

State of the Market
Wage and Hour
October 2016

Wage and Hour

Claims Are on the Rise, Not Expected to Fall Soon

Takeaway

Several changes implemented recently by the federal government have increased the number of claims for wage and hour (W&H) violations made against employers substantially, and more are on the way. W&H coverage has never been easy to come by. Existing availability for coverage remains stable, but with a negative outlook as the impact of these rules are absorbed. Carriers will continue to ratchet down terms and sublimits and ramp up pricing, and claims are expected to continue sharply upward in 2017, as these new rules take effect.

New federal overtime rules taking effect in December 2016 will extend overtime pay protection to 4.2 million workers who are currently exempt. That, as well as proposed rules that would require companies to provide a breakdown of pay by race, gender and ethnicity will likely bring more allegations of W&H violations.

Also, the National Labor Relations Board refined its standard for determining joint-employer status in 2015, allowing that two or more entities could be considered employers of a single workforce. The decision creates weighty W&H liability for franchisors. States are also putting pressure on employers by enacting laws that allow individual managers to be held liable for W&H claims.

Unfortunately, W&H violations are rarely covered by employment practices liability insurance (EPL). Many U.S. carriers are willing to endorse their standard EPL forms, on a case-by-case basis, to grant defense costs only W&H coverage, up to a specified sublimit. In very limited situations, indemnity coverage – not just defense – is available.

Overview

Wage and hour (W&H) exposure is an often misunderstood and frequently underinsured risk. Naturally, a business seeking protection from the catastrophic exposure of W&H violations may look into purchasing Employment Practices Liability (EPL) insurance. However, to their dismay, W&H violations are largely excluded in EPL policies.

What is W&H? It is commonly – and incorrectly – assumed that W&H claims are restricted to either misclassification of exempt/nonexempt employment status or failure to pay overtime. However, W&H liability also includes allegations such as underpayment of overtime, not paying overtime, miscalculating wages, refusing breaks, expecting employees to work off the clock, not paying employees regularly, refusing to pay exempt employees for absences, and following federal minimum wage guidelines when state guidelines warrant higher pay.

When the Department of Labor's Fair Labor Standards Act (FLSA) was passed in 1938, wage and hour claims were born. The law defined which employees were to receive overtime pay (nonexempt) and which were not (exempt). Since that time, W&H claims have risen steadily, with sharp increases starting in 1993 and increasing year over year.

Recent Claims and Settlement Activity

Multi-plaintiff wage and hour lawsuits are expensive, and they pose a substantial threat to employers today.

- ▶ The number of W&H cases increased 28% in 2015, marking a continued upward trend, with a 58% rise in cases from 2013 to 2015¹

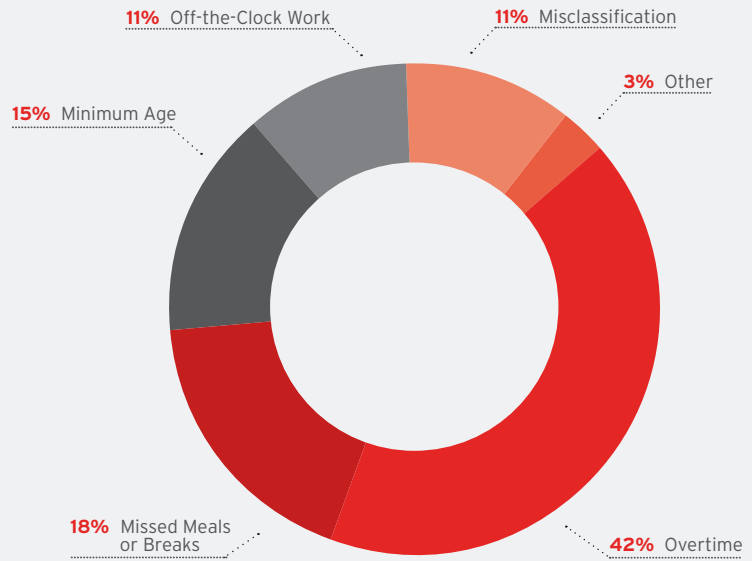
Sample Wage and Hour Exclusion

Based upon, arising out of, directly or indirectly resulting from, or in consequence of, or in any way involving any actual or alleged violations of any federal, state, local or foreign wage and hour laws, whether statutory or common law, including without limitation, the Fair Labor Standards Act, including any amendments thereto.

- ▶ Federal court cases filed under the Fair Labor Standards Act (FLSA) in 2015 numbered 8,954. For context, that number is up from 6,793 in 2011, 4,021 in 2005, and 888 in 1990.²
- ▶ Some estimates put average settlements between \$1.9 million and \$6.9 million. NERA's overall median settlement amount from 2007-2015 was \$2.2 million.³
- ▶ Notable recent settlements include: Brinker Restaurant Corp for \$56.5 million involving 108,000 workers, City of Los Angeles for \$26 million involving 1,074 trash truck drivers alleging they were refused breaks, and Walgreens Co. for \$23 million involving 40,000 workers alleging they were denied overtime and breaks over 7 years.⁴

MOST COMMON ALLEGATIONS IN WAGE AND HOUR CASES

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Source: NERA

Federal Legislation and Regulation

New legislation and changes to employment rules, combined with a presidential election cycle are putting more strain on the W&H market. Some of the more significant action at the federal level includes the following:

- ▶ **Overtime Pay Rules:** On December 1, 2016, the new federal overtime rule will take effect. Under the updated FLSA overtime regulations, the definitions of exempt and nonexempt workers have been redefined. Thus, overtime pay protection will extend to 4.2 million workers who currently earn less than \$47,476 annually.⁵ It also establishes a mechanism for automatic updates every three years, beginning on January 1, 2020 expanding the number of employees falling under W&H guidelines.
- ▶ **Franchisors:** In the August 2015 Browning-Ferris Industries decision, the National Labor Relations Board refined its standard for determining joint-employer status. The decision held that two or more entities could be considered employers of a single workforce if (1) they are both employers within the meaning of the common law; and (2) they share or codetermine those matters governing the essential terms and conditions of employment.⁶ This decision impacts staffing firms, subcontractors, and franchisees, such as fast-food operations.
- ▶ **Equal Pay:** In January 2016, the Obama Administration proposed new rules that would require companies to report what their employees are paid, broken down by race, gender, and ethnicity. Meant to close the gender pay gap, the new rules would apply to employers with 100 or more employees.

Regional Considerations

In some states, the impact of legislation and court decisions has caused carriers to limit drastically any available coverage or simply not offer it.

California: An active plaintiff's bar and regulatory environment has created a wave of lawsuits.

- The California Fair Day's Pay Act which took effect January 1, 2016 holds employers responsible as well as any "other person acting on behalf of an employer" for violations of any provisions regulating minimum wages or hours and days worked, which has made it possible for employees to file suit against individual managers. The law states "Any employer or other person acting on behalf of an employer" who violates the Act would be subject to a fine of \$50 per underpaid employee for each pay period in which the employee was underpaid, which is "in addition to an amount sufficient to recover underpaid wages." Each subsequent violation would result in a \$100 fine for each underpaid employee and each pay period, with the same wage-recovery stipulation.⁷
- California experiences higher-than-average W&H claim activity. As a result, many carriers have exited the state, and those that remain have tightened terms. This increased exposure has driven up the price of EPL, as reflected in higher premium rates, deductibles and self-insured retentions.

Texas: The Texas Payday Law, which applies to private employers, gives employees the ability to file a wage claim in any dollar amount, and has no limits on the size of the business or the number of employees. Employers are mandated to set pay schedules, have regulatory authority over payroll deductions, and regulate final paycheck amounts.⁸



Florida: An active plaintiff's bar has resulted in a 400% spike in W&H litigation in southern Florida, which has been fueled by its large service industry and a recognition that W&H suits are more likely to be settled in the plaintiff's favor.⁹

Massachusetts: Effective July 2018, a Massachusetts law will strike to close the gender wage gap by barring companies from asking prospect employees to state their salary prior to a job offer. This law will ensure that historically lower wages and salaries assigned to women and minorities do not follow them for their entire careers.¹¹ In addition, the law will ensure that companies do not prohibit employees from sharing their salary and broadens the definition of equal work.

Placement Considerations

For the most part, the insurance marketplace has not seen new entrants in the W&H coverage space. Existing carriers have reduced their offerings, including restricted coverage and terms.

Small to Mid-Sized Businesses

For small and mid-sized employers, generally coverage has been restricted to sublimited defense costs only, with no indemnity for judgments or settlements and even that restricted offering may be unavailable in certain regions and for certain classes of business, such as healthcare, restaurants, and franchisee business.

Currently, the defense costs only sublimits range from \$50,000 to \$150,000 to the small and middle markets. In a small number of cases, employers may be able to negotiate an option to \$250,000. However, carriers have begun pulling back in light of increased focus on W&H legislation and attention from the plaintiff's bar.

In states where the risk is higher, those limits are tightened even further, or not offered. With more than 20 percent of W&H claim cases costing employers over \$1 million and 50 percent costing over \$100,000¹⁰, the pressure on premiums and availability will continue in the near future.

Large Businesses

Overseas, with roughly \$100 million in capacity, options for standalone or blended W&H and EPL coverage is still available, though mostly reserved for the Fortune 500 or larger companies. The Bermuda and London markets continue to quote coverage with large retentions and heavy premiums. For smaller companies, standalone W&H is simply not available at an affordable rate.

Other Solutions

As rules change regarding individual liability, Side A Difference-in-Conditions (Side A DIC) is a necessary coverage that can protect directors or officers from personal liability in W&H claims, particularly where no indemnification is available from the company.

Prevention is always the best line of defense. Therefore, beyond insurance, employers can reduce their risks in a few ways:

- Employers can assess the risk within the company, starting with the State and Local Government Self-Assessment Tool from the U. S. Department of Labor's Wage and Hour Division
- Review exempt/nonexempt employee classifications regularly and update/revise job descriptions
- Enact policies that prohibit employees from working when off the clock
- Review managerial practices to ensure that supervisors are discouraging work after hours
- Understand the state wage and hour laws, as well as what changes are happening federally
- Consult with outside counsel to assist in navigating the wage and hour field

Conclusion

The W&H market is at a crossroads. As new legislation and changes to employment rules come into effect, the market is expected to harden. While there remains plenty of overall market capacity, carriers are unwilling to allocate that capacity to the W&H space.

There is a clear disconnect in the insurance marketplace between need and availability of W&H coverage, particularly for the small to mid-sized employer. For now, coverage availability is stable with a slight reduction. Should the supply of W&H coverage remain the same and claims increase dramatically, either a shortage of available product or a significant increase in premium could occur. Likewise, there's some concern that remaining carriers could opt to exit the market.

Coverage, while difficult to come by, is available. More often, the right relationship with a wholesale broker that has connections and industry expertise, like CRC, CRC Swett or SCU, can make the difference when it comes to navigating this complex marketplace.



For more information, contact your CRC, CRC Swett or SCU broker.
To find a conveniently located broker visit us on the web at:
crcins.com, crcswett.com or scui.com.

Endnotes

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