



# The *Slippery Slope* of Employment Practices Liability

by Charles C. Hewitt

**A**S AN EMPLOYER, YOU MAY THINK YOU understand the intricacies of employment discrimination policies, but don't be so sure. Employment policies are complex, may vary from state to state, and leave plenty of room for missteps that could cost you thousands of dollars. But you can protect your organization by knowing the rules, making them clear and available to employees, and seeking counsel before you make an irrevocable

move, such as terminating an employee.

Consider this situation. One of your employees has been out of work on disability with a workers' compensation injury, and you have gotten solid advice and service from your workers' compensation provider on how to manage this employee while she is out on leave. Ultimately you're advised that the employee has reached maximum medical improvement (in some states, this is known as a *permanent and stationary* condition) and cannot

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return to her job because of a permanent disability. With regret, you terminate her because she now receives workers' compensation vocational rehabilitation benefits and your understanding is that workers' compensation is the exclusive legal remedy for employees who suffer workplace injuries.

But not so fast. If an employer has 15 or more employees, it is subject to the Americans with Disabilities Act (ADA) and/or a state disability accommodation law with a different threshold for applicability. In this case, even though you haven't discriminated against an employee based on a work-related injury in violation of workers' compensation law, you have violated ADA by failing to engage in the "interactive process." That is, you have neglected to determine whether there is any reasonable accommodation that would have allowed the employee to return to work (perhaps she could have returned and taken a different job, for example). Failing to engage in the interactive process prior to terminating a disabled employee is a violation of ADA and subjects you to legal liability resulting from the employee's termination.

OK, so maybe you knew about that issue. But what about the other employment law moguls out there just waiting for you? Let's explore some of the common—and not-so-common—employment-related legal concerns for nonprofits, how to guard against mistakes, what it can cost if you err, and how insurance fits into the picture.

### Timing Really Is Everything

Culled from the claims files of the Nonprofits' Insurance Alliance of California (NIAC) and, the Alliance of Nonprofits for Insurance, Risk Retention Group (ANI-RRG), both member companies of the Nonprofits Insurance Alliance Group (NIA Group), here are just a few examples of seemingly appropriate terminations by 501(c)(3) nonprofits that failed to withstand scrutiny because of timing.

- A couple of disruptive employees whose paychecks had been withheld because of their failure to complete work on time filed a complaint about not being paid and were then terminated. The organization gets two strikes on this one! First, most states prohibit withholding paychecks just for poor performance. Second, terminating these two employees *after* they complained resulted in valid claims under

the state's whistle-blower laws.

- A poorly performing employee complained of sexual harassment. A thorough investigation concluded that no harassment had taken place. The employee was then terminated on performance grounds alone. The problem, however, was that no contemporaneous documentation of the alleged poor performance existed, so it appeared to the state administrative agency that the termination was a result of the harassment allegation because it followed closely behind the report of it.
- A long-term employee of a day-care facility for the elderly, who was a "mandatory reporter" under state law, filed a report with the state about inadequate staffing at the facility when an elderly client was left unattended and wandered into street traffic. The employee was terminated for not following "internal reporting procedures." (In this case, a warning was the appropriate remedy, not immediate termination.)

### What's an Employer to Do?

Let's start with the exposures under Employment Practices Liability (EPL) that give rise to liability claims. Both federal—and most state—laws proscribe the most commonly known unfair employment practices of wrongful termination, sexual harassment, discrimination, and ADA violations. Each of these categories, however, includes some lesser-known prohibitions and strict liabilities.

By now most everyone knows that in most jurisdictions you can't terminate someone based on age, race, gender, or sexual preference. But what if a poor-performing employee is the only one working for your nonprofit that's in a protected category? Termination here may have the *appearance* of discrimination sufficient to subject you to administrative or civil exposure.

You know that sexual harassment is illegal and that procedures need to be in place to train supervisory and management personnel about its ins and outs. But what if you're in a state that imposes *strict liability* on an employer, even if the employer didn't know the harassment occurred? Or what if a party external to your organization, such as a delivery person, makes inappropriate comments to your receptionist or, alternatively, claims that one of your employees

has harassed him? That can get you into as much trouble as the typical case.

So what to do? Defense of EPL claims starts with your agency having documented procedures in place that you and your counsel can use to demonstrate to an administrative agency or a court that you intended to be—and were—in compliance. This is best accomplished from the beginning with a robust personnel handbook available to employees that includes policy statements and procedures (see “Twelve Components of a Model Personnel Handbook” on page 46).

### The Old Ounce of Prevention

The last, and most-overlooked, step in EPL claim prevention is checking with experienced employment counsel *before* taking a significant personnel action. A poorly drafted employment offer letter can lock you in to a lot more than you planned. And even if it's meant to be a “positive” for employees, an improperly announced new personnel policy or procedure can cause similar problems.

More than anything else, however, every EPL defense lawyer's mantra is that you consult counsel before terminating an employee. A lawyer would have obvious questions about clear documentation of performance issues, protected classes of employees, and compliance with your own policies and procedures, but some circumstances might require further inquiry. Suppose a health issue—whether or not it has been disclosed to an organization—is involved. Is an employee entitled to an ADA accommodation? What about Family and Medical Leave Act entitlement or workers' compensation benefits?

The answer is *always* to check with counsel experienced in employment law. Some lawyers are available on a pro bono basis, so check with your local bar association. A number of directors and officers (D&O) and EPL insurance carriers provide this service to their policy holders, although sometimes on a limited basis. So ask if they do. If they don't, ask for a referral. At ANI-RRG and NIAC, we feel so strongly that members get good advice before they take an important employment action that we have two experienced labor law attorneys dedicated solely to providing preventive advice on this subject to our member-insureds.

### The New Pound of Flesh

If you haven't heard or read about it, employment practices law is one of the latest and greatest fertile fields for aggressive plaintiff attorneys. It doesn't matter that you are a charitable nonprofit (particularly if you have good insurance limits). Six-figure jury verdicts have become more frequent, particularly in metropolitan areas where the majority of the nonprofit sector does its work. Need further evidence? Consider this data gathered from 10 recent years of our closed claim files:

- One out of every 100 nonprofits (regardless of size) will have an EPL claim this year.
- Of all claims against directors' and officers' policies, 95 percent are in the EPL category.
- The average cost to defend a party when a claim has some merit is \$29,000, and the average loss on those claims is \$44,000; the combined average is \$73,000.
- Of EPL claims, 40 percent have some merit. When they are deemed to have merit, one in 10 will cost more than \$100,000.
- When claims do not have merit, the average cost to defend is only \$5,000, thanks to early intervention by experienced employment defense counsel.
- The two largest claims cost \$1 million and \$400,000, respectively.

### Did You Say Something about Insurance?

Unless you have tens or even hundreds of thousands of dollars just sitting around, you should think about how your organization can protect itself from claims of employment discrimination. And you need to consider another issue.

When EPL claims first came into vogue years ago, the insurance industry's knee-jerk reaction was to find a way to exclude the exposure. Smarter heads prevailed, fortunately, so that today EPL coverage is readily available. But like many things, it comes in different shapes and sizes, and not always where you might expect.

Let's talk first about EPL as stand-alone coverage. It's available and commonly protects the nonprofit from damages claimed as a result of some adverse employment actions. The defense component provides for payment of attorney fees and costs, and the indemnification component provides for payment of actual damages, if there are any. As discussed below, there are exclusions.

It is more common, however, to find EPL cov-

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## Twelve Components of a Model Personnel Handbook

The following are 12 areas that all personnel handbooks should include regarding an organization's policies:

- Introductory statements
- Nondiscrimination and sexual harassment
- Organization and structure
- Training and orientation
- Employee classifications and categories
- Employment policies, including wage and hour regulations
- Benefits disclaimer
- Leaves of absence and time off
- Standards of performance
- Workplace violence prevention and safety
- Search and inspection
- Drug-free workplace

At a minimum, the handbook should include statements regarding at-will employment, introductory or benefit waiting periods, and examples of disciplinary offenses (always prefaced with "including, but not limited to" language). Always ensure that employees sign a written acknowledgment that they have read and understand your workplace-related policies, or you might as well not have created them in the first place.

Next comes training and adherence. Regardless of size, every nonprofit needs to train its management personnel about the employment laws relevant to its jurisdiction and the policies and procedures the agency has adopted. Include any state mandates, such as sexual harassment training, for supervisory personnel. Then, walk the talk! Follow those policies and procedures diligently every day. It's also crucial to include your board members in the training. Because these board members are ultimately responsible for the agency's overall management, they are at risk just as much as executive directors.

era ge as part of nonprofit D&O liability insurance. The components are generally the same as described above. Key issues to consider are detailed below, but beware some tricky provisions, such as one that requires your consent before the carrier settles a claim but makes you responsible for *all* the ongoing legal expenses if you don't accept the carrier's recommendation.

Typical exclusions include fines, penalties, and sanctions (these are uninsurable risks), back wages, multiplied damages, and plaintiff's attorney's fees. Wage and hour claims are a major area of uncovered liability for nonprofits. Properly classifying an employee as exempt from the overtime requirements of the Fair Standards Labor Act (or similar state laws) can be tricky business and sometimes requires extrasensory powers of hindsight. To be properly classified as exempt, an employee must make a threshold salary as defined by federal and state law and pass the duties test of the professional, executive, or administrative exemptions. While most insurance policies do not cover payment of back wages and penalties, a few at least provide some defense costs to cover wage and hour claims.

So what are the key EPL components of a good D&O policy? At a minimum, expect the following elements to be included:

- **Adequate policy limits.** An amount of \$1 million is generally adequate for small and medium-size nonprofits. Larger agencies should consider higher limits or an umbrella policy.
- **A broad definition of who is an insured.** The policy should outline not only whether the nonprofit agency is insured but also whether the following parties are insured:
  - Directors and officers
  - Prior directors and officers
  - Committee members
  - Employees and volunteers (volunteers don't have all the federal or state immunities that you might expect)
- **Broad coverage for employment practices liability.** This protection should be included either by endorsement or embedded in the D&O policy itself.
- **Duty to defend.** Does the scope of duty to defend extend to administrative proceedings (where most EPL claims start) or just to suits in civil courts?
- **Advancing of defense costs.** The carrier should pay for defense costs as incurred, not

after the nonprofit has paid for them and is seeking reimbursement.

### Anything Else?

Before you have occasion to use it, make sure that you understand your policy. Be sure, for example, that you understand *when* you need to report facts that may result in employment practices liability. You may decide, for example, not to report to the insurer an employee grievance filed with your human resources department pertaining to the employee's termination, perhaps believing that no legal claim would develop from it. Unbeknownst to you, however, your policy may require you to report potential claims, including grievances filed with your HR department. By the time the terminated employee files a legal complaint with the district court, the reporting period may have passed and your insurer may in turn deny coverage.

Don't be disappointed if your insurance carrier insists on using defense counsel of its own choosing. It has the right to do so and may have accrued a panel of attorneys experienced in employment law and who understand the nonprofit sector better than most.

While not directly EPL related, make sure your D&O policy also protects you from fiduciary liability claims, such as failure to properly account for grant funds.

If you are unsure about the nature and extent of your EPL coverage, consult your insurance agent or broker. These professionals are usually paid commissions when they place your coverage, and providing appropriate advice is part of what they are paid for—and a service you have a right to expect.

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Has your organization faced employment-related claims, and how were they handled? What advice would you give to other *NPQ* readers? Let us know at [feedback@npqmag.org](mailto:feedback@npqmag.org). Reprints of this article may be ordered from <http://store.nonprofitquarterly.org>, using code 150208.

If you are unsure about the nature and extent of your EPL coverage, consult your insurance agent or broker.