

Order 98-5

Issuance of defense within limits employment practices liability policy

January 22, 1998

ORDER

Now on this day the aforementioned matter comes before Mike Pickens, Insurance Commissioner for the State of Arkansas, and from the facts, matters and other things before him, as presented by Roger McNeil, Associate Counsel for the Arkansas Insurance Department ("Department"), the Commissioner finds as follows:

FINDINGS OF FACT

1. That St. Paul Mercury Insurance Company has submitted for approval and issuance within the State of Arkansas its Bankers Professional Liability Policy.

2. That such policy contains at Section V -- General Conditions and Limitations, Subsection A -- Limit of Liability, Retention and Coinsurance, Paragraph 6, the following language:

Defense Costs shall be part of and not in addition to the Limits of Liability set forth in Item 3 of the Declarations, and Defense Costs shall reduce such Limit of Liability.

3. That said provision, enabling the insurer to include the costs of defense within the limits of its total claim liability, causes this policy to be characterized as one which provides "defense within limits".

4. That under the terms of Ark. Code Ann. s 23-79-307(5) it is provided that no liability policy may be approved for use within Arkansas if it contains provisions which would reduce the limit of liability available for judgments or settlements by the amount of payments made for defense cost or expenses, i.e., "defense within limits," UNLESS a separate limit for defense costs equal to one hundred percent (100%) of the annual aggregate liability for judgments or settlements is also offered or provided for defense costs and claims expenses.

5. That the separate aggregate limit for high defense cost liability lines such as pollution liability, attorney's malpractice (securities oriented), non-profit directors and officers management liability, media risk (defamation) liability, design professionals liability, employment practices liability, for-profit directors and officers liability has not proved practicable for insurers, as it places them in the untenable position in the course of litigation of having to determine whether they should abandon their defense when that limit is "used up" but when their liability exposure is as yet undetermined.

6. That because defense costs in directors and officers liability often exceed damages awarded, it has been difficult to price the directors and officers product on the traditional defense without limits basis since the upper limit of exposure could not be reasonably and predictably calculated. This has resulted in a very restricted market for this type of coverage, and further, separate aggregate limits within this limited spectrum is not necessary or desirable for the protection of the public.

7. That the policy of the Department continues to be that the public is best served if liability contracts are, in general, issued on a traditional "defense outside of limits" basis; it is therefore appropriate to limit the circumstances in which defense within limits contracts such as that proposed in the instant matter may be utilized.

CONCLUSIONS OF LAW

That the Commissioner has authority to issue a limited order of exception upon findings as set forth above.

IT IS THEREFORE ORDERED AS FOLLOWS:

1. That no insurer may issue any "defense within limits" directors and officers liability policy within Arkansas unless:
 - a. such policy is issued with liability and defense limits of \$500,000 or more;
 - b. the applicant for the policy (whether an individual or firm) has executed a "Consent Form" acknowledging his or its understanding that the subject policy has limits of liability which may be reduced or completely eliminated by payments for defense costs and claims expenses; and
 - c. the "Consent Form" noted above is made a part of the policy upon issuance.
2. That no directors and officers liability policy may be otherwise issued on a "defense within limits" basis without specific written approval of the Insurance Commissioner.

Mike Pickens
Insurance Commissioner
