers. For anyone else, customers, vendors, service people and so forth, there is no way to find an employment relationship, so no coverage is available for any claims that might come from them.

Most underwriters offer a solution. They'll endorse "Third Party EPL Coverage" onto your policy, usually for a very nominal charge. The major difference between the way this coverage operates from any other EPL claim is that the list of covered types of claims is generally pared down substantially. Most common by far is to just find coverage for claims of discrimination and harassment. That's not a major negative, since those two items encompass the large majority of all claims that might come from unrelated third parties. Otherwise, the coverage operates just as it would for any other EPL claim.

If you are in a business in which your employees are routinely interacting with members of the public, and most especially if you are in a retail or service business, Third Party EPL coverage is important for you. Lawsuits alleging discrimination or harassment continue to increase. It's worth having this coverage to turn to, even if only to cover the cost of defense.

Increased Cost of Construction

The recent earthquake in California were notable mostly because of where it happened, right in the middle of Napa Valley, home to some of the finest wineries in both

California and the U.S. News reports were full of pictures of toppled wine racks and barrels, and the breakage and loss of considerable amounts of fine wine. A few reports also went on to note that while barrels and tanks suffered major damage, in most cases the buildings that housed them, having been constructed to modern earthquake resistant standards, withstood the quake with minimal damage. The buildings that were damaged were mainly the older ones in towns, built before current standards were implemented.

California, like many other states, has significantly strengthened building codes over the past decade or two. To understand why it's only necessary to look at the news. Earthquakes, wildfires, sudden massive rainfall events, tornadoes, hurricanes, winter storms...all seem to be increasingly more frequent, and increasingly more severe. Building officials read the same news reports, and are overhauling building codes to make new structures more resistant to the types of events to which they might be exposed.

Hurricane Andrew, back in 1992, really started this process. It did massive damage to south Florida, but also exposed severe weaknesses in the buildings it destroyed. Experts (including many insurance company claims people) realized that most of the buildings they looked at were constructed with virtually no consideration to the possibility of a hurricane, resulting in unnecessarily severe damage from the storm. Subsequently, Florida drew on what was learned from the storm and enacted new building codes that significantly strengthened hurricane resistant features in new buildings.

This same scenario has been repeated in other states across the country. What this means for almost all building owners is if you own a building more than ten or twenty years old, chances are if it were to be significantly damaged tomorrow you would most likely not be able to rebuild it the same way it was originally constructed; newer, stricter (and more expensive) building codes now apply.

This has insurance implications. Property policies are most commonly written to provide replacement cost coverage on insured property. Replacement cost, by definition, is the cost to replace damaged or destroyed property with property of "like kind or quality". Put another way, you'll get paid to rebuild what was there before the loss, new for old, without depreciation.

But suppose what was there was not up to current building codes? The cost to rebuild a building thirty or more years old to current codes could easily be increased by ten or twenty percent, or more in certain parts of the country. Who pays for that? Your replacement cost property policy will pay you for what was there before the loss, but a standard, unmodified property insurance policy gives you only a token coverage enhancement of $10,000 for additional costs you'll incur to comply with current building codes. If your costs exceed that modest threshold, you have no coverage for them.

There is a solution, of course. A simple and common endorsement to your policy, called Increased Cost of Construction, fills the gap. Think of it as replacement cost, plus. You get replacement cost for the damaged building, plus increased costs to comply with current codes. Nifty, easy, and the endorsement doesn't cost anything.

There is no cost but it's not without cost because of course in theory you must buy higher limits. That's not the problem it might appear to be, though. Most folks who buy property insurance on a replacement cost basis generally make a good faith effort to accurately determine for insurance purposes the actual current replacement cost, in current dollars, of their property. There are a number of resources out there to aid in that, up to and including an appraisal by a qualified contractor or appraiser. The thing is, the replacement cost valuations all these sources give you will be current replacement costs to current building codes. So if you have made a good faith effort to keep your replacement cost insurance limits up to date, you are likely already paying for insurance to values that include the increased costs of rebuilding to current building codes.

Yet, surprisingly, we still occasionally see folks who have neglected to add coverage for Increased Cost of Construction to their policy. This is the worst of all worlds; a loss would be paid based on replacing only what was there, not what needs to be there based on current building codes, even though you paid for the higher amount of insurance all along.

So, real problem, simple solution, and in most cases no additional cost. Give us a call and let us see if this is something we can help you with.

Hired and Non-Owned Auto Exposures

We look at a lot of commercial insurance programs and often find ones that do not include a business auto policy. The normal explanation is that "the business owns no autos". The business may not have owned autos, but there is almost always some exposure to auto related claims from non-owned or hired autos. Since the standard general liability policy includes an absolute exclusion for any auto related claims, the absence of an auto policy creates a potential gap in coverage.

In today's litigious society, accident claimants will often seek recovery from as many sources as can be found. It's not difficult to imagine scenarios wherein any company with employees (and possibly not even operating from a physical location) can still be sued based on non-owned auto liability in the aftermath of a motor vehicle accident.

The classic example is an employee using their personal vehicle for a work errand who is involved in an at fault accident. At the accident site, the employee mentions, "I was just on an errand for XYZ Company"; sure enough, XYZ Company ends up being named in the ensuing lawsuit. This is particularly likely if the employee doesn't have sufficient liability limits on his personal auto policy, which is quite often the case.

Hired auto exposures arise differently, but again, it's not difficult to anticipate situations where an employee or officer of a company may need to travel and rent an auto, and if it's in the course of business, assume it's covered by the company's insurance. Hired auto physical damage exposure occurs here as well, but again, without specific coverage in place prior to an accident, a company may be looking at an uninsured claim.

Whether or not a business owns any autos almost every commercial entity has some potential liability exposures from hired and non-owned autos, and frequently for hired car physical damage as well.

It's an easy fix. Some insurance companies will add an endorsement to their general liability policy covering non-owned and hired cars; in other cases a separate auto policy must be purchased. Either way, such protection can be added for minimal additional cost (think hundreds, not thousands in most cases) and fill an important gap in coverage.

Insurance Policy Exclusions

Every insurance policy has two basic parts, an insuring agreement that states what is insured, then a list of exclusions that exclude or limit coverage for certain types of claims. Policy exclusions can seem on the surface to sometimes be random or capricious, but there is actually some rhyme and reason to them. It's worth understanding why exclusions are added to insurance policies.

In general, exclusions will fall into three types. The first type is for events or occurrences that are just so large or catastrophic that they are simply not insurable under almost any circumstance. A good example of that would be exclusions for claims arising from war or nuclear explosion found in property policies. Unlikely as they may be, both events would result in the types of damage that might otherwise be insurable in a property policy, but the potential magnitude of ensuing damage and claims could literally bankrupt an insurance company, and potentially even the entire insurance industry. Events of this type are not insurable simply because of the potential magnitude of claims that could arise from them. Closely related are claims from terrorism, which since 9/11 are also excluded. These could be large claims, but they also suffer from being utterly unpredictable. An insurance company that can't reasonably predict claims can't develop a premium. These are also uninsurable (absent a government program).

The second type of exclusion is for predictable claims. Another example from property policies is the exclusion for claims arising from gradual wear and tear, deterioration or depreciation. Policyholders are expected to maintain their property and fix things as they wear out. General liability policies exclude claims from faulty workmanship. If you do a job incorrectly, that's your problem, just a risk of being in business; no insurance company wants to be in the business of insuring competent workmanship.

There's a third class of exclusions that generally add to the complexity of policies, for types of claims that are insurable, but that properly need to be insured somewhere else. A basic example is the exclusion for auto claims on the general liability policy. Auto claims are certainly insurable, and a robust market exists to supply such insurance. The GL policy excludes these claims because it's just not the right place for them to be covered.

Other examples of these types of exclusions would include the one for employee dishonesty in a property policy. If you want that coverage, buy a crime policy. Property policies exclude claims from boiler explosion or electrical short circuits. If you want that covered, buy an equipment breakdown policy. We've written recently about pollution exclusions in policies, particularly the GL policy. Sure, most policies exclude pollution these days, but if you need that coverage, pollution policies are readily available.

Insurance policies can seem confusing, no doubt, but there is generally some bedrock reason for the exclusions they contain.

The Mysterious IBNR

Here is a subject that may only be of interest to a few of our readers, but if you're interested in it you'll likely be very interested in it.

IBNR is an insurance term that means "Incurred But Not Reported". When actuaries and insurance underwriters look at large casualty insurance policies (usually workers compensation or liability) they'll try to predict total cost of claims from past years to help to determine needed reserves and/or future pricing.

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Occurrence type casualty policies always present the possibility that something may have happened (an occurrence) that the policyholder doesn't yet know about, but that will lead to a covered claim in the future. That's true IBNR; there was an occurrence that will lead to a covered claim, but it has not yet been reported to the policyholder or the insurance company. The loss is incurred, but not yet reported; IBNR.

Unfortunately the term IBNR is often misused to also refer to normal loss development. It's an irrefutable fact that the longer claims stay open the more they cost, and that development, over time, can be pretty accurately calculated from historical loss experience. It's not uncommon to hear the term IBNR applied to describe what would correctly be described as loss development.

If you have a large retro rated or paid loss policy, you've more than likely heard this term before. Just remember: loss development and true IBNR will both factor into your ultimate costs, but they are not the same thing.