Five Tips: Insurance Fundamentals For In-House Counsel

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Many of our posts address specific issues for risk managers and in-house attorneys with insurance coverage experience. Recognizing that some in-house lawyers are relatively new to the insurance world, we thought some may appreciate a summary of some of the fundamental issues in insurance coverage. Today, we offer five sets of distinctions between related concepts at the heart of many insurance matters:

First-Party vs. Third-Party Coverage

First-party coverage pays you for loss or damage to your own property. For example, if your plant suffers a fire, you may want to make a claim under the property policy for damage to the building, equipment and machinery. The same policy may include business interruption coverage that can replace some of the profits lost while the plant is not operating normally. Third-party coverage pays another party for your potential liability to it. If that same fire started in your plant and spread to a neighbor's building, your commercial general liability (CGL) policy may cover a claim that your negligence caused the fire and damaged that building. Some policies include both first and third-party coverages. For example, a business auto policy, much like your own car insurance, can cover damage to your company's own vehicle (first party coverage) as well your company's liability for an accident with another car (third party coverage).

Occurrence vs. Claims Made

For third-party liability coverage, you need to know whether your policy is on an occurrence basis or claims made basis. This determines which policies over a period of time may cover a particular claim. An "occurrence policy" responds to a suit when there is injury, damage or an offense, during the policy period, even if the suit is filed against the insured years later. Because occurrence policies look to when there was damage or injury, policyholders often can get coverage under policies purchased decades ago for new lawsuits alleging environmental damage or asbestos claims, because there could have been damage or injury during the older policy periods. This analysis can be just as important for a more typical product liability case as well. Most CGL policies use occurrence forms. In contrast, a "claims made policy" focuses on when the claim was asserted. It typically covers claims made against you during the policy period. The policies can be configured to define the "claims made" period to a specified period and arising out of events that occurred during the policy period and possibly reaching back to

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an earlier retroactive date. This is common with directors & officers (D&O) policies. For example, if you have a D&O policy for 2015 with a retroactive date of Jan. 1, 2010, your company and its directors and officers might be able to access coverage under that 2015 policy for a securities claim made in 2015 but alleging wrongful acts in prior years.

Duty to Defend vs. Duty to Indemnify

Third-party policies like CGL usually impose two separate obligations on your insurer: (1) a duty to defend you, that is, to hire and pay for lawyers to defend the claim; and (2) a duty to indemnify you, that is, to pay a settlement or a judgment. The duty to defend is broader than the duty to indemnify. In most states, if there is anything in the suit against you -- one count or even one allegation within the complaint -- that could fall within the scope of coverage, even if such allegations are false, the insurer must provide a defense for the entire claim. Some policies expressly provide that defense costs will be allocated between covered and non-covered claims, with the policyholder responsible for the latter. That is more common in policies like directors and officers (D&O) and employment practices liability (EPL) than in commercial general liability (CGL) policies. The duty to indemnify is the insurance company's ultimate obligation to pay for a settlement or judgment against you according to the terms and conditions of the policy. If there are multiple counts against you, some covered and some not, insurance companies may assert that they are not obligated to indemnify the entire settlement or judgment, asserting that they are obligated to indemnify only amounts attributable to covered counts.

Deductible vs. Self-Insured Retention

A deductible and self-insured retention both identify amount for which the insured is responsible. The distinction between a deductible and a self-insured retention (SIR) may have little to do with money and more to do with control. Often, if your policy has a deductible, the insurance company's obligation to defend and resolve the claim may be immediate, with the insurance company collecting the deductible from the insured. In contrast, if your policy has an SIR, your company may be obligated to satisfy the SIR first, through payment of defense costs or settlement amounts, with your company controlling the litigation within the SIR. The SIR arrangement may then give the insurer some role regarding claims that exceed the SIR, depending on how the clause is written.

Defense Outside of Limits vs. Defense Within Limits

The distinction between the duty to defend and the duty to indemnify may resonate with you because you know that attorneys' fees and other litigation expenses can far exceed any settlement or judgment in a particular case -- especially if you litigate all the way to a defense verdict. You also need to know whether those defense costs will "erode" the policy limits (defense within policy limits), or whether the policy limits will remain the same regardless of defense costs (defense outside policy limits). For example, when defense costs are unlimited, a policy with a $1 million limit and no deductible will require the insurer to pay all the defense costs and still leave that $1 million limit available for a settlement or judgment. Of course, as the cost of defense increases, so does the insurance company's incentive to

settle the case. In contrast, some policies, referred to as a burning, eroding or wasting limits policy, have the policy limit eroded by payment of defense costs. With the same $1 million limit, if the carrier spends $200,000 in attorneys' fees and other litigation expenses in your defense, $800,000 will be available for a settlement or judgment. Thus, with a burning limits policy, you need to keep a close eye on the defense costs even though your company isn't paying them, and you may have greater concern about the potential for a verdict that exceeds the remaining policy limit. These explanations are intentionally general, and we hope they will help as you confront some of the nuances and variations that sometimes exist within these general concepts. Your policy language may differ. We plan to return to this theme and post additional fundamentals of insurance coverage, like the difference between an additional named insured and a named additional insured. We also welcome your requests or suggestions of what you'd like to have explained. Co-authored by Kenneth Gorenberg and Joseph Fullenkamp