Defense-Cost Indemnification in Excess-Liabiliy Policies

Limited-Coverage Provisions Can Add Up to Trouble for Agent

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How would you feel if you sold an excess-liability policy to your client that you thought provided defense-cost coverage only to discover it did not?

How about an excess-liability policy that forced the insured to fund its own defense (even if defense costs amount to millions of dollars) and did not pay any defense costs if the insured took the claim to trial -- and won!?

Excess-liability insurers are disputing defense-cost coverage under even the clearest language. As such, you need to do whatever you can to help your clients avoid such coverage disputes, and help yourself avoid errors-&-omissions claims.

There are several typical forms of defense-cost coverage provisions in excess-liability policies. Some read as though they provide coverage for defense costs as they are incurred for potentially covered claims. Some cover defense costs only after the underlying claim is resolved. Still others cover defense costs after the underlying claim is resolved, but only on a proportionate basis.

It is this last type of provision where the insured could incur millions in uncovered defense costs if it settles the underlying claim for an amount within the self-insured retention (SIR) or deductible of the excess-liability policy, or if the insured takes the case to trial and wins.

The best type of excess-liability policy covers defense costs as they are incurred for potentially covered claims. In other words, the liability policy acts like a comprehensive-general-liability policy containing a duty to defend.

Litigation Over Language

Insureds have been locked in heated litigation with excess-liability carriers for the past several years over whether the following standard excess-liability coverage language provides such defense-cost coverage:

Insuring Agreement

"The company will pay on behalf of the insured all loss that the insured becomes legally obligated to pay on account of personal injury, property damage or advertising injury."

Loss Payable Condition

"The insured shall make a definite claim for any loss for which the company may be liable under the policy after the insured shall have paid an amount of loss in excess of the amount borne by the insured [i.e., the SIR or deductible] or after the insured's liability shall have been fixed and rendered certain either by final judgment against the insured after actual trial or by written agreement to which the company consents, if any subsequent payments shall be made by the insured on account of the same occurrence, additional claims shall be made similarly from time to time. Such losses shall be due and payable within thirty (30) days after they are respectively claimed and proven in conformity with this policy."

In the past several years, insurers have argued that the provisions quoted previously obligate them to provide coverage for defense costs only after the underlying claim is resolved. The carriers also argue that if the insured settles the underlying claim for an amount within the SIR or deductible applicable to the policy, or takes the case to trial and wins, the policy does not provide any coverage.

What Producers Can Do

Such arguments are belied by the very language of the policies and by most court decisions. What can agents and brokers do to address possible major coverage problems in a placement or renewal? The agent or broker could procure a letter of intent from the excess-liability carrier, making it clear the insurer understands that the defense-cost coverage in the policy obligates the insurer to pay for such expenses as they are incurred for potentially covered claims.

An alternative to a letter-of-intent approach is a revision to policy language. One court has construed an excess-liability policy containing the following language as providing the same defense-cost coverage as a policy that has a duty to defend:

"The company will pay on behalf of the insured all court costs and reasonable attorneys' fees on account of any loss, claim or damage which, if established against the insured, would constitute a valid and collectible loss under the terms of this policy."

The court did ***not*** say that the insurer had a duty to defend. Rather, the court said the same "potentiality" standard that applies to duty-to-defend policies applies to the excess-liability policy containing this provision. In other words, the insurer has the duty to pay defense costs as they are incurred for potentially covered claims.

Keep in mind the insurer that issued the policy with this language disputed that interpretation, which is why the language was the subject of litigation.

A possible way to close the door on an insurer disputing the meaning of the language quoted previously is to add the phrase "as they are incurred" after "fees" and before "on account of." Then again, perhaps a letter of intent on this subject is the better alternative.

Defense-cost coverage that your client might be able to live with is coverage that pays for all defense costs incurred for potentially covered claims, but not until after the underlying claim is resolved. Such coverage is typically afforded in policies that contain variations of the language quoted previously with one important additional phrase, one that includes language identical or similar to the following:

"The company shall not be obligated to pay any loss until the underlying claim is resolved either by trial court judgment or by agreement to which the company consents."

When Is Coverage Available?

One issue being raised by excess-liability insurers, however, is whether policies containing such language provide coverage for potentially covered claims or only actually covered claims that have been settled or taken to judgment for amounts in excess of the SIR or deductible.

Accordingly, brokers are advised to address this important issue either with express policy language or a letter of intent.

The third type of defense-cost provisions, proportionate-basis coverage, has to be the most worthless, in my opinion. I can't imagine why any in-

sured would want this type of coverage if it really understood the dangers inherent in using it. An example of such coverage is as follows:

> "We have neither the right nor the duty to defend a 'suit' seeking damages or to investigate or settle any claim or 'suit,' nor does this policy apply to 'loss adjustment expense,' except as outlined below...
>
> "'Loss adjustment expense' will be apportioned between you and us as follows:
>
> "a. If the amount of the judgment or settlement exceeds the amount of the 'retained limit,' all 'loss adjustment expense' in connection therewith will be borne by the insured and us in the same proportion as the insured's and our respective obligations for payment of the judgment or settlement.
>
> "b. If the amount of the judgment or settlement does not exceed the amount of the 'retained limit,' or if the claim or 'suit' is settled without payment of damages, the amount of the 'loss adjustment expense' shall be borne solely by the insured."

Under this language, if the insured incurs $30 million in defense costs battling a life-or-death lawsuit for the company, and wins, the insured has to pay the entire $30 million. That's not my idea of excess-liability coverage protection; it looks more like an E&O claim against the broker unless the insured knew what it was buying.

If you place an excess-liability policy with this type of language in it, I highly recommend that you discuss with your client the different ways it can get burned by this language and confirm it in writing. If your client decides to purchase the insurance (why, I can't imagine), at least you should be protected from an E&O claim.

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