Insurance Coverage for Wage-and-Hour Lawsuits

By James R. Murray, Arthur F. Silbergeld and Omid Safa

Businesses have faced a tsunami of wage-and-hour lawsuits over the last decade, with the number of new class actions increasing particularly in recent years, as more and more disgruntled ex-employees file lawsuits against their former employers in the wake of the “Great Recession.” In federal courts alone, more than 7,000 wage-and-hour lawsuits were filed last year, representing both a record high and a roughly 400% increase since 2000.1

Most often asserting claims under state labor laws, and to a lesser extent, the Fair Labor Standards Act (FLSA), these lawsuits pose potential multimillion-dollar liability and constitute a serious risk to the business of any employer. In fact, the costs of defending such wage-and-hour lawsuits can easily exceed hundreds of thousands, if not millions, of dollars.

Fortunately, employment practices liability (EPL) insurance will often protect companies against the substantial costs and liabilities associated with these types of lawsuits. EPL insurance provides coverage for claims arising out of the employment relationship and typically obligates an insurer to pay all “loss” resulting from an employment-related claim. This includes the payment of all damages, judgments, settlements, pre-judgment interest, post-judgment interest and defense costs, subject to the policy language.

In addition to covering traditional employment-related claims, such as those alleging sexual harassment, discrimination or wrongful termination, an EPL policy ordinarily also provides coverage for a wide array of claims falling within the broad concepts of “employment-related torts,” “employment practice violations” or similar catch-all terms. Examples of the latter types of claims include those alleging “misrepresentation,” “negligent supervision” or the “failure to adopt adequate workplace or employment policies and procedures.”

Wage-and-hour lawsuits commonly allege claims falling within the scope of such EPL coverage provisions. For example, many wage-and-hour plaintiffs assert classic employment-related claims, alleging that they were wrongfully terminated as retaliation for their complaints about inadequate overtime pay, meal breaks or rest periods. Plaintiffs also routinely assert claims falling within the broad concepts of “employment-related torts” or “employment practice violations.”

Indeed, wage-and-hour lawsuits consistently involve allegations that the employer misclassified and misinformed employees as to their status with respect to overtime laws, failed to implement adequate wage-and-hour policies and procedures to protect employees, and allowed supervisors to force employees to work excessive hours without adequate pay. Such claims should trigger coverage under an EPL policy.

Nevertheless, employers should be mindful that many EPL policies contain exclusions that bar coverage for violations of the Fair Labor Standards Act or “similar provisions of any federal, state or local law.” Insurers often incorrectly contend that such exclusions eliminate coverage for all wage-and-hour claims under state laws serving a “similar” purpose as the FLSA. This argument ignores the actual language of such exclusions, however, which merely limits coverage in circumstances where the relevant provisions of the state law are “similar” to the provisions of the FLSA.

Many wage-and-hour plaintiffs file claims under state labor laws, rather than the FLSA, precisely because of the differences between the state and federal laws. For example, the California Labor Code identifies an employee as “exempt” or “non-exempt” from overtime requirements based on the percentage of time the employee spends performing in a managerial capacity.

In particular, California law calls for a quantitative inquiry into whether the employee was “primarily engaged in” (i.e., spent greater than 50% of the time) performing overtime-exempt work. By contrast, the determination under the
FLSA turns on a qualitative inquiry into what constitutes the “primary duty” of the employee during the course of his or her work.

The California Labor Code also requires employers to provide adequate meal and rest breaks, maintain adequate wage-and-hour recordkeeping, and provide prompt payment to discharged employees at the time of termination; subject to stiff penalties for non-compliance. The FLSA includes no such provisions.

Courts have recognized such distinctions and considered them significant.2 In such circumstances, the traditional FLSA exclusion described should not bar coverage for wage-and-hour claims brought under distinct state labor laws, such as the California Labor Code. If an EPL policy was meant to exclude FLSA and similar state or local laws, rather than simply the similar provisions of such laws, the insurer would have drafted the policy to that effect.3

Notwithstanding an FLSA exclusion, an employer should never assume that coverage is unavailable simply because a wage-and-hour lawsuit asserts claims under the FLSA, in addition to state labor laws. One of the most valuable aspects of an EPL policy (or any liability policy for that matter) is the provision obligating the insurer to defend a policyholder against third-party claims.4

An insurance company with a duty to defend must pay for the defense of its policyholder whenever the allegations in the underlying complaint raise the mere possibility that a claim may ultimately be covered by the policy.5 This is true where a complaint alleges both covered and uncovered claims, and even where the uncovered claims predominate.6

Thus, even where an FLSA exclusion may bar indemnity coverage for certain claims alleged under the federal statute, a policyholder should still obtain full defense coverage in connection with the lawsuit (absent express allocation and reimbursement provisions in the policy), so long as the complaint includes at least one state law claim potentially covered by the policy.7

In sum, EPL insurance can provide businesses with critical protection against the substantial costs and liabilities associated with increasingly prevalent wage-and-hour lawsuits. The key to obtaining coverage, however, is being prepared to refute the arguments (such as the applicability of an FLSA exclusion) that insurers are likely to make in an attempt to avoid their coverage obligations. The policyholders that do, stand the best chance of maximizing their insurance recovery.

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2 See Ramirez v. Yosemite Water Co., 20 Cal. 4th 785, 797–98, 801 (1999) (“By choosing not to track the language of the federal exemption and instead adopting its own distinct definition ..., the [California Industrial Welfare Commission] evidently intended to depart from federal law and to provide, at least in some cases, greater protection for employees.”).
3 Indeed, this is borne out by the fact that in recent years certain insurance companies have started selling EPL policies with revised FLSA exclusions that expressly bar coverage for claims under the FLSA “and any other law concerning wage and hour practices.” See, e.g., Zurich Specimen Employment Practices Liability Insurance Policy, Section IV.4(c), available at http://www.zurichna.com/internet/zna/sitecollectiondocuments/en/products/employmentpracticesliability/employmentpracticesliabilityzurichcorporatepolicy.pdf (excluding coverage for claims under the FLSA “and any other law concerning wage and hour practices,” including, but not limited to any Claim for off-the-clock work, failure to provide rest or meal periods, failure to reimburse expenses, improper classification of employees as exempt or non-exempt, failure to timely pay wages, conversions, unjust enrichment, or unfair business practices.”). (emphasis added).
4 See, e.g., Truck Ins. Exch. v. Vanport Homes, Inc., 147 Wn. 2d 751, 760–61 (2002) (“An insurer’s duty to defend is broader than its duty to indemnify” and “[t]he duty is one of the main benefits of the insurance contract.”).
5 See id. at 760 (“The duty to defend ‘arises when a complaint against the insured, construed liberally, alleges facts which could, if proven, impose liability upon the insured within the policy’s coverage.’”); see also Woo v. Fireman’s Fund Ins. Co., 161 Wn. 2d 43, 53 (2007) (“[T]he duty to defend is triggered if the insurance policy conceivably covers the allegations in the complaint[,]”).
6 See, e.g., Am. Best Food, Inc. v. Atea London, Ltd., 138 Wn. App. 674, 683 (2007) (“Only if there is no possible factual or legal basis on which the insurer might be obligated to indemnify will there be no duty to defend.”); Pekin Ins. Co. v. Wilson, 237 Ill. 2d 446, 455 n.2 (2010) (“[I]f [the insurer] has a duty to defend as to at least one count of the lawsuit, it has a duty to defend in all counts of that lawsuit.”).
7 See Nat’l Union Fire Ins. Co. v. Earl Scheib, Inc., Am. Arb. Ass’n Case No. 72-195-00415-11 (Oct. 30, 2001) (arbitrator held that insurer was obligated to pay all defense costs despite an FLSA exclusion, where at least some of the underlying claims were brought under California labor laws having no federal counterpart).

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