

**Circling Your Wagons:**  
**Controlling Legal Risks In Today's Litigious Workplace**

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Hiring and managing employees today is risky business for any employer but particularly for a smaller one. There are over 586 pages of regulations in California's Labor Code. There are over two dozen major federal and state laws regulating employment that require compliance by employers with as few as one worker. Over a dozen federal and state agencies exist for the sole purpose of enforcing compliance with the various labor and employment laws and regulations. Several of them have authority to award punitive damages if a violation is found.

Most of these employment laws were passed when many employers were larger and could afford the in-house legal and human resources expertise required to achieve compliance and avoid legal problems. Now smaller businesses are faced with having to comply, but don't have the deep pocket resources necessary to protect themselves. And smaller businesses continue to be the growth area in Orange County and national economies.

In Orange County, 95% of the businesses employ 50 or fewer employees. In California, employers of 100 or fewer workers comprise 97.4% of the state's workforce. Nationally, employers of fewer than 100 employees constitute 98% of the employers.

**Lawsuits Increasing**

Courts and the plaintiff's bar have upped the ante for smaller businesses as well. Federal and state employment-related lawsuits have been steadily increasing since the 1990's. Today they comprise a significant percentage of the law suits file in the United States and particularly in California. According to the Trial Digest of Oakland, for the years 2000 and 2001, in the state and federal courts of California, the average jury verdict in employment cases was a startling \$1,105,020.

Plaintiffs and contingency fee lawyers are attracted to the prospect of recovering high dollar awards from juries, such as the \$50 million verdict against Wal-Mart for sexual harassment, the \$7.1 million verdict against the law firm of Baker & McKenzie for sexual harassment and the \$17.6 million verdict against Texaco for race discrimination. In the last two years, court approved settlements, involving overtime claims, against Allstate, Farmers, City of Houston, Radio Shack, Starbucks, Computer Sciences Corp., and Merrill Lynch have totaled over a staggering \$379,000,000.

Following the maxim used in "Jurassic Park" that "life will find a way", smaller businesses have had to protect themselves in some creative ways. The practice of using temporary employees rather than hiring employees to meet permanent staffing needs is growing yearly. According to a survey conducted by the Consumer Survey

Center of Half Moon Bay, California, among executives of the nations 1,000 largest companies, 82% of the respondents indicated they now include temporary help in their human resources budget.

Using independent contractors to perform work that could be done by full or part-time employees is another means of avoiding the legal requirements of being an employer. The use of these contractors has grown considerably in the past several years and the practice is increasingly being scrutinized by the IRS and California's EDD.

### **Risk Reduction**

Professional employer organizations (PEOs) have developed to reduce risks in the employment area for smaller businesses. PEOs actually assume primary responsibility for the most heavily regulated aspects of the employee-employer relationship for their clients. Their expertise lies in complying with the regulatory and reporting requirements of the various laws controlling employment, thus relieving their clients of any risks. However, much of the law controlling the co-employment relationship that exists between a PEO and its client remains unsettled. Regardless, the PEO industry has grown by 30% annually over the past three years. Some PEOs now are publicly traded and many "employ" over 100,000 employees.

Defense oriented law firms have even gotten into the act. Business law firms, for example, have created various asset protection strategies such as limited liability partnerships and corporations that protect owners, directors and shareholders from the liability and personal financial risks that could follow from being held liable in an employment related suit. Sole partnerships are relics of a less litigious marketplace.

Defense side employment law firms have also established practices which advise their smaller clients regarding hiring and managing their employees in proactive ways that not only prevent problems, but improve organizational and individual performance as well. Applicant drug testing and pre-employment agreements providing for the submission of all employment related claims to binding arbitration are processes being recommended to combat legal exposure.

Additionally, the employment practices assessments are being conducted by law firms and HR consulting practices with in-house employment law expertise, under the protection of the attorney-client privilege, to diagnose and treat discrimination, hiring, management, compensation and termination challenges before claims and suits can be filed. Legal services including the drafting of results-focused human resource management policies, practices and procedures and providing the supervisory training required to consistently implement them also are being offered as ways to "litigation-proof" client's businesses.

Finally, the insurance industry has entered the fray. Employment practices liability insurance (EPLI) is now being made available to smaller businesses by major carriers. EPLI covers the defense of most employment-related claims such as negligent hiring, wrongful termination, discrimination or sexual harassment. To qualify, a smaller

business must complete an extensive application that asks about employment litigation history, hiring and management practices and the availability of in house or outside human resources expertise. The annual premium for EPLI coverage for a firm with 30 or fewer employees is around \$5000.

### **Evaluating EPLI**

As with most insurance products, EPLI policies come in a wide variety of coverages. The cost of premiums, coverage limits, deductibles and coinsurance rates vary with each policy. Additionally, these policies differ in myriad dimensions, all of which must be considered in determining the value of particular policy. There are some important questions to ask in evaluating EPLI policies such as:

- ← What are the coverage limits and deductibles? Rarely do EPLI policies cover the entire amount of a claim. Some have substantial deductibles; others allow a cap on the insurer's liability. Usually, paying a higher premium may expand the range of coverage.
- ← Who is insured? Is just the corporation covered, or are officers, managers, employees, and former employees also included? With increasing frequency, managers and even non-management employees are being sued in employment cases, and in many states the employer must indemnify the employee (or former employee) for any damages paid and for defense costs.
- ← What damages are covered? Most policies provide coverage for damages attributable to lost wages and emotional distress damages, but in states such as California, coverage for punitive damages is not allowed, making EPLI coverage and incomplete solution to the problem of exposure to employment claims.
- ← When does the insurer's duty to provide coverage arise? In many policies, the insurer has no obligation to pay defense costs or pay settlement fees until an actual lawsuit has been filed. Pre-litigation settlements, of the cost of participating in a lengthy EEOC investigation, may not be covered. Better policies, however, provide for coverage to begin as soon as the claim is made.
- ← Who chooses defense counsel under the policy? In many EPLI policies, the insurer retains the absolute right to appoint counsel to defend any lawsuit that may arise. Thus, the insured has no say in who will be defending the lawsuit, even though the lawsuit might leave the insured with substantial liability in excess of the policy limits. The right to appoint counsel may be negotiable with some EPLI carriers. So, if agreed to, an employer can still purchase the right to use its regular employment counsel to defend any litigation under the policy.

### **Employer Alliances**

Some EPLI insurance carriers and brokers have formed alliances with employment law firms having preventive capabilities to help their insured qualify for coverage, reduce premium costs and avoid claims under the policies. These alliances reduce risks in the employment practices area in much the same ways as the insurance industry helped its clients reduce their workers' compensation risks by implementing policies and practices that emphasized workplace safety. Likewise, human resources

policies that achieve compliance with the various federal and state laws governing employment and result in better dispute-resolution, hiring, performance management, compensation and termination practices will lower employment practices risks.

The reality of today's workplace is such that smaller businesses are being forced to comply with complex employment laws that in the past were intended for a relatively few much larger organizations. To succeed, smaller businesses must educate themselves and then proactively take advantage of the many ways that exist today to reduce their exposure.

Utilizing available legal and HR consulting expertise and securing EPLI coverage from a reliable carrier that emphasizes the importance of preventive human resource management are of the best ways of avoiding the potentially disastrous consequences that could follow from employment litigation.

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