EMPLOYMENT PRACTICES LIABILITY INSURANCE AND EX POST MORAL HAZARD

Erin E. Meyers† *& Joni Hersch*‡

Many businesses purchase Employment Practices Liability Insurance (EPLI), a form of insurance that protects them from claims of discrimination, harassment, retaliation, and wrongful termination. But critics of EPLI argue that allowing insurance coverage for employment liability detracts from employment law's goal of deterrence and from notions of justice. We assess the validity of these criticisms by examining the nature of employment law claims and by reviewing characteristics of the current EPLI market. We find that past critiques miss the mark in diagnosing EPLI's major problem.

The EPLI market, for the most part, functions in a way that poses little to no threat to the goals of employment law. However, one specific characteristic of EPLI stands out as particularly concerning. Our review of market sources indicates that EPLI contracts, as currently written, often do not exclude intentional actions of any sort. As such, EPLI policies generally cover employment law claims regardless of whether upper management (i.e., those responsible for decision making on behalf of the business) played a role in the prohibited employment action, either from the outset or as part of a cover-up.

This current EPLI market norm explains why insurers agreed to pay out The Weinstein Company's (TWC) and codefendants' liability for Harvey Weinstein's pervasive sexual harassment, even though Weinstein's behavior was widely known within TWC. We argue that this outcome is troubling from the standpoint of ex post moral hazard. Insuring liability for this type of behavior incentivizes a business's decision makers to attempt to cover up instances of discrimination, harassment, retaliation, and wrongful termination, rather than addressing them head-on.

Despite this significant concern, we argue that the EPLI market can enhance employment law's goals of deterring bad behavior and compensating victims but only if properly struc-

† J.D./Ph.D., Program in Law and Economics, Vanderbilt Law School. erin.e.meyers@vanderbilt.edu. We are grateful to David Eckles, Jennifer Bennett Shinall, and Kevin Stack for their extremely helpful comments. Many thanks to the editors of the *Cornell Law Review* for their help in preparing this piece for publication.

‡ Cornelius Vanderbilt Professor of Law and Economics, Vanderbilt Law School. joni.hersch@vanderbilt.edu. (615) 343-7717.

tured. Specifically, we suggest that the extent of a business's fault, as evidenced through upper-management involvement, should correlate with their direct payment of damages. Under such a system, a business like TWC in which upper management knew of the unlawful activities would be held to a higher standard of accountability than, for instance, a business that immediately addresses allegations of a hostile work environment created by a mid-level employee.

We propose regulating EPLI contracts by mandating that—in cases of upper-management bad faith—either EPLI insurers have the right to pursue subrogation against the business or the business must pay a minimum proportional risk sharing (i.e., coinsurance) rate. Concurrently, legislatures could grant the EEOC (and corresponding state and local agencies) the power to pursue uninsurable fines in the most egregious cases. Such a structure would hold businesses accountable in situations when upper management plays a role in the commission or cover-up of a prohibited employment action while still allowing the EPLI market to reduce risk to businesses, disseminate best practices, and help compensate victims.

INTRODUCTION

In a class action regarding Harvey Weinstein's serial sexual harassment, insurers recently offered a settlement of $18.9 million to his victims.[1] Despite the clearly intentional nature of Weinstein's actions, insurance companies would have paid the full tab under this agreement.[2] Under this agreement, insurers were further set to pay more than $15 million to cover Weinstein and other defendants' defense costs.[3] While the court rejected the settlement, insurers will most likely pay for all damages in the case.

At first glance, insurance coverage for sexual harassment seems to violate both insurers' profit-maximizing incentives and society's notions of fairness. Indeed, the majority of insurance contracts either cover only losses arising from "accidents" or contain express exclusions for intentional acts. These exclusions stem from the fundamental premise that insurance protects against losses stemming from unforeseen and exogenous occurrences (i.e., risks). Intentional acts are the product of a decision rather than a risk, and thus tend to fall outside the scope of insurance. Yet, as the Weinstein example demonstrates, sometimes insurance covers liability from intentional acts. This leads to questions of when, and why, illegal intentional employment practices like sexual harassment are insured. The answer is complicated and rooted in theories of principal-agent relationships.

The workplace is covered by a panoply of laws intended to protect workers, and businesses that violate these laws can be sued by private parties or government agencies. Businesses can purchase insurance policies—known generally as Employment Practices Liability Insurance (EPLI)—to cover various claims brought under these laws. The most common EPLI coverage protects businesses from claims of discrimination, harassment, wrongful termination, and retaliation.

EPLI may seem undesirable and an affront to fairness. Weinstein and his enablers' likely payment via insurance rather than from personal funds clearly runs afoul of societal

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1 Settlement Agreement and Release at 120, Geiss v. Weinstein Co. Holdings, No. 1:17-cv-09554-AKH (S.D.N.Y. June 30, 2020).

2 Geiss v. Weinstein Co. Holdings, No. 1:17-cv-09554 (AKH), 2020 WL 4266925, at *2 (S.D.N.Y. July 24, 2020) (noting that the $18.9 million class action settlement came from a fund set up by The Weinstein Company's (TWC) insurers).

3 *Id.* at *2, *6 (noting that under the bankruptcy agreement that was paired with the proposed class action settlement, insurers allocated $15.2 million in defense costs for TWC officers and directors, including the Weinstein brothers).

notions of justice.[4] Moreover, insuring intentional acts heightens the well-known problem of moral hazard, in which insurance weakens incentives to act prudently.[5] Indeed, EPLI has been criticized on both of these grounds.[6]

In this Article, we combine insurance theory, a review of EPLI market reports, and previous academic commentary to assess EPLI's desirability in today's legal environment. Despite concerns that EPLI is counterproductive to the deterrence function of employment law, EPLI creates many benefits. It enhances the ability of the legal system to compensate victims of wrongful employment acts, provides well-intentioned businesses with risk transfer, and disseminates risk management practices through insurer-business relationships.

Our conclusion is that the existence of EPLI is beneficial to society, with one major caveat. For the most part, EPLI as it operates today is no more or less desirable than any other type of liability insurance. In the many cases when a business is held liable because of the actions of its employee on either a negligence or vicarious liability basis, EPLI acts just as other types of commercial liability insurance. While an individual employee's actions may have been intentional and reprehensible, upper management might reasonably have been unaware of its employee's behavior. From the standpoint of the business itself in these cases, the employee's behavior becomes more akin to an unanticipated risk and similar to the type of risks that insurance is intended to, and does, protect.

However, a certain subset of EPLI coverage should give regulators pause. Namely, EPLI coverage in cases when upper management either participated in or failed to adequately react to allegations of wrongful employment acts diverges from standard insurance practices. For simplicity, we refer to these cases as employer-facilitated wrongs. Also included in our definition of employer-facilitated wrongs is a business's failure to set up a reasonable reporting system for wrongful employment

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4 While Weinstein was ultimately held accountable in criminal court, there are many examples of sexual harassment that do not rise to the level of criminal conduct. *See* Alan Feuer, *5 Takeaways from the Weinstein Verdict*, N.Y. TIMES (Feb. 25, 2020), https://www.nytimes.com/2020/02/25/nyregion/harvey-weinstein-rape-guilty.html [https://perma.cc/N5RD-VUJZ]. For instance, serial verbal abusers may not be held accountable under criminal law, regardless of their conduct's severity. *See Sexual Harassment*, RAINN, https://www.rainn.org/articles/sexual-harassment [https://perma.cc/2YBY-DS8V] (last visited Aug. 30, 2020).

5 Efficient awards for deterrence are set as the ratio of loss divided by probability of detection.

6 *See infra* Part IV.

acts. The definition of upper management should vary based on company size and structure and should reflect the locus of decision making in the company.

Consider a situation wherein a company's upper management fails to address an employee's continuous racist comments because the employee's performance at work is especially valuable. Or consider the instance of Weinstein himself, wherein his harassing behavior was "widely known" within The Weinstein Company, yet it went unaddressed for years.[7] Providing full insurance coverage for these employer-facilitated wrongs introduces, what we argue is, an unjustifiable level of ex post moral hazard. The fact that EPLI further covers punitive damages only aggravates the situation.

We propose two related solutions that could maintain the benefits that EPLI creates while penalizing the actions of businesses that tolerate illegal employment practices. First, legislators could regulate EPLI contracts. This could take on many different forms and we suggest two—either mandatory proportional risk sharing (i.e., coinsurance) or a right to subrogation in cases of employer-facilitated wrongs. Each of these options would place a greater expected financial burden on insured businesses when their decision makers either commit or cover up illegal employment actions.

Currently, even lawsuits filed by the EEOC and state employment commissions are insurable under EPLI contracts. This leaves regulatory action at minimal effectiveness against insured businesses. Under our proposal, damages resulting from EEOC or state employment commission actions would be subject to the same contractual regulations as damages from private actions, that is, mandatory coinsurance or right to subrogation. In addition to regulating EPLI contracts, legislatures could expand the enforcement toolbox available to the EEOC and state employment commissions by giving them the power to pursue uninsurable regulatory fines.

This Article proceeds as follows. Part I discusses the goals of employment law. Part II introduces the concept of commercial liability insurance and explains how EPLI has developed as a part of businesses' insurance portfolios. Part III examines

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7 Ronan Farrow, *From Aggressive Overtures to Sexual Assault: Harvey Weinstein's Accusers Tell Their Stories*, NEW YORKER (Oct. 10, 2017), https://www.newyorker.com/news/news-desk/from-aggressive-overtures-to-sexual-assault-harvey-weinsteins-accusers-tell-their-stories [https://perma.cc/5YRV-REXU] (noting that sixteen executives and assistants stated that Weinstein's "behavior was widely known within both Miramax and the Weinstein Company").

facets of the current EPLI market. Part IV summarizes prior commentary on EPLI and pushes back on broad criticisms of EPLI as a whole. Part V presents our assessment of EPLI's ability to further employment law's goals of compensation and deterrence. In this Part, we argue that the only major problem with EPLI is insurance coverage for upper management's intentional acts, which is exacerbated by providing coverage for punitive damages. Part VI discusses our proposed solutions of either regulating EPLI contracts or instituting uninsurable regulatory fines and explains how these options could help alleviate the acute issue of ex post moral hazard in EPLI.

I
THE GOALS OF EMPLOYMENT LAW

A subset of employment law creates rights for individual workers.[8] Major areas of protective employment law include employment discrimination, minimum wage regulations, unemployment compensation, and regulation of pension plans.[9]

While employment law prohibits a range of business practices, only some fall under the scope of EPLI's coverage. The language in EPLI policies generally provides coverage for "wrongful employment acts," which are defined in the policy and subject to a number of exclusions.[10] While the definition and exclusions vary by policy, coverage typically extends at a minimum to instances of discrimination, retaliation, harassment, and wrongful termination.[11] This Article focuses its analysis on these four actions, which will collectively be referred to as wrongful employment acts.

Congress and state legislatures have passed an extensive body of laws seeking to combat wrongful employment acts. For example, on the federal level, discriminatory acts in the workplace are outlawed by Title VII of the Civil Rights Act of 1964

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8 *Employment*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/employment [https://perma.cc/Q6BT-TE42] (last visited Aug. 26, 2020) (describing employment laws as "protective labor legislation" and describing various subsets of employment law that protect workers).

9 *Id.*

10 JOSEPH M. GAGLIARDO & SARA P. YAGER, PRACTICAL LAW LABOR & EMP'T, EMPLOYMENT PRACTICES LIABILITY INSURANCE (EPLI) POLICIES AND COVERAGE 7–8 (2017), http://www.lanermuchin.com/media/news/10_Employment_Practices_Liability_Insurance_EPLI_Policies_and_Coverage.pdf [https://perma.cc/DV9H-Z9QR].

11 *Id.* In contrast, employment laws involving compensation and benefits policies at the firm level, such as practices covered under the Fair Labor Standards Act (FLSA) and Employment Retirement Income Security Act (ERISA) laws, are generally excluded from EPLI coverage. *Id.* at 8.

(on the basis of race, sex, religion, nationality, and color),[12] the Americans with Disabilities Act (on the basis of physical and mental disabilities),[13] and the Age Discrimination in Employment Act (on the basis of age),[14] among other laws. Federal laws create a floor for protections, and some states offer additional protections via state laws. Regardless of the source, prohibitions on wrongful employment acts seek to protect workers with two goals in mind: deterring future wrongful employment acts and compensating employees who are wronged.[15]

A. Compensation

When crafting regulations, Congress can choose a public or private enforcement mechanism or a combination of the two. Public enforcement involves the government stepping in to enforce the law, like in criminal justice actions or regulatory fines.[16] Private enforcement, in contrast, involves providing incentives for private individuals to bring suits against those who break the law.[17]

Employment law enforcement relies heavily on private rights of action.[18] To incentivize plaintiffs who experience wrongful employment acts to bring suits against their employers, Congress and state legislatures have granted the right to damages that compensate those victims for their losses.

Available damages in employment actions include backpay,[19] front pay,[20] compensatory damages, punitive damages, and attorneys' fees.[21] While all five of these serve the

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12 42 U.S.C. § 2000e–2 (2018).

13 *Id.* §§ 12101–12102.

14 29 U.S.C. § 623 (2018).

15 *See, e.g.*, Franks v. Bowman Transp. Co., 424 U.S. 747, 764–65 n.21 (1976) (endorsing the "rightful place" theory); Albemarle Paper Co. v. Moody, 422 U.S. 405, 420–21 (1975) (endorsing the "make whole" theory). *See also* H.R. REP. NO. 102-40, pt. 2, at 1 (1991) (stating that a purpose of the Title VII amendments "is to strengthen existing protections and remedies available under federal civil rights laws to provide more effective deterrence and adequate compensation for victims of discrimination").

16 *See* J. Maria Glover, *The Structural Role of Private Enforcement Mechanisms in Public Law*, 53 WM. & MARY L. REV. 1137, 1147 (2012).

17 *See id.*

18 *See id.* at 1151.

19 H.R. REP. NO. 102-40, pt. 2, at 34.

20 *Front Pay*, U.S. EQUAL EMP. OPPORTUNITY COMMISSION, https://www.eeoc.gov/federal-sector/front-pay [https://perma.cc/C4RJ-94AV] (last visited Nov. 13, 2020) ("Front pay is an equitable remedy, an element of the 'make whole' relief available to victims of employment discrimination.").

21 Civil Rights Act of 1991, Pub. L. No. 102–166, §§ 102–103, 105 Stat. 1071, 1072–74 (1991). Note that punitive damages are not available in disparate impact

deterrence mechanism that private enforcement seeks to achieve, four of the damages categories also seek to provide fair compensation to wrongful-employment-act victims. Only punitive damages are not directly related to the goal of compensating victims for their costs and therefore serve solely the purpose of deterring bad behavior.

B. Deterrence

Preventing discrimination in the workplace is one of the named purposes of many employment statutes.[22] Theoretically, making businesses liable to their employees for any wrongful employment acts should incentivize businesses to find ways to reduce or eliminate the occurrence of such acts.

Employment laws ideally should incentivize businesses to reduce wrongful employment acts both ex ante and ex post. Ex ante efforts are a business's investments that seek to prevent the occurrence of wrongful employment acts in the first instance. Ex post efforts are those taken by a business to minimize the harm caused by a wrongful employment act that has already occurred.

From an ex ante standpoint, businesses can make investments designed to prevent wrongful employment acts within their workplaces.[23] Each firm's risk of wrongful employment acts varies based on a number of factors, including the size of the firm, its industry, its culture, and its system of training and accountability. Some of these factors are not realistically within the company's range of potential changes when it comes to managing the risk of wrongful employment acts. For example, a firm will not change its industry to reduce the risk that its employees experience discrimination, nor will it reduce its workforce size with only that goal in mind.

However, a firm can meaningfully alter its culture and its system of training and accountability in order to achieve a fairer workplace. Under this framework, the firm can invest resources in developing a culture and accountability system

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cases. *See* 42 U.S.C. § 1981a(a) (2018). Punitive damages are also not available in ADEA actions; instead, liquidated damages act as a substitute for punitive damages in cases of willful violations. *See* 29 U.S.C. § 626(b) (2018).

22 *See, e.g.*, 42 U.S.C. §§ 12101–12102 (stating its purpose is to eliminate "discrimination against individuals with disabilities").

23 *See e.g.*, *What Is Employment Practices Liability Insurance (EPLI)?*, INS. INFO. INST., https://www.iii.org/article/what-employment-practices-liability-insurance-epli [https://perma.cc/UL6X-9DPW] (last visited Feb. 8, 2021) (listing different ways businesses can train their managers and employees to prevent employment lawsuits).

that reduce the likelihood that prohibited employment practices occur in the first place. Employment law, then, seeks to incentivize businesses to invest in healthy workplace cultures and effective systems of training and accountability.

From an ex post standpoint, the threat of employment liability should incentivize businesses to address wrongful employment acts head-on in order to reduce their impact. For example, if a human resources department is made aware of alleged racial discrimination in one of its stores, it should work to resolve the issue instead of ignoring or attempting to hide it. The threat of employment liability should additionally discourage deliberate ignorance of wrongful employment acts. In other words, a business should not be able to avoid ex post responsibilities by failing to set up a reasonable system for reporting wrongful employment acts.

In order to induce businesses to responsibly address wrongful employment acts, the penalties for a business that fails to address or attempts to cover up a wrongful employment act of which it is aware—or fails to set up a reasonable reporting system in the first instance—should be more severe than the penalties for a business that maintains an adequate reporting system and addresses employment wrongs swiftly. If there is no additional penalty for attempting to cover up an employment wrong, businesses will face economic incentives that encourage them to ignore or cover up their wrongs.

Indeed, this is a function of punitive damages in employment law. For example, in cases where a business might otherwise be held liable for punitive damages in a Title VII suit, it is protected by a safe harbor if it can establish that it acted in good faith to comply with Title VII.[24] In cases where upper management attempts to cover up a wrongful employment act, a business certainly could not establish the good faith safe harbor and would expose itself to punitive damages.

While businesses can invest resources to reduce instances of and mitigate harms from wrongful employment acts, they still may wish to purchase insurance to cover the risk of employment suits. For instance, it may be impossible for some businesses to eliminate all wrongful employment acts, especially large companies that cannot directly monitor and control all of their employees. Others may purchase insurance be-

24 *See, e.g.*, Kolstad v. Am. Dental Ass'n, 527 U.S. 526, 528 (1999) ("[I]n the punitive damages context, an employer may not be vicariously liable for the discriminatory employment decisions of managerial agents where these decisions are contrary to the employer's good faith efforts to comply with Title VII.").

cause of concerns about false accusations of wrongful employment acts and a desire to have insurance to cover defense costs. We next move to explain the overall function of commercial insurance and the specific nature and history of EPLI.

II
COMMERCIAL INSURANCE AND EMPLOYMENT LIABILITY

Most people's experience with liability insurance is largely limited to personal lines, such as homeowners or automobile insurance. In exchange for a premium payment, an insurer promises to pay for certain instances of legal liability.[25] For example, if my neighbor experiences a slip-and-fall on my icy sidewalk, my homeowners policy would pay for their medical costs. If I get into a car accident that is my fault, my automobile liability policy would pay for the other drivers' car damage and medical costs. Each of these policies provides peace of mind that a moment of bad luck or negligence will not strip me of my assets.

Most of us do not devote much brain space to the world of liability insurance that exists beyond our own personal policies. However, commercial insurance makes up a large portion of the insurance market, as businesses face an array of risks in everyday operations that expose them to potential liability.[26] One of the major liability risks faced by businesses is employment liability.[27] This subset of liability includes any claim brought by an employee or job applicant (outside of bodily injury and physical harm, which is covered by workers' compensation). This Part discusses how employment liability fits into the broader nature of business risk and how businesses manage and insure against such risks.

A. Commercial Insurance

Businesses face a complicated set of risks, only some of which are insurable. For instance, a business cannot purchase insurance for the risk that its product is unpopular and doesn't sell. The set of insurable commercial risks can

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25 *See* John Rappaport, *How Private Insurers Regulate Public Police*, 130 HARV. L. REV. 1539, 1551–52 (2017).

26 In 2018, insurers wrote $287.1 billion in commercial property and liability insurance. *Archived Graphs*, INS. INFO. INST., https://www.iii.org/graph-archive/96080 [https://perma.cc/HAP7-6HKW] (last visited Sept. 21, 2020).

27 *See infra* note 44 and accompanying text.

generally be subdivided into property risks and liability risks.[28] Property risks cover damage to a business's own property (e.g., damage to an assembly line caused by a fire), while liability risks include damages owed to a third party via legal liability.

At the most common level, a basic Commercial General Liability (CGL) policy covers liability to third parties for bodily injury, property damage, and emotional distress, subject to a wide range of exclusions.[29] Because CGL policies are subject to many exclusions, businesses must determine what additional coverages their specific situation requires. For instance, lawyers and doctors often purchase professional liability (malpractice) coverage, which is not available under a CGL policy.[30] Manufacturers purchase products liability insurance, similarly excluded from CGL.[31]

Other, more commonplace business risks are also excluded under CGL policies. For instance, any coverage for liability arising from operation of commercial vehicles must be purchased under a separate policy.[32] Most importantly for this Article, on-the-job harm that employees experience is excluded from CGL policies. Specifically, injuries to employees are excluded from CGL policies either under the workers' compensation exclusion (no coverage for physical injuries) or the employer's liability exclusion (no coverage for violations of employment law).[33] While workers' compensation coverage is mandated by law in almost all states and dealt with under a

28 While the insurance industry sometimes refers to liability insurance as casualty insurance, we refer to it here as liability insurance to avoid using insurance-industry-specific terms.

29 *See* 9A STEVEN PLITT, DANIEL MALDONADO, JOSHUA D. ROGERS & JORDAN R. PLITT, COUCH ON INSURANCE § 129:3 (3d ed. 2020); *see also Commercial General Liability Insurance*, INS. INFO. INST., https://www.iii.org/article/commercial-general-liability-insurance [https://perma.cc/UE75-7XH6] (last visited Jan. 31, 2021) (describing commercial general liability insurance). These policies also cover personal injury arising specifically from false arrest, malicious prosecution, wrongful eviction, slander or libel, and privacy violations. PLITT, MALDONADO, ROGERS & PLITT, *supra* at § 129:8. For examples of what is excluded from CGL policies, see *infra* notes 30–35 and accompanying text.

30 *See General Liability vs Professional Liability Insurance*, PROGRESSIVE COM., https://www.progressivecommercial.com/business-insurance/general-liability-vs-professional-liability/ [https://perma.cc/2HTK-RD99] (last visited Aug. 26, 2020).

31 *See Product Liability Insurance vs General Liability*, EK INS., https://ekinsurance.com/cgl/product-liability-insurance-vs-general-liability.html [https://perma.cc/72KF-BV3K] (last visited Aug. 26, 2020).

32 *See What Does General Liability Insurance Cover?*, HARTFORD, https://www.thehartford.com/general-liability-insurance/what-does-general-liability-cover [https://perma.cc/D76L-YKXX] (last visited Aug. 26, 2020).

33 *See* PLITT, MALDONADO, ROGERS & PLITT, *supra* note 29 at § 129:12.

separate insurance scheme,[34] individual business are left to determine whether to purchase coverage for employment practices (i.e., EPLI).[35] The remainder of this Part describes the history of EPLI, the risks it covers, and its unique features as compared with other types of commercial liability insurance.

B. EPLI History

While federal employment discrimination laws have been on the books since the 1960s,[36] EPLI did not come on the scene until the early 1990s. The thirty-year gap between the development of federal employment liability and the development of insurance to protect against that liability is likely due to the absence of financial incentives under the 1964 Civil Rights Act. Prior to the 1991 Civil Right Act, which amended Title VII, damages in Title VII lawsuits were limited to equitable relief of backpay and front pay,[37] meaning plaintiffs could recover neither compensatory nor punitive damages for violations of employment law.

Not only were damages limited to backpay and front pay before 1991, but a string of cases in the late 1980s made it increasingly difficult for plaintiffs to win employment discrimination cases.[38] The low value of these claims combined with the low likelihood of success caused Congress to become concerned about the efficacy of private enforcement. In response, Congress enacted the 1991 amendment to the Civil Rights Act in order to increase incentives for private plaintiffs to bring suits for violations of civil rights laws.[39] The amendment

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34 *See Workers' Compensation Laws – State by State Comparison*, NFIB (June 7, 2017), https://www.nfib.com/content/legal-compliance/legal/workers-compensation-laws-state-by-state-comparison-57181/ [https://perma.cc/8CZ5-AC2Z].

35 *See Does My Business Need EPLI Insurance?*, JUSTWORKS (Nov. 9, 2017), https://justworks.com/blog/what-is-epli-and-does-your-company-need-it [https://perma.cc/Q4UB-WQZH] ("Although it's not a legal requirement for a company to have EPLI insurance, it may be a good idea given the rising volume and costs of employment practices litigation.").

36 *See Laws Enforced by EEOC*, U.S. EQUAL EMP. OPPORTUNITY COMM'N, https://www.eeoc.gov/statutes/laws-enforced-eeoc [https://perma.cc/U6DW-P3CV] (last visited Jan. 31, 2021). An earlier federal law prohibits intentional discrimination on the basis of race. *See* Civil Rights Act of 1866, ch. 31, § 2 (codified as amended at 42 U.S.C. § 1982 (1970)).

37 The Supreme Court construes front pay as a form of backpay. *See* Pollard v. E.I. Du Pont De Nemours & Co., 532 U.S. 843, 849 (2001) (giving examples of two 1971 cases in which front pay was awarded and describing front pay as a form of backpay).

38 *See* Sean Farhang & Douglas M. Spencer, *Legislating Incentives for Attorney Representation in Civil Rights Litigation*, 2 J.L. & CTS. 241, 248 (2014).

39 *See id.*

sought to achieve this goal in two ways. First, it allowed for compensatory and punitive damages, raising the potential dollar value of employment claims.[40] Second, by allowing compensatory damages, plaintiffs were additionally granted the right to a jury trial, which many perceive as more plaintiff friendly.[41]

As a result of the 1991 amendment, the expected value of employment suits increased greatly. As economists would—and Congress did—predict, employment-related litigation increased markedly in the following years.[42]

Prior to the 1990s, the losses a business might have paid out for employment-related claims were likely too low to warrant concern over insurability.[43] However, the 1991 amendment not only markedly increased monetary damages for successful employment discrimination claims, but relatedly increased the volume of claims.[44] Thus, the exposure that businesses faced from employment practices liability increased both in scope and severity.

During this same timeframe, businesses were filing employment liability claims against their insurance companies under their CGL policies.[45] These businesses achieved mixed success in obtaining recovery.[46] Due to the legal uncertainty surrounding CGL coverage of employment claims, combined with the rising prevalence and cost of employment lawsuits, insurers began explicitly excluding employment-related liability from coverage under CGL policies.[47] These exclusions left a hole in coverage for businesses wanting to shield themselves from costs associated with defending employment lawsuits and paying damages, creating a demand for a new product.

This demand eventually evolved into a new insurance product—EPLI. At the outset, EPLI was somewhat uncommon and only five insurers wrote EPLI coverage.[48] Now, there are

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40 *See* Civil Rights Act of 1991, Pub. L. No. 102–166, § 102, 105 Stat. 1071, 1072 (1991); Farhang & Spencer, *supra* note 38, at 249.

41 § 102, 105 Stat. at 1073; Farhang & Spencer, *supra* note 38, at 249.

42 *See* Farhang & Spencer, *supra* note 38, at 253 fig.2.

43 *See id.* at 249.

44 *See id.*

45 *See* Amanda D. Smith, *"Supervisor" Hostile Environment Sexual Harassment Claims, Liability Insurance and the Trend Towards Negligence*, 31 U. MICH. J.L. REFORM 263, 279–81 (1997).

46 *See id.*

47 *See* Francis J. Mootz III, *Insurance Coverage of Employment Discrimination Claims*, 52 U. MIAMI L. REV. 1, 13 (1997).

48 RICHARD S. BETTERLEY, THE BETTERLEY REPORT: EMPLOYMENT PRACTICES LIABILITY INSURANCE MARKET SURVEY 3 (2019).

more than fifty active insurers in the stand-alone EPLI market.[49] Even as employment liability exposure has expanded and contracted over time, EPLI continues to grow.

III
THE EPLI MARKET TODAY

The Betterley EPLI report is a well-respected publication that has summarized the state of the EPLI market each year since 1991.[50] Each year's report provides a wealth of information, including policy provisions and definitions, limits usually purchased, deductibles and coinsurance available, and a general market snapshot.[51]

EPLI coverage extends to both the business itself and any employee working for the business.[52] However, the majority of employment discrimination law is designed with vicarious liability of the business in mind, and many times liability from employment law doesn't reach the actual employee who committed a violation. For instance, an employee who sexually harasses a coworker is not individually liable for their actions under Title VII.[53] Given this structure of employment law, EPLI most often acts to protect businesses themselves for vicarious liability arising from the actions of their employees.

Insurers generally offer EPLI in one of two ways: as an endorsement to Directors & Officers liability insurance (D&O insurance) or separately as a standalone policy.[54] An endorsement to a D&O policy covers the instances in which an individual is liable as a fiduciary. In contrast, standalone policies are more wide sweeping, are more common, and cover the business itself.

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49 *Id.*

50 *See id.* Richard Betterley is a risk consultant who publishes six reports annually on the state of specialty insurance products. Betterley markets his consulting "services to corporations, educational institutions, and other organizations throughout the United States[,]" and his reports are available for purchase online. *See Biographies: Richard S. Betterley*, IRMI, https://www.irmi.com/biographies/richard-betterley [https://perma.cc/7ULQ-JND6] (last visited Sept. 1, 2020).

51 *See* BETTERLEY, supra note 48.

52 *Id.* at 42–52.

53 *See* Ann M. Anderson, Note, *Whose Malice Counts?:* Kolstad *and the Limits of Vicarious Liability for Title VII Punitive Damages*, 78 N.C. L. REV. 799, 801–02 (2000).

54 Tamara Bruno, *An Overview of Insurance Coverage for Claims of Sexual Harassment and Assault*, 16 J. TEX. INS. L. 17, 21 (2018).

A. Scope of the Market

Large employers purchase EPLI at much higher rates than small employers. A recent estimate puts take-up rates in the 40 percent range for companies with more than 1,000 employees, in contrast to a 7 percent take-up rate in companies with 1–25 employees.[55] A range of businesses across industries purchase EPLI. In 2018, the largest purchaser was the "Information, Finance, Insurance, Real Estate and Rental and Leasing, and Professional Business Services" industry.[56] Other large drivers of premiums include "Educational Services, Health Care, and Social Assistance," "Trade, Transportation, and Warehousing," and "State and Local Government."[57]

Some industries clearly present higher risk for workplace misbehavior than others. For instance, the #MeToo movement carries implications for insurers writing EPLI coverage. The Betterley Report predicts that many EPLI carriers are at risk of paying out large claims in the coming years, especially in the entertainment industry.[58] As a result, many insurers have pulled out of the market for EPLI in the entertainment industry and are refusing to provide coverage to entertainment businesses altogether due to the risks they present.[59] Other insurers are scrutinizing EPLI applicants in the entertainment industry more thoroughly than those from other industries.[60]

The entertainment industry is not the only problematic segment of businesses. Other examples of industries that some insurers refuse to write EPLI coverage for include law offices, car dealerships, adult entertainment businesses, and casinos, among others.[61] One inference that might be made about these industries is that the risks they present are unacceptable to insurers either because of unpredictability or a high loss rate.

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55 *See* ADVISEN INS. INTEL., COMPLETE THE PICTURE: A SPOTLIGHT ON THE UNITED STATES EMPLOYMENT PRACTICES LIABILITY INSURANCE MARKET 12 (2014).

56 BETTERLEY, *supra* note 48, at 10. This is measured in terms of direct written premium. *Id.*

57 *Id.*

58 *Id.* at 4.

59 *Id.* at 28–30.

60 *Id.* at 6–7.

61 *See id.* at 28–30.

B. Addressing Moral Hazard

Moral hazard—described by insurance law expert Tom Baker as the "insurance-deterrence tradeoff"[62]—stands for the concern that a business with liability insurance will under-invest in precautions that would reduce the likelihood or severity of a loss.[63] Or, in simpler terms, moral hazard posits that those who have insurance coverage are prone to act less carefully.

Moral hazard is problematic from both a public policy standpoint and the insurer's profit-driven standpoint. Any moral hazard arising from liability insurance is problematic for society in general. All else equal, society would prefer a world with fewer wrongs. Thus, if moral hazard reduces care and, in turn, increases the prevalence of injuries and other wrongs, society is worse off.

From a private standpoint, moral hazard creates a direct loss to the insurer. Moral hazard arises when an insurer cannot precisely know the level of care its insured invests in and, therefore, cannot set the premium to perfectly reflect the insured's expected loss.[64] Any reduction in care on the part of the insured increases the likelihood of a loss, which is paid for by the insurer.[65] Thus, insurers seek to minimize moral hazard among their insureds.[66]

Insurers have come up with a variety of strategies for reducing moral hazard among insureds. Some common methods used are deductibles, limits, and proportional risk sharing (also called coinsurance in some contexts). Two of these strategies—deductibles and limits—are commonly used in liability insurance and act as a means of keeping the insured's "skin in the game."[67]

A deductible is the amount the insured must pay toward a loss before the insurance coverage kicks in. A limit is the maximum amount the insurer will pay for the loss. Policies can be

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62 *See* Tom Baker, *Reconsidering Insurance for Punitive Damages*, 1998 WIS. L. REV. 101, 102 (1998).

63 *See* Steven W. Pottier & Robert C. Witt, *On the Demand for Liability Insurance: An Insurance Economics Perspective*, 72 TEX. L. REV. 1681, 1687 (1994).

64 *Id.*

65 *See* Rappaport, *supra* note 25, at 1553. One counterargument is that insurers can simply adjust their premiums upward to reflect moral hazard. However, insurers benefit from reducing moral hazard because it allows them to reduce their premiums and increase their market share. *Id.*

66 *See* Eric D. Beal, *Posner and Moral Hazard*, 7 CONN. INS. L.J. 81, 86–87 (2000).

67 Rappaport, *supra* note 25, at 1555.

written with both a deductible and a limit. Example 1 illustrates how each works.

Example 1

The Pawnee Parks Department (the Department) purchases an EPLI policy from JJ's Insurance. Jean-Ralphio Saperstein applies for a job with the Department and is passed over for another candidate. Jean-Ralphio sues for discriminatory hiring practices under Title VII. Although Jean-Ralphio loses his case, the suit costs $60,000 to defend.

Policy Provision	Paid for by the Department	Paid for by JJ's Insurance
$5,000 Deductible	$5,000	$55,000
$20,000 Deductible	$20,000	$40,000
$50,000 Limit	$10,000	$50,000
$100,000 Limit	$0	$60,000
$5,000 Deductible & $50,000 Limit	$10,000	$50,000
$20,000 Deductible & $100,000 Limit	$20,000	$40,000

While insurers benefit from deductibles and limits because they reduce moral hazard, insureds often choose policies with such provisions because they reduce their premiums. In general, the higher a deductible and the lower a policy limit, the less expensive the policy will be.[68]

The 2019 Betterley Report summarizes the major EPLI insurers' menu of options for insureds when it comes to deductibles, limits, and proportional risk sharing. Twenty of the thirty-two insurers included in the report do not offer policies with a $0 deductible and list a minimum deductible ranging from $1,000 to $1,000,000.[69] Of the twelve insurers that do not list a nonzero minimum, only four specifically state that they offer policies with a $0 deductible, and the remaining eight are ambiguous.[70]

68 For example, for AXIS's EPLI line in Tennessee, an insured pays 60 percent more for a policy with a deductible of $0 than a policy with a retention of $25,000. In comparison to a policy with a deductible of $1,000,000, an insured pays 220 percent more for a policy with a deductible of $0. This rating reflects the tradeoff between reducing moral hazard and lower premium costs. This information is available at https://filingaccess.serff.com/sfa/search/filingSummary.xhtml?filingId=131595539 [https://perma.cc/2ZZK-BFHZ] (last visited Mar. 5, 2020) (file labeled "Rating Plan Addendum").

69 BETTERLEY, *supra* note 48, at 31–32.

70 *Id.*

In terms of policy limits, the highest listed limit is $50 million, with the majority of companies offering limits up to $25 million.[71] None of the thirty-two insurers require a minimum proportional-risk-sharing rate, and the majority state that the insured can choose any level. Proportional risk sharing is both uncommon and used largely by choice of the insured.

Beyond using the tools of deductibles and limits, insurance companies can raise premium prices or refuse to renew an insured's policy based on its annual loss experience. The threat of a rate increase or nonrenewal provides another incentive for insureds to invest in measures that would prevent wrongful employment acts. Insurers can also base premiums on insureds' reported employment practices, as set forth in their EPLI applications.

Applications for EPLI insurance are generally extensive, asking about the applicant's business practices, employment numbers and turnover rates, and any past employment claims.[72] Any material misstatement or omission on an insurance application is grounds for noncoverage if a claim arises.[73] Thus, businesses have strong incentives to provide all relevant information requested on an EPLI application. This, in turn, means that insurance companies have a wealth of information on applicants' and renewing insureds' employment practices and loss experience when pricing EPLI policies. Renewal applications, however, are generally less extensive than initial applications.[74]

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71 *Id.* at 33–34.

72 *See, e.g.*, *Application for Employment Practices Insurance*, IRONSHORE, https://www.ironshore.com/pdfs/products/EPLI_Application.pdf) [https://perma.cc/QFJ3-A6LE] (last visited Sept. 1, 2020) (listing questions related to business practices and other relevant information for underwriting); *Employment Practices Liability Coverage Application*, TRAVELERS, https://www.travelers.com/iw-documents/apps-forms/epl/epl-1100e-ind.pdf [https://perma.cc/5S9H-S9YY] (last visited Sept. 1, 2020) (showing the typical questions asked on insurance forms relating to business processes).

73 *See, e.g.*, Oregon Mut. Ins. Co. v. Victorville Speedwash, Inc., No. Cv. 14-07909-AB (SHx), 2015 WL 12656274, at *1, *4 (C.D. Cal. July 6, 2015) (revoking an insurance contract in light of a material misrepresentation and explaining that the level of fault surrounding the misstatement is irrelevant).

74 One of Weinstein's EPLI insurers initially argued for noncoverage on the basis of an application misrepresentation from 2005. *See* Defendant Harvey Weinstein's Third-Party Complaint for Breach of Contract and Breach of the Duty of Good Faith and Fair Dealing (Bad Faith) at 2–11, Fed. Ins. Co. v. Weinstein, No. 18 Civ. 2526 (PAC), 2019 WL 1407455 (S.D.N.Y. Mar. 28, 2019). Presumably, the fact that the insurer had to reach back to a misrepresentation made on an application twelve years prior is because the renewal applications were less extensive and, thus, did not contain enough information to include any misrepresentations.

Finally, loss prevention programs are another means for reducing moral hazard. Insurers in the EPLI realm offer extensive loss prevention programs for their insureds, which insurers market as being provided at no additional cost.[75] Seven of the thirty-two insurers included in the Betterley Report offer a 1-800 number for employee complaints, while twenty-four of thirty-two offer a hotline for insured businesses to call with legal questions regarding employment practices.[76] Twenty insurers offer assistance with crafting employment policies or handbooks, either through a model employment handbook or sample guidelines for employment practices.[77] Twenty-one insurers offer education and training on employment best practices.[78]

Twenty-nine insurers offer risk management consulting services, provided mostly on an unlimited basis. Three insurers offer consulting from an HR professional, twenty-five offer the consulting services of an attorney, and one insurer offers consulting from either an HR professional or attorney.[79]

C. Claims Handling and Liability Limits

Liability policies can be written in one of two ways: defense inside or outside limits. EPLI is generally written with defense costs inside the limits of the policy—also known as a "shrinking limits" provision.[80] An example illustrates. Suppose Eleanor's Margarita Bar is sued by Tahani. Eleanor has an insurance policy with a $1 million limit. If the defense costs $200,000, there will be only $800,000 left of insurance coverage to pay out any damages to Tahani. Therefore, if a judgment for Tahani is any greater than $800,000, Eleanor—if she has the available funds—will have to pay the additional money out of her own pocket.[81] In contrast, a policy that is written

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75 BETTERLEY, *supra* note 48, at 95–102. Of course, the net cost of these loss prevention services is priced into the premiums. There is no opt out option that would lower premiums, which would indicate insurers seek to incentivize firms to use these services. This provides an additional rationale for our subrogation and coinsurance proposals. If firms do not use these services that are available to them at zero marginal cost, the argument for not covering intentional acts is heightened.

76 *Id.* at 95–100.

77 *Id.*

78 *Id.*

79 *Id.* at 101–02.

80 *See Employment Practices Liability Insurance (EPLI)*, IRMI, https://www.irmi.com/term/insurance-definitions/employment-practices-liability-insurance [https://perma.cc/B6ZV-FAL5] (last visited Sept. 3, 2020).

81 In practice, however, there is good evidence that in cases against commercial defendants, actual payouts rarely exceed the policy limit. Tom Baker, *Liabil-*

outside the limits would cover the $200,000 defense costs and still have $1 million left available to pay damages.

The defense-in-limits setup is advantageous to insurers because it places a definite cap on the amount of loss for any single claim. However, as the example illustrates, it can be counterproductive for victim compensation. For claims that exceed the policy limit, any money spent on defense costs whittles away at the likely damage award for the victim, as research demonstrates that insurance policy limits often act as de facto limits on damages.[82]

One of the reasons cited by the District Court for the Southern District of New York in rejecting the proposed Weinstein class action settlement was related to the problems created by shrinking limits. The proposed settlement would have been paid entirely by insurance policies and would have allocated approximately $19 million to compensate victims in the class, while allocating approximately $15 million to Weinstein's legal defense.[83] The judge noted that favoring the costs of Weinstein's defense at the expense of impacted victims was "obnoxious."[84]

D. Intentional Acts and Punitive Damages

Punitive damages are a point of contention in liability insurance. A number of states have outlawed insurance for punitive damages on the basis of public policy concerns.[85] However, EPLI insurers have come up with workarounds to respond to market demand for insurance against punitive damages even in states that prohibit punitive damages coverage. All insurers from the Betterley Report offer policies without a punitive damages exclusion.[86]

Many EPLI policies include "most favored venue" language or are written using a "wrap-around" policy, each of which

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ity Insurance as Tort Regulation: Six Ways that Liability Insurance Shapes Tort Law in Action, 12 CONN. INS. L.J. 1, 6–7 (2005). We return to this point as it relates to the employment context.

82 *Id.*

83 *See* Geiss v. Weinstein Co. Holdings, No. 1:17-Cv-9554 (AKH), 2020 WL 4266925, at *2 (S.D.N.Y. July 24, 2020).

84 *Id.* at *6.

85 *See* Tom Hams, *EPLI & Punitive Damages: Coverage Exists, But Be Careful*, NU PROPERTY CASUALTY 360° (Dec. 5, 2010, 7:00 PM), https://www.propertycasualty360.com/2010/12/05/epli-punitive-damages-coverage-exists-but-be-careful/ [https://perma.cc/Q4S5-S6GX].

86 *See* BETTERLEY, *supra* note 48, at 91–94. For Title VII and the ADA, punitive damage caps are low and do not present much financial threat. However, many corresponding state claims have no statutory punitive damage caps.

allows insurance for punitive damages regardless of an individual state's laws.[87] Most favored venue clauses state that the jurisdiction that is most permissive towards coverage of punitive damages will govern their insurability, so long as the jurisdiction meets certain criteria.[88] Wrap-around policies are written abroad, often in Bermuda, and write coverage for punitive damages on the basis that state laws do not apply to them.[89] Insurers often use these strategies to provide punitive damages coverage and market their EPLI policies as inclusive of punitive damage awards.[90] Notably, both of these strategies for insuring punitive damages are seldom used for other insurance lines, highlighting that the insurance of punitive damages is especially prevalent in the EPLI context.[91] While the validity of wrap-around policies has not been tested in court, they are nonetheless written by insurers and purchased by large companies.[92]

Beyond covering punitive damages, many insurers offer policies that contain no exclusion for intentional acts. Of the thirty-two insurers listed in the Betterley Report, twenty-six state that they offer EPLI policies with no intentional acts exclusion.[93] Of the remaining six insurers, three state that exclusions apply for deliberately fraudulent or criminal actions, but only if a court finds in a final adjudication that the action giving rise to the loss was fraudulent or deliberate.[94] Examples A and B below show provisions from sample policies of major insurers to illustrate how intentional, criminal, and fraudulent acts are treated, as well as punitive damages.

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87 *See* Jeffrey P. Klenk, *Emerging Coverage Issues in Employment Practices Liability Insurance: The Industry Perspective on Recent Developments*, 21 W. NEW ENG. L. REV. 323, 331 (1999).

88 *Most Favored Venue Wording*, IRMI, https://www.irmi.com/term/insurance-definitions/most-favored-venue-wording [https://perma.cc/668G-GXWP] (last visited Sept. 3, 2020).

89 *Wrap-Around Policy*, IRMI, https://www.irmi.com/term/insurance-definitions/wrap-around-policy [https://perma.cc/5WRY-B4R2] (last visited Sept. 3, 2020).

90 *See, e.g.*, *Employment Practices Liability*, PHILA. INS. COMPANIES, https://www.phly.com/mplDivision/managementLiability/EPLI.aspx [https://perma.cc/LRR8-FEDR] (last visited Oct. 13, 2020) (listing "[m]ost favorable venue wording for punitive, multiple or exemplary damages" as a benefit of EPLI coverage).

91 Most favorable venue clauses are generally used in EPLI, directors and officers insurance, and professional insurance policies. *See Most Favored Venue Wording*, *supra* note 88; *Wrap-Around Policy*, *supra* note 89.

92 *See Wrap-Around Policy*, *supra* note 89.

93 BETTERLEY, *supra* note 48, at 91–94.

94 *Id.*

EXAMPLE A

Example Policy Language - A	
Employer-Level Fault	Coverage includes "failure or refusal to create or enforce adequate workplace or employment policies and procedures . . ."[95]
Exclusions	None related to criminal, fraudulent, or intentional acts
Most Favored Venue Clause	Covered loss includes "punitive or exemplary damages or the multiple portion of any multiplied damage award if insurable under the applicable law most favored to the insurability of punitive, exemplary, or multiplied damages"[96]

EXAMPLE B

Example Policy Language - B	
Employer-Level Fault	Coverage includes "failure to provide and enforce adequate workplace or employment policies and procedures"[97]
Exclusions	No coverage for employer if a final adjudication determines that the employer committed a deliberately fraudulent or criminal act[98]
Most Favored Venue Clause	"The enforceability of the foregoing coverage shall be governed by such applicable law which most favors coverage for punitive or exemplary damages or the multiple portion of any multiplied damages award"[99]

IV
PREVIOUS CRITICISMS OF EPLI

Discussion on EPLI's desirability has popped up in legal scholarship since it began growing in the mid-1990s.[100] A variety of criticisms have been launched against EPLI, framing it as

95 EMPLOYMENT PRACTICES LIABILITY COVERAGE § II.Y.10, TRAVELERS (2009), https://www.travelers.com/iw-documents/apps-forms/epl/epl-3001.pdf [https://perma.cc/M3H2-XMXB].

96 *Id.* § II.L.

97 *Employment Practices Liability Insurance Policy* § III.G.10, GREAT AM. INS. COS., https://abais.com/Data/Sites/1/media/specimen/sbg/gaic-epli-policy.pdf [https://perma.cc/M5MN-4AEX] (last visited Jan. 31, 2021).

98 *Id.* § IV.A.

99 *Id.* § III.J.

100 *See, e.g.*, Mootz, *supra* note 47, at 4 ("This article analyzes the increasing reliance by employers on liability insurance to manage the risk of employment discrimination liabilities, and predicts some of the consequences of this emerging trend."); Francis J. Mootz III, *Insuring Employer Liability for Hostile Work Environment Claims: How Changes in Discrimination Law May Affect the Growing Market for Employment-Related Practices Liability Insurance*, 21 W. NEW ENG. L. REV. 369,

cutting against the goals of employment law. The criticisms brought against EPLI focus on moral hazard at a general level, along with notions of justice.[101] This Part addresses each of these points in turn and explains why the criticisms are overstated in many EPLI claims. All in all, we find that from all but one angle, EPLI is no more concerning than any other type of liability insurance.

As discussed in subpart III.B, insurance elicits concerns of moral hazard—in other words, that businesses purchasing insurance will choose to invest less in culture and accountability (ex ante moral hazard) and fail to act to minimize the harm from a wrongful employment act that has already occurred (ex post moral hazard). To the authors' knowledge, no EPLI analysis has considered separately how moral hazard affects businesses' ex ante and ex post efforts at addressing wrongful employment acts.

Moral hazard is far from a unique concern in the EPLI context. It has been debated extensively in courtrooms and academic literature and is a problem that is inherent to the very nature of insurance.[102] Thus, in considering the desirability of EPLI, it is not sensible to consider whether EPLI introduces *any* moral hazard into the world but rather whether the moral hazard it introduces raises concerns above and beyond that of the insurance industry more generally.

Some commentators have argued that moral hazard is indeed of special concern in the EPLI context.[103] They claim that businesses face only liability damages as a disincentive from committing wrongful employment acts and that insurance for liability removes this sole incentive.[104] In making this argument, they contrast wrongful employment acts to car accidents, pointing out that a driver deciding how carefully to drive faces potential injury to themself, above and beyond any harm they cause other drivers and pedestrians. Thus, even if they have an insurance policy to pay out any damages to a third party, they are still incentivized to take care in order to avoid

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370 (1999) (discussing the complexity of employment law and insurers' ability to succeed in the market).

101 Joan T.A. Gabel, Nancy R. Mansfield & Gregory Todd Jones, *The Peculiar Moral Hazard of Employment Practices Liability Insurance: Realignment of the Incentive to Transfer Risk with the Incentive to Prevent Discrimination*, 20 NOTRE DAME J.L. ETHICS & PUB. POL'Y 639, 648–49 (2006).

102 *See* Sean W. Gallagher, Note, *The Public Policy Exclusion and Insurance for Intentional Employment Discrimination*, 92 MICH. L. REV. 1256, 1285–86 (1994).

103 Gabel, Mansfield & Jones, *supra* note 101, at 640–41.

104 *Id.*

hurting themself and their own car in an accident. In contrast, these critics suggest that the employee-victim is the only one who is harmed in cases of employment discrimination and harassment, whereas the business is not injured itself.[105]

However, this argument overlooks research on discrimination, harassment, and productivity in the workplace. Businesses do suffer harm in cases of discrimination in terms of both reputational harm and lost productivity from inefficient turnover and absenteeism.[106] This criticism further ignores that many forms of commercial liability insurance track similar incentives as those in the EPLI context. Insureds in the context of medical malpractice, legal malpractice, workers' compensation, commercial general liability, and products liability all face similar incentives as businesses in the EPLI context. The hospital, law firm, employer, business owner, and manufacturer in these contexts do not face potential for direct injury outside of reputational harm and legal liability. In these cases, the main incentive for avoiding third-party injury comes in the form of liability damages.

Some also criticize EPLI as cutting against societal notions of justice.[107] To the extent that EPLI allows discriminators to evade financial responsibility for their actions, victims and society will likely have some justice-related objections. However, this particular criticism is weakened by the fact that the insured businesses and individual employees who commit these acts are not one and the same. Thus, insuring the business is

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105 *See id.*

106 *See* JONI HERSCH, SEXUAL HARASSMENT IN THE WORKPLACE 1 (IZA World of Labor, 2015), available at https://wol.iza.org/articles/sexual-harassment-in-workplace/long [https://perma.cc/7Y9W-G6NJ]; U.S. MERIT SYS. PROT. BD., SEXUAL HARASSMENT IN THE FEDERAL WORKPLACE: TRENDS, PROGRESS, AND CONTINUING CHALLENGES 24 (1995), https://www.mspb.gov/MSPBSEARCH/viewdocs.aspx?docnumber=253661&version=253948&application=ACROBAT [https://perma.cc/2M7P-AAFY]; Louise F. Fitzgerald, Fritz Drasgow, Charles L. Hulin, Michele J. Gelfand & Vicki J. Magley, *Antecedents and Consequences of Sexual Harassment in Organizations: A Test of an Integrated Model*, 82 J. APPLIED PSYCHOL. 578, 583–86 (1997); Joni Hersch, *Equal Employment Opportunity Law and Firm Profitability*, 26 J. HUM. RESOURCES 139, 148 (1991) (showing that firms involved in employment discrimination litigation suffer substantial loss in stock market value); Jana L. Raver & Michele J. Gelfand, *Beyond the Individual Victim: Linking Sexual Harassment, Team Processes, and Team Performance*, 48 ACAD. MGMT. J. 387, 392–95 (2005); Chelsea R. Willness, Piers Steel & Kibeom Lee, *A Meta-Analysis of the Antecedents and Consequences of Workplace Sexual Harassment*, 60 PERSONNEL PSYCHOL. 127, 135–37 (2007); Roger Showley, *Sexual Harassment: A Hit to Business Bottomline?*, SAN DIEGO UNION TRIB. (Dec. 1, 2017, 2:36 PM), https://www.sandiegouniontribune.com/business/growth-development/sd-fi-econometer3dec17-story.html [https://perma.cc/AX3Q-KVAR].

107 *See infra* notes 108–109 and accompanying text.

more like the insurance of a risk to be mitigated than the insurance of an intentional act. A business cannot perfectly screen out employees who will commit unlawful or objectionable acts. This is especially true of large companies, where extensively monitoring every employee would be nearly impossible.

One commentator takes issue with the fact that "insurance companies and institutions use a risk-based logic and institutionalize a way of thinking centered on risk management and reduction."[108] This objection expresses concern that EPLI undermines legal rights because insurers frame the acts underlying employment litigation as risks that "need[ ] to be managed (rather than a sign of morally wrongful conduct that must be eradicated)."[109]

However, this argument seems to disapprove of the exact actions that employment law is designed to encourage. Many instances of discrimination are not the morally wrongful conduct of the business itself but rather acts of its employee(s). Indeed, employment liability is designed not to hold an individual bad actor liable, but rather to hold that bad actor's employer liable through respondeat superior.

To the extent that insured businesses prioritize managing risk and minimizing employees' discriminatory conduct over focusing on the moral wrongness of discrimination and harassment, they are prioritizing the deterrence goal of employment discrimination law. In the same way that businesses are responsible for the physical safety of their employees, they are responsible for ensuring their employees do not experience discrimination or harassment. Both are risks to be managed, and the more effective a business is at managing risks and reducing harm to employees, the better.

While we disagree with the need to think of most employment law violations under a moral framework, given this level of separation between the insured business and its employees committing wrongful employment acts, there are moral undertones in cases of employer-facilitated wrongs. The next Part sums up our assessment of the current EPLI market, with a focus on our concern with the apparent practice of insuring employer-facilitated wrongs.

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108 Shauhin A. Talesh, *Insurance Companies as Corporate Regulators: The Good, the Bad, and the Ugly*, 66 DEPAUL L. REV. 463, 492 (2017).

109 Shauhin Talesh, *Legal Intermediaries: How Insurance Companies Construct the Meaning of Compliance with Antidiscrimination Laws*, 37 L. & POL'Y 209, 233 (2015).

V
ASSESSING EPLI'S IMPACT

Insurance's impact on compensation and deterrence are widely discussed themes within both the law and the insurance literatures. This Part combines insurance theory, our market review, and previous commentary on EPLI to assess the impact of EPLI on employment law's goals.

In reviewing the current EPLI market, a number of factors point toward EPLI being beneficial to society. First, liability insurance reduces the problem of judgment-proof defendants,[110] allowing victims greater access to compensation for harm.

Second, EPLI provides a major benefit to businesses. It allows them to reduce uncertainty and operate their businesses without fear of catastrophic employment liability based on negligence or vicarious liability. Finally, and perhaps most importantly, insurance companies provide loss prevention programs, such as trainings, legal and HR advice, and best practices materials to their insureds.[111] These programs may ultimately reduce the amount of discrimination in the world by harnessing expertise of large insurance companies and HR professionals to inform smaller businesses' employment practices.

On the other side of EPLI's desirability are moral hazard and justice-based notions. Moral hazard provides the easiest and most common basis to criticize any form of liability insurance. This criticism presents a more general problem than that created by EPLI specifically and, as such, is not alone a justification for deeming EPLI undesirable.

To the extent insurance creates moral hazard, it is important to consider whether the level of moral hazard extends beyond a level society is willing to accept. In examining EPLI's effect on deterrence, we split moral hazard concerns into ex

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110 Judgment-proof defendants are those who have insufficient assets to cover the damages from a lawsuit, and insurance funds can supplement their ability to pay. *Judgment-Proof*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/judgment-proof [https://perma.cc/8RYT-3EZC] (last visited Aug. 26, 2020).

111 For example, The Hartford provides trainings on "sensitive topics" such as sexual harassment and wrongful termination, articles on current employment practices trends, and model employee handbooks. *See Employment Practices Liability Insurance*, HARTFORD, https://www.thehartford.com/employment-practices-insurance [https://perma.cc/VF36-EA6X] (last visited Aug. 26, 2020). Many insurers also provide self-audit checklists that help businesses maintain employment best practices. *See, e.g.*, *EPLI Insurance*, GRANGE INS., https://www.grangeinsurance.com/insurance/business/epli-insurance [https://perma.cc/38AA-A52Q] (last visited Aug. 26, 2020) (noting that insureds are granted access to self-audit checklists from The McCalmon Group).

ante moral hazard and ex post moral hazard. Ex ante moral hazard involves the risk that, because of EPLI coverage, businesses will invest fewer resources into strategies that would reduce the likelihood of wrongful employment acts occurring. Ex post moral hazard is the risk that EPLI coverage will cause businesses to take less care in reacting to wrongful employment acts.

We ultimately conclude that nothing exceptional stands out in the EPLI market as far as ex ante moral hazard goes. The incentives and actions of insurers on this issue appear to match reasonably with society's wellbeing, or at least no less than in other insurance markets. However, we argue that EPLI creates a unique and acute problem of ex post moral hazard by providing full coverage for employer-facilitated wrongs.

A. Ex Ante Moral Hazard

The existence of EPLI does not appear to introduce ex ante moral hazard to any greater extent than other forms of commercial liability insurance. First, insurers appear to be monitoring and reducing the likelihood of wrongful employment acts. In the market for EPLI insurance, insurers use a variety of strategies that reduce the amount of moral hazard from their insureds, including deductibles, limits, and charging premiums based on a business's individual risk level.[112] Indeed, insurers themselves have private incentives to reduce moral hazard,[113] so their use of these strategies is unsurprising. When insurers seek to reduce moral hazard for purposes of their bottom line, society benefits as well. Loss prevention programs offered by many insurers are designed to combat ex ante moral hazard and can help disseminate industry best practices to businesses purchasing insurance.

While previous EPLI commentators have argued that the risk-based approach to implementing loss control cuts against the moral notions of employment law,[114] we counter that any shift away from moral notions is appropriate when there is a

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112 *See, e.g.*, Ariel Rubinstein & Menahem E. Yaari, *Repeated Insurance Contracts and Moral Hazard*, 30 J. ECON. THEORY 74, 74 (1983) (suggesting that the practice of setting premium rates based on claims history, which is evidence of an insured's risk level, reduces moral hazard); Ralph A. Winter, *Optimal Insurance Under Moral Hazard*, *in* HANDBOOK OF INSURANCE 205, 207 (Georges Dionne ed., 2d ed. 2013) (discussing deductibles and limits as potential tools for reducing moral hazard).

113 *See, e.g.*, Winter, *supra* note 112, at 205 (describing moral hazard as imposing an externality on the insurer).

114 *See supra* Part IV.

disconnect between the perpetrator and the entity that is held liable for the perpetrator's actions.

B. Ex Post Moral Hazard

At first glance, it would seem that insurers should face the same incentives with regard to reducing ex post moral hazard as with ex ante moral hazard. After all, moral hazard overall is generally bad from an insurer's profit-maximizing standpoint.

However, the structure of the EPLI market as it stands seems to indicate that EPLI insurers have chosen to ignore ex post moral hazard for the most part by purporting to insure employer-facilitated wrongs and punitive damages. Given the lack of case law surrounding insurability for employer-facilitated wrongs,[115] it is hard to say whether a court would allow an insurance policy to stand in such cases. It is possible that if an insurer wanted to challenge insurability on a public policy basis, it could succeed in court.

However, four pieces of evidence seem to point to the fact that insurance is widely available to cover employer-facilitated wrongs. First is the Weinstein settlement itself. If ever there was both a basis for a public policy challenge and a financial incentive for an insurer to dispute coverage, this would appear to be it.[116] Yet, insurers are attempting to foot the settlement bill for Weinstein's serial harassment, even going as far as to note in the (since rejected)[117] settlement agreement that, absent a settlement, some of Weinstein's insurers would dispute coverage based on an intentional acts exclusion.[118]

Second, policy language in available sample policies provides little to no basis for excluding coverage of punitive damages associated with employer-facilitated wrongs.[119] Indeed, the existence of wraparound policies and most favored venue clauses indicate an intent to provide such coverage. Third,

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115 *But see* Manganella v. Evanston Ins. Co., 746 F. Supp. 2d 338, 342, 348 (D. Mass. 2010) (finding that coverage of sexual harassment committed by company's president was excluded under an especially expansive intentional acts exclusion, which had no final adjudication requirement), *aff'd*, 700 F.3d 585 (1st Cir. 2012).

116 Some insurers did attempt to dispute coverage at the outset of the case but are ultimately listed on the settlement agreement.

117 Geiss v. Weinstein Co. Holdings, No. 1:17-Cv-9554 (AKH), 2020 WL 4266925, at *11–12 (S.D.N.Y. July 24, 2020).

118 *See* Settlement Agreement and Release, *supra* note 1, at 130 ("Accordingly, in light of the charges against and conviction of Harvey Weinstein, absent a settlement, the insurance companies would continue to contest coverage in separate insurance coverage litigation with the Defendants.").

119 *See, e.g.*, *supra* notes 95–99 and accompanying text.

twenty-six of the thirty-two insurers surveyed by the Betterley Report do not exclude intentional actions.[120] The remaining insurers only exclude businesses' intentional actions to the extent that they are criminal or fraudulent and are proven to be so in a final adjudicatory judgment.

Finally, many states interpret insurance policies under a reasonable expectations doctrine.[121] While the specifics of the doctrine vary by state, it generally calls for the terms of insurance policies to be interpreted in accordance with the "objectively reasonable expectations of applicants and intended beneficiaries . . . even though painstaking study of the policy provisions would have negated those expectations."[122] This doctrine would further provide a solid basis for an insured to argue that its EPLI policy should be construed in favor of coverage, given the minimal intentional acts exclusions written into many current EPLI policies.[123]

It makes sense that intentional actions are included under EPLI policies for those cases in which an employee commits an intentional wrongful employment action, such as sexual harassment or disparate treatment discrimination, and their employer is held vicariously liable. However, the apparent coverage of employer-facilitated wrongs, via a lack of exclusions for intentional acts along with only minimal exclusions for businesses' criminal or fraudulent actions, generates strong ex post moral hazard concerns.

To the extent that insurers do write coverage for employer-facilitated wrongs and punitive damages, upper management's incentives to act responsibly are at a minimum. As discussed in subpart II.B., punitive damages are meant to incentivize businesses to respond to instances of wrongful employment acts by levying punitive damages in cases of bad faith. However, if an insurer does not hold a business any more or less accountable based on upper management's actions, they will be incentivized to cover up any misbehavior.

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120 *See* BETTERLEY, supra note 48, at 36–37.

121 *See, e.g.*, Clark-Peterson Co. v. Indep. Ins. Assocs., 492 N.W.2d 675, 677 (Iowa 1992) (holding that a coverage exclusion can be overridden by the reasonable expectations doctrine when an "ordinary layperson would misunderstand [the policy's] coverage, or . . . circumstances attributable to the insurer would foster coverage expectations").

122 Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961, 967 (1970).

123 *See, e.g.*, Davidson v. Cincinnati Ins. Co., 572 N.E.2d 502, 508 (Ind. Ct. App. 1991) ("Provisions in an insurance policy, which are unambiguous when read within the policy as a whole, but in effect, provide only illusory coverage, should be enforced to satisfy the reasonable expectations of the insured.").

Previous research on the market for Directors & Officers (D&O) liability insurance can help explain this result. D&O insurance tends to exclude criminal and fraudulent acts in the same way that the stricter EPLI policies do (by final adjudication), providing an apt case study for comparison. Also, EPLI policies are sometimes written as a part of a D&O policy, making them closely related.

As mentioned in Part III, EPLI insurers offer policies that either contain no exclusion for intentional or fraudulent acts, or contain a provision that excludes coverage only if criminal or fraudulent acts are established by a final adjudication. The exclusion of acts that are deemed to be criminal or fraudulent by final adjudication tracks very closely with typical exclusions used in D&O insurance.[124] Tom Baker and Sean J. Griffith have done extensive research on D&O insurance and moral hazard. They suggest that the "final adjudication" language in D&O policies means that in practice, insurers often provide insurance for fraud and criminal activity.[125]

They suggest a few reasons for this. First, plaintiffs often plead facts that maximize their access to insurance funds.[126] Thus, they will avoid pleading facts that indicate criminal activity or fraud — even if such facts exist — in order to maintain access to insurance funds.[127] Second, because most litigation settles, a final adjudication on which to base the exclusion is rarely reached. Lastly, Baker and Griffith state that D&O insurers "understand that, in the long run, their D&O insurance market will dry up if they press too hard on the fraud exclusion."[128]

While it may appear likely that an insurer will cover intentional actions based on the lack of exclusion language in the policy, plaintiffs may still worry (or be advised by their own counsel) that a court could potentially invalidate the insurance coverage and leave them without access to insurance money if they plead that the upper management acted intentionally, fraudulently, or criminally.

Insurers can capitalize on this uncertainty. Indeed, in the Weinstein case, the insurers at issue were willing to offer an $18.9 million settlement rather than risk a larger jury award

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124 *See* TOM BAKER & SEAN J. GRIFFITH, ENSURING CORPORATE MISCONDUCT 187 (2010).

125 *Id.*

126 *Id.*

127 *Id.*

128 *Id.* at 188.

and pay to dispute coverage responsibilities.[129] The combination of Weinstein's apparent bankruptcy and the insurers' threat of disputing coverage reduces the value of the settlement by taking away bargaining power from the plaintiffs. Plaintiffs understand that if insurers were to successfully challenge their coverage responsibilities, there would be minimal funds available for damages.

If, instead, coverage for employer-facilitated wrongs had been tested extensively and were upheld in court, plaintiffs would not shy away from pleading facts of employer-facilitated wrongs. To the extent that plaintiffs avoid pleading such facts due to uncertainty, the potential for punitive damages and the value of a settlement are reduced, and the insurer (and employer) benefit. In sum, it appears that—while legality has not been tested in court—the insurance industry is operating for the most part under the assumption that businesses' intentional, criminal, or fraudulent acts, along with punitive damages, are insurable in the EPLI context.

Tom Baker has argued that the moral-hazard concern surrounding coverage for punitive damages is potentially overblown specifically because most insurance policies contain exclusions for intentional damages.[130] The exclusions for intentional damages, he suggests, negate any perverse incentives that come with insuring punitive damages. Baker's analysis applies to most insurance contexts. However, given that EPLI policies cover punitive damages *and* rarely preclude coverage for intentional acts, the EPLI market is operating in a state of largely unrestrained ex post moral hazard.[131]

VI
PROMOTING ACCOUNTABILITY FOR EMPLOYER-FACILITATED WRONGS

This Part suggests regulatory changes designed to hold businesses accountable for employer-facilitated wrongs. These changes would reduce ex post moral hazard while allowing the benefits created by EPLI to continue.

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129 *See* Settlement Agreement and Release, *supra* note 1, at 120.

130 *See* Baker, *supra* note 62, at 102–03. Baker notes D&O insurance as a potential exception to this analysis and acknowledges that punitive damages coverage in the D&O context may indeed be of concern. *Id.* at 120 n.66.

131 *See, e.g.*, *Employment Practices Liability Insurance for Law Firms*, CHUBB, https://www.chubb.com/us-en/business-insurance/employment-practices-liability-insurance-for-law-firms.html [https://perma.cc/PRD2-2W7W] (last visited Jan. 31, 2021) ("No 'intentional acts' exclusion . . . ").

First, employment laws could place specific restrictions on EPLI contracts relating to employer-facilitated wrongs. These restrictions would ensure that businesses with EPLI coverage would be responsible for a larger portion of damages in cases of employer-facilitated wrongs. Additionally, legislatures could grant the EEOC (and corresponding state and local agencies, known as Fair Employment Practices Agencies)[132]—the ability to pursue uninsurable regulatory fines against businesses that enable discrimination.

Both proposed changes would increase the expected cost associated with employer-facilitated wrongs and, in turn, incentivize businesses to implement reasonable reporting systems and take action when faced with a wrongful employment act.

A. Regulating Insurers

The first group of strategies to improve accountability involves regulating EPLI contracts. Our two proposed changes—right to subrogation and mandatory coinsurance—would both increase the amount a business would owe in cases of employer-facilitated wrongs. At the same time, these changes would not upset the amount of victim compensation available.

While insurance is typically regulated at the state level, it is occasionally regulated at the federal level. Indeed, ERISA—an employment law that EPLI does not cover—has regulated insurance as it applies to covering violations of ERISA.[133]

Because many employment suits are brought under federal law, such as Title VII, the ADA, or the ADEA, Congress could feasibly amend these statutes to place restrictions on the EPLI market. Notably, any state legislatures making similar changes would need to explicitly disavow most favored venue clauses to combat insurers' attempts to circumvent state regulation of punitive damages. Both Congress and any state legis-

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132 *See How to File a Charge of Employment Discrimination*, U.S. EQUAL EMP. OPPORTUNITY COMM'N, https://www.eeoc.gov/how-file-charge-employment-discrimination [https://perma.cc/EC42-J8PX] (last visited Aug. 29, 2020).

133 29 U.S.C. § 1110 (2018) ("Except as provided in sections 1105(b)(1) and 1105(d) of this title, any provision in an agreement or instrument which purports to relieve a fiduciary from responsibility or liability . . . under this part shall be void as against public policy."); 3 SUBCOMM. ON LABOR OF THE S. COMM ON LABOR AND PUBLIC WELFARE, 94TH CONG., 2d Sess., LEGISLATIVE HISTORY OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, at 320–21 (Comm. Print 1974) ("The substitute also provides, however, that a plan may purchase insurance for itself and for its fiduciaries to cover liability or loss resulting from their acts or omissions if the insurance permits recourse by the insurer against the fiduciaries in case of a breach of fiduciary responsibility.").

latures would need to disavow the legality of wrap-around policies to avoid coverage from off-shore policies.

1. *Mandatory Risk Sharing*

As mentioned in subpart III.B, all insurers currently offer EPLI policies that carry zero percent coinsurance. While insureds may purchase a policy with a nonzero coinsurance rate in exchange for a lower premium, this is not required. We suggest that one means for realigning businesses' incentives with the goals of deterrence could be requiring a mandatory minimum coinsurance rate in the case of employer-facilitated wrongs. Under this proposal, all EPLI contracts would be required to contain a clause with a minimum coinsurance rate that would kick in for cases of employer-facilitated wrongs. Such a provision, as long as the minimum mandated coinsurance rate is set high enough, would create a needed incentive for businesses to implement reasonable reporting systems and address wrongful employment acts head-on as they are made aware of them.

2. *Subrogation*

Another potential solution may be to mandate that all EPLI contracts contain a right to subrogation in cases of employer-facilitated wrongs. In general, subrogation allows an insurer to pursue a lawsuit against the wrongdoer in place of the victim.[134] In the typical subrogation context, an insurer will pay out a claim for losses to make the victim whole. The insurer will then seek to recover the money paid in that claim from the wrongdoer. Figure 1 illustrates the current structure of employment claims when EPLI is involved, while Figure 2 illustrates what the process would look like if subrogation existed as we envision.

[134] *See* Julia Kagan, *Subrogation*, INVESTOPEDIA (Aug. 19, 2019), https://www.investopedia.com/terms/s/subrogation.asp [https://perma.cc/WHV6-94HX].

Figure 1. Current System

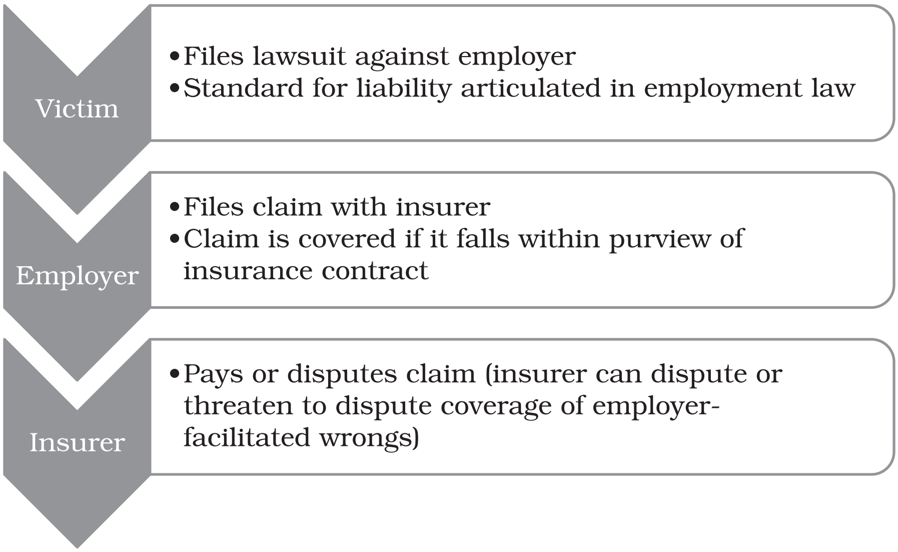
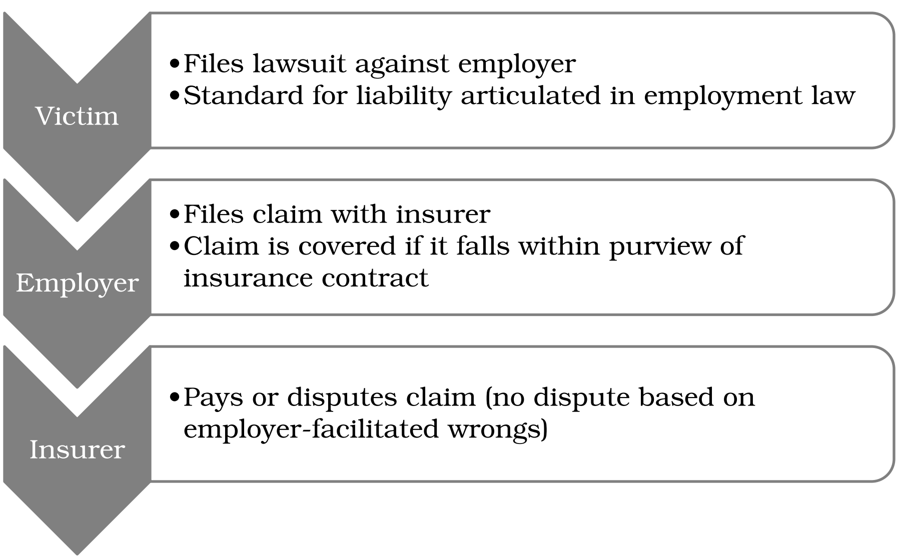


Figure 2. Proposed System

Step 1:



Step 2:

Insurer

- Files lawsuit against employer
- Standard for liability is failure to set up a reasonable reporting system or involvement/awareness of upper management

Employer

- Can settle
- If court determines the standard for employer-facilitated wrong is met, the employer owes the insurer any money paid to the victim in settlement or damages

Subrogation is traditionally only brought by an insurance company against a third party. In fact, in most instances it is impossible or illegal for an insurance company to bring a subrogation action against its own insured.[135] We argue that in cases of employer-facilitated wrongs — which are already incredibly unique to the extent they are insurable—such subrogation is a desirable possibility.[136]

3. *Promoting Victim Compensation*

One might wonder why — if the moral hazard issue is so concerning — it isn't desirable to just place an outright ban on insurance coverage for employer-facilitated wrongs. The short answer is that ideally, victims of employer-facilitated wrongs should not bear the burden of insufficient funds to pay damages. Rather, we argue, this burden should be on insurance companies.

Another line of insurance — commercial crime insurance — provides a useful framework for explaining this point. Commercial crime insurance provides employee theft coverage, which insures against any employee's theft of a business's

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135 Craig F. Stanovich, *Subrogation and the CGL Policy*, IRMI (Dec. 2013), https://www.irmi.com/articles/expert-commentary/subrogation-and-the-cgl-policy [https://perma.cc/4DPX-QT5L]; *see Antisubrogation Rule*, BLACK'S LAW DICTIONARY (11th ed. 2019).

136 Rick Swedloff argues that if insurers were to offer coverage for intentional torts, subrogation against an insured would be appropriate. *See* Rick Swedloff, *Uncompensated Torts*, 28 GA. ST. U. L. REV. 721, 759 (2012).

money or property.[137] Commercial crime insurance resembles EPLI coverage in that it covers bad acts by employees.

Unlike EPLI, the commercial crime insurance market has come to exclude coverage for any crimes that are committed directly by company owners or partners.[138] Commercial crime insurance further excludes coverage for any crime committed by an employee if the owner was aware of a prior theft by that same employee.[139] In other words, commercial crime insurance creates incentives for owners, partners, and other company decision makers to avoid participating in employee theft and to take an active role in combatting employee theft. Both of these exclusions mirror our concerns of employer-facilitated wrongs.

When upper management fails to address an existing employment wrong of which it is aware, it can still benefit from EPLI coverage. In contrast, if a business owner fails to address even a *risk* of employee theft — as evidenced by that individual employee's prior theft record — the business cannot benefit from its commercial crime insurance policy. Thus, in the ways that EPLI fails at reducing ex post moral hazard, commercial crime insurance succeeds. Commercial crime insurance has essentially eliminated coverage for its equivalent of employer-facilitated wrongs.

The difference between commercial crime insurance and EPLI is that no third party is harmed in cases of employee theft. Commercial crime insurance covers theft of the insured business's own property. EPLI, in contrast, involves harm to a third party — the wronged employee. Thus, EPLI presents the additional consideration of the availability of damages to properly compensate the injured employee.

In both of our suggestions to regulate insurance contracts, the victim of an employment wrong would not lose out on insurance funds because of upper management's fault. In these situations, any insurance funds would be available to victims in cases of employer-facilitated wrongs, and it would be between the insurer and the insured business to determine the split of liability between them. By making it clear that upper management's fault does not drive the existence of insurance

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137 *See The Basics of Commercial Crime Insurance*, MARSH, https://www.marsh.com/us/insights/research/basics-of-commercial-crime-insurance.html [https://perma.cc/VM3L-4532] (last visited Aug. 29, 2020).

138 *See* Adrian Mak, *Commercial Crime Insurance*, ADVISORSMITH (Dec. 18, 2020), https://advisorsmith.com/commercial-crime-insurance/ [https://perma.cc/E28R-F6GK].

139 *Id.*

coverage — and rather is only relevant as to what the business owes the insurer — society would be able to avoid situations like that of Weinstein, where insurers are seemingly using the threat of a coverage dispute to lower the settlement's value.

Additionally, entirely banning insurance for employer-facilitated wrongs would create an even stronger incentive for plaintiffs to strategically plead facts that avoid the issue of upper-management involvement. As mentioned above, plaintiffs often prioritize access to insurance money and seek to craft complaints such that insurance coverage is available.

Thus, even in cases where upper management acted intentionally, the wronged employee would have an incentive to avoid bringing that fact to light. This would lead to the same outcome as the current system, in that businesses would likely not be held any more accountable for employer-facilitated wrongs than other wrongful employment acts in which upper management responds appropriately.

4. *Potential Downsides to Insurance Regulation*

The greatest criticism of combating ex post moral hazard through insurance regulation is that insurance companies may refuse to spend the money to investigate whether a claim is the result of an employer-facilitated wrong. Indeed, this is an issue in both insurance-based solutions we offer. As was the case in the proposed Weinstein settlement, insurers made the conscious choice to offer a settlement worth $18.9 million rather than risk greater damages at trial and pay to dispute their coverage responsibilities.

However, the current EPLI market is a result of competition that has created a pressure to provide coverage for punitive damages and employer-facilitated wrongs. Further, the uncertainty surrounding insurability in cases of employer-facilitated wrongs means that insurers can use the threat of coverage disputes to pressure plaintiffs into lower settlements. By requiring contractual provisions that would both clarify coverage in cases of employer-facilitated wrongs and place the burden of insured businesses' bankruptcy on the insurer — rather than the victim — the status quo would change and likely leave insurers with a more stable ground and better incentives to challenge their share of liability. Regardless, the next subpart discusses a supplemental solution that could help alleviate this concern.

B. Creating Uninsurable EEOC Fines

Although not its primary role, the EEOC has the authority to litigate on behalf of injured employees. From a deterrence standpoint, the main problem with the current setup is that any damages resulting from these suits are insurable, just as those brought by private parties. Regulatory fines, in contrast, are generally excluded from insurance contracts except in the data privacy context.[140]

With regard to public enforcement, the simplest policy solution is to have any damages awarded from EEOC litigation subject to the same standards we propose for suits brought by employees; that is, require proportional risk sharing and allow subrogation against businesses sued by the EEOC for cases of employer-facilitated wrongs. This option would then parallel the insurance regulation structure we propose for businesses sued by employees instead of by an agency.

To combat the concerns described above about insurer enforcement, we additionally suggest that legislatures grant the EEOC and state agencies the power to pursue uninsurable regulatory fines in cases of employer-facilitated wrongs, above and beyond damages for individual victims. The idea of uninsurable regulatory fines would parallel fines in many other regulatory structures. It is unique that the risk associated with the EEOC's sole enforcement mechanism can be transferred entirely to an insurance company. Currently, a company that purchases an EPLI policy is completely shielded from any action the EEOC wishes to bring, as long as it is willing to pay the right price for its premiums.

This change would leave in place the EEOC's traditional mission while promoting deterrence and reducing ex post moral hazard, without reducing the amount of money available to victims for compensation. Further, the addition of uninsurable regulatory fines would allow the EEOC to supplement insurers' responsibility in holding businesses responsible for employer-facilitated wrongs.

CONCLUSION

The creation and expansion of the EPLI market have reduced loss uncertainty for businesses wishing to transfer risk of employment liability. Moreover, EPLI insurers couple exten-

140 *Regulatory Defense and Penalties Coverage*, IRMI, https://www.irmi.com/term/insurance-definitions/regulatory-defense-and-penalties-coverage [https://perma.cc/LMN9-LMD4] (last visited Aug. 29, 2020).

sive risk management programs with their coverage offerings, designed to help businesses comply with employment law. Coverage also generally expands the funds available to victims of wrongful employment acts.

Along with these benefits, however, comes one considerable cost. The current structure of the EPLI market seems to generate strong ex post moral hazard. By providing full insurance for actions that are either facilitated or covered up by high-level employees, EPLI removes incentives to address wrongful employment acts at the company level.

Legislators could address this by regulating EPLI contracts and granting the EEOC the power to issue uninsurable fines. Both options would incentivize businesses to take appropriate actions in the face of wrongful employment acts without disturbing the benefits created by EPLI.