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Who's in Charge Here? Dealing with the Difficulties that Arise Between Insurer and Insured as the Value of a Case Nears the Insured's Self-Insured Retention[1]

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I. Introduction

Self-insured retentions ("SIRs") can be a great way for businesses of all sizes to manage risk and maintain a greater level of control over at least some claims. SIRs are attractive to insurers because they require an insured to expend a certain amount of money on a particular claim or on multiple claims during the policy period before the insurer has a responsibility to provide any defense or indemnity. Because of these potential advantages, insurers and insureds have embraced SIRs in place of the more traditional deductible on many different types of commercial insurance policies.

Because of the nature of SIRs, however, certain problems can arise as well. In particular, the way in which duties and rights are divided between insurer and insured under the policy can create tension between the two, particularly as the value of a case approaches the total amount of the insured's SIR. Although courts in some jurisdictions have addressed these issues, there remain many unanswered questions regarding SIRs and the division of rights and responsibilities under insurance policies utilizing SIRs.

One area where issues arise is in balancing the insurer's general duty to defend and indemnify the insured with the insured's duties until the value or potential exposure of a claim or case reaches the SIR. An SIR allows an insurer to defer the decision whether to defend or indemnify until the SIR has been exhausted, until it appears the potential value of the claim or case may exceed the SIR, or until some other threshold defined in the policy is met. As a result, at least in the early stages of a claim or suit, often the insured has primary responsibility, not only as to investigation, handling, defense, and settlement of a claim or suit, but also providing proper notice to the insurer. Depending on the policy language, the insured's duty may even extend to making reasonable efforts to settle the claim or suit.

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[1] This paper is adapted in large part from "*Between a Rock and a Real Hard Place: How Carriers and Their Insureds Handle the Stress of a Case's Value Approaching the Policy's Self-Insured Retention*," written by Martin A. Levinson and Warner S. Fox in February 2014.

Similarly, since the insurer's duty to defend and indemnify generally does not apply until the SIR is exhausted, disputes may arise as to which expenditures by the insured will apply toward exhausting the SIR. One of the most common such issues arises when an insured is faced with a claim or suit involving some allegations or items of damages that are covered under the applicable policy and others that are not. The insured may contend all costs incurred in defense of the claim or suit go toward exhausting the SIR, while the insurer likely will try to apportion costs between covered and non-covered claims, applying only those costs in defense of covered claims toward exhausting the insured's SIR.

Finally, where multiple claims or lawsuits arise from the same or similar circumstances, or when a single loss extends across multiple policy periods, there may be disagreement as to how many times the SIR must be satisfied before the insurer's duties begin. An insurer may contend each of the claims or suits is a different "occurrence" requiring payment of a separate SIR, whereas the insured most likely will prefer to pay a single SIR. The answer will depend on the language of the policy at issue, the facts of the claim or claims, and the law of the relevant jurisdiction.

II. SIRs vs. Deductibles – Key Functional and Practical Distinctions

To better understand the issues that can arise when an SIR is in place, it is important to understand the distinction between a deductible and an SIR. Although the terms are sometimes used interchangeably and the two mechanisms share some similarities, they are distinct and can function quite differently. Where an insurance policy is subject only to a deductible, the insurer must indemnify the insured and carries the risk of a potential judgment or other payout from the outset of the claim or lawsuit.[2] By contrast, an SIR is an amount retained and covered by the insured before insurance coverage begins to apply, and the insurer is liable to indemnify the insured only after the SIR is exhausted by the insured.[3] Another difference is that a deductible generally is advanced by the insurer and collected from or credited against the insured when the claim is finally paid.[4]

Generally, where an SIR is in place, the insurance policy will impose specific requirements on the insured's handling and reporting of claims and lawsuits within the SIR to the insurer. Sometimes, insureds are required to report claims of a certain severity (e.g., fatalities), whereas some policies impose a reporting requirement where the insured sets a reserve equal to a certain dollar amount or percentage of the SIR on a particular claim. The insurer also is likely to require the insured to have certain risk management protocols in place as a precondition to writing a policy with an SIR. Depending on the size of the

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[2] See *Axis Spec. Ins. Co. v. Brickman Group Ltd.*, 458 Fed. Appx. 220, 222, fn. 1 (3rd Cir. 2012); *In re Sept. 11th Liab. Ins. Coverage Cases*, 333 F. Supp. 2d 111, 124, fn. 7 (S.D.N.Y. 2004), citing Barry R. Ostrager & Thomas R. Newman, HANDBOOK ON INSURANCE COVERAGE DISPUTES, § 13.13[a] (12th ed. 2004).

[3] *Id.*

[4] See *Spector v. Cushman & Wakefield, Inc.*, 2012 N.Y. Misc. LEXIS 2794, *11, fn. 4 (N.Y. Sup. Ct. June 13, 2012), citing Flory & Walsh, *Know Thy Self-Insurance (And Thy Primary & Excess Insurance)*, 36 A.B.A. Tort & Ins. L.J. 1005 (2000-01).

insured's business and assets, as well as the extent of the insured's preference for lower policy premiums over full insurance coverage for lower-value claims, an SIR can range from around $100,000 to many millions of dollars.

Another key difference between an SIR and a deductible concerns when the insurer's duty to defend and indemnify arises. Where an insurance policy includes an SIR, the SIR serves as primary liability insurance, while the insurance coverage under the policy acts as excess insurance coverage that does not apply until the SIR is exhausted.[5] Where an SIR applies, the insured must pay *all* costs, including both indemnity and defense, until the SIR is exhausted.[6] A policy may be subject to both an SIR *and* a deductible, in which case the deductible must be paid once the SIR has been exhausted, but the insurer would have the duty of providing a defense to its insured once the SIR has been exhausted, even if the deductible has not yet been paid by the insured. Ultimately, the language of the policy will control the parties' duties under the policy; a policy can be written so that it has an "SIR" but functions more like a policy based on a deductible, or vice versa.

SIRs are most frequently utilized by companies expecting to face a high number of relatively low-exposure or low-severity claims or losses, as a method of controlling the companies' policy premiums.[7] From a risk management perspective, the use of an SIR may also provide an insured with a greater ability to fix and project the dollar amount of risk. Another important feature of an SIR is that the insured generally retains control over the handling, defense, and payment of claims until the SIR is exhausted.[8]

Where a policy features an SIR rather than a deductible, the insurer generally needs not have any involvement until the value or expense of a claim or suit exceeds or nears the SIR. Moreover, where an SIR applies, an insurer may defer its decision whether to provide a defense and/or indemnity until the value of the case exceeds or approaches the SIR.[9] In

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[5] See *State Indus., Inc. v. Twin City Fire Ins. Co.*, 158 Fed. Appx. 694, 697 (6th Cir. 2005); *U.S. Fid. & Guar. Ins. Co. v. Comm. Union Midwest Ins. Co.*, 430 F.3d 929, 937-38 (8th Cir. 2005); *Pac. Employers Ins. v. Domino's Pizza*, 144 F.3d 1270, 1276-77 (9th Cir. 1998); *U.S. v. Baxter Int'l, Inc.*, 345 F.3d 866, 894, fn. 20 (11th Cir. 2003); *Solid Waste Servs., Inc. v. N.Y. Marine & Gen. Ins. Co.*, 2013 U.S. Dist. LEXIS 173849, *16, fn. 10 (E.D. Pa. Dec. 12, 2013); *Koch Dev. Co. v. Clarendon Am. Ins. Co.*, 2008 U.S. Dist. LEXIS 5375, *30-31 (E.D. Mo. Jan. 24, 2008).

[6] See *Hormel Foods Corp. v. Northbrook Prop. & Cas. Ins. Co.*, 938 F. Supp. 555, 560 (D. Minn. 1996); *Boston Gas Co. v. Century Indem. Co.*, 910 N.E.2d 290, 294, fn. 8 (Mass. 2009); Allan D. Windt, INSURANCE CLAIMS AND DISPUTES, § 11.31 (5th ed. 2007).

[7] See *In re Sept. 11th Liab. Ins. Coverage Cases*, 333 F. Supp. 2d at 124, fn. 7; *CSX Transp., Inc. v. Continental Ins. Co.*, 680 A.2d 1082, 1096 (Md. 1996).

[8] See *Hartford Fire Ins. Co. v. Terra Ins. Co.*, 2004 U.S. Dist. LEXIS 15340, *9, fn. 8 (E.D. Pa. Aug. 3, 2004); Douglas R. Richmond, *Issues and Problems in 'Other Insurance,' Multiple Insurance, and Self-Insurance*, 22 Pepp. L. Rev. 1373, 1449 (Feb. 1995).

[9] See, e.g., *Comsys Info. Tech. Servs. v. Twin City Fire Ins. Co.*, 130 S.W.3d 181, 190 -91 (Tex. Ct. App. 2003) (policy at issue provided that if insurer exercised right to defend insured in a particular case, insurer was obligated to decide coverage issues "within a reasonable time after" suit was filed, but if insurer chose

addition, an insurer will most likely prefer that claims or suits be settled within the insured's SIR wherever possible, so as to minimize the insurer's litigation expenses and potential liability. The insured, by contrast, will want the insurer to cover as much of the litigation and settlement expenses as possible. These competing interests can create tension between insurer and insured as an insured comes closer to exhausting the SIR or as the estimated potential value of the case approaches the SIR.

III. Does the *Insured* Have a Duty to Settle Within the SIR for the Benefit of the Insurer?

Many insurance policies give the insurer the unfettered right to decide whether to settle a case. Where an SIR is involved, the policy may allow the insurer to step in at any time and assume control of the defense or settlement negotiations.[10] Those provisions vary widely from one policy to the next, some giving the insurer the absolute right to take over the defense and to control settlement and others providing that right only under certain circumstances (such as when a claim or suit is "reasonably likely" to result in damages in excess of the insured's SIR).[11] The insurer also may be entitled to require the insured to settle a claim or case, even if the settlement amount and potential exposure remain within the insured's SIR.[12] Whether the insurer has these rights and when they "kick in" will be defined by the terms of the particular policy, including any SIR endorsement.

In particular, whether an insured has a duty to its insurer(s) to settle within the SIR depends largely on the specific language of the policy. Some insurance policies explicitly impose a duty on the insured to make "reasonable efforts" to settle a claim or suit within the amount of the SIR, and courts appear to be willing to enforce those provisions.[13] In one such case, the Florida Court of Appeals held an insurer was not required to pay the amount of a judgment that exceeded the insured's SIR because the insured had rejected a

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not to defend and only to indemnify, coverage issues could be decided "within a reasonable time after settlement").

[10] See, e.g., *1200 Grand St. Condo. Ass'n v. 1200 Grand St. Urban Renewal LLC*, 2013 Bankr. LEXIS 1676, *19-20 (Bankr. D.N.J. Apr. 16, 2013) (policy's SIR clause gave insurer "the right but not the duty, at our own expense, to assume charge of the defense and/or settlement of any claim or 'suit' brought against an insured and, upon [insurer's] written request, you shall tender such portion of the self-insured retention as [insurer] consider[s] necessary to complete the settlement of a claim or 'suit.'" (brackets in original)); *Comsys Info. Tech. Servs. v. Twin City Fire Ins. Co.*, 130 S.W.3d 181, 190-91 (Tex. Ct. App. 2003) (policy provided insurer would "not be obligated to assume charge of, participate in, or pay for the investigation or defense of any 'claim' or 'suit,'" but that if claim/suit was "reasonably likely" to result in damages in excess of SIR, insurer had "the right but not the duty to assume control of the defense").

[11] See *Id*.

[12] See *Id*.

[13] See, e.g., *National Casualty Co. v. Green*, 711 So. 2d 609 (Fla. Ct. App. 1998); *Kmart Corp. v. XL Ins. Am.*, 2010 Cal. App. Unpub. LEXIS 809, *16 (Feb. 3, 2010) (applicable policy contained similar language); *Hillerich & Bradsby Co. v. Ace Am. Ins. Co.*, 2013 U.S. Dist. LEXIS 46976 (D. Mont. Mar. 26, 2013).

"reasonable settlement offer" within the SIR.[14] The plaintiff in that case allegedly was injured when she slipped and fell at one of the insured's supermarkets, and prior to trial, the plaintiff made settlement demands of $27,000 and $20,000, both of which were well within the insured's $75,000 SIR. The insured rejected both demands and never made an offer higher than $8,000. At trial, the jury returned a verdict of $120,000 against the insured.

The plaintiff later filed a separate action against the insurer seeking to enforce the final judgment as a purported third-party beneficiary under the insured's policy. The insurer argued that the policy's SIR endorsement relieved the insurer of any duty to pay the judgment. The SIR endorsement in the policy specifically provided, in pertinent part:

> **The Insured shall have the obligation** to provide at its own expense adequate defense and investigation of any claim and **to accept any reasonable offer of settlement within the Self-Insured Retention**. In the event of failure of the Insured to comply with this clause, no loss, cost or expense will be paid by the Company.[15]

The insurer contended the two offers its insured had rejected were "reasonable settlement offers" within the meaning of the SIR endorsement, so the insurer was relieved of any duty to pay the subsequent judgment against the insured. The trial court rejected this argument and entered judgment in favor of the plaintiff and against the insurer for the difference between the verdict and the SIR, plus interest. The Florida Court of Appeals reversed, holding the proper question was not whether the insured acted reasonably in rejecting the plaintiff's settlement offers, but whether the offers were "reasonable settlement offers."[16] Under the unambiguous language of the SIR endorsement, the court held, it was irrelevant whether the *insured* acted reasonably in rejecting the plaintiff's settlement offers:

> An offer may be a reasonable one yet be reasonably rejected. Litigation is a constant exercise in the selection of pathways to the ultimate result. Both sides may act totally reasonably based upon their separate knowledge and experience, yet one side -- to its surprise and dismay -- may suffer a major loss, notwithstanding the reasonableness of its position and its actions.
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> The language of the endorsement is not ambiguous and thus is to be given effect as written. If the settlement offer [was] reasonable, [was] within the retention amount, and [was] not accepted by [the insured], then [the insurer] is not responsible for payment of the loss, and it matters not whether [the insured] reasonably, or unreasonably, rejected the offer.[17]

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[14] *Green*, 711 So. 2d 609 (Fla. Ct. App. 1998).

[15] *Id.* at 609-10 (bolded emphasis added).

[16] *Id.* at 610.

[17] *Id.* (internal citations omitted).

Accordingly, the Florida Court of Appeals reversed and remanded the case, presumably for a determination whether the plaintiff's settlement offers were "reasonable."

In another case raising similar issues, a federal district court in Montana held an insurer could had no duty to pay additional litigation expenses and interest incurred by its insured after the insured rejected the insurer's "recommendation" to pay a judgment rendered against the insured rather than pursuing an appeal. The insurer offered to pay the entire amount of a judgment returned against the insured beyond the policy's self-insured retention, and the insurer recommended the insured pay the judgment and put the matter to rest without an appeal, but the insured instead decided to appeal the judgment. The insured lost its appeal, and when the time came to pay the judgment, the insurer refused to pay any litigation expenses or post-judgment interest incurred after the insurer recommended payment of the judgment and offered to pay its share of the judgment.

The insured sued its insurer, contending the latter had to pay post-judgment interest and a share of expenses incurred on appeal. The insurer moved for and was granted summary judgment, the district court holding the insurer had satisfied the requirements of an endorsement to the policy "by recommending a settlement to [the insured] that would have been acceptable" to the plaintiffs.[18] The district court further held that since the insurer made an offer to pay the part of the judgment above the SIR, the insurer had satisfied the post-judgment interest provision in the policy endorsement and had no duty to pay post-judgment interest accrued beyond the date of the insurer's "offer."[19]

Where a policy does not contain such a clause, however, it is questionable whether the insured has a duty to make reasonable efforts to settle or accept a reasonable settlement demand within the SIR. Insurers sometimes argue an insured's failure to settle a case within the insured's SIR is a violation of the "cooperation clause" that is present in most or all modern liability insurance policies. In that regard, an insurer's duty to defend or indemnify the insured may be diminished or eliminated entirely where the insured fails to cooperate with the insurer in the investigation and defense of a claim or suit against the insured. Since the language of "cooperation clauses" varies from one policy to the next, however, whether an insured has a duty to the insurer in deciding whether to settle within the SIR may depend at least in part on whether the particular policy's "cooperation clause" specifically requires the insured to cooperate or assist in the context of settlement.[20]

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[18] *Hillerich & Bradsby Co. v. ACE American Insurance Co.*, 2013 U.S. Dist. LEXIS 46976, *6-9.

[19] *Id.* at *10-12.

[20] See, e.g., *Cont'l Cas. Co. v. City of Jacksonville*, 283 Fed. Appx. 686, 690 (11th Cir. 2008) (insurance policy at issue contained "cooperation clause" providing that "[t]he insured shall cooperate with the company, and upon the company's request, shall attend hearings and trials ***and shall assist in effecting settlements***, securing and giving evidence, obtaining the attendance of witnesses and in the conduct of suits." (emphasis supplied)). Compare *Med. Prot. Co. v. Bubenik*, 594 F.3d 1047, 1051 (8th Cir. 2010) (policy's cooperation clause stated only that "[t]he Insured shall at all times fully cooperate with the [insurer] in any claim hereunder and shall attend and assist in the preparation and trial of any such claim").

Before an insured's failure to pay its SIR will relieve an insurer of its duties under an insurance policy, the insured's actions probably must amount to a material breach that substantially prejudices the insurer's right to defend the case.[21] While the "materiality" of an insured's failure to cooperate ordinarily is a question of fact, some courts have held that whether an insurer has been sufficiently prejudiced by an insured's breach of a cooperation clause may be determined as a matter of law under appropriate circumstances.[22]

For example, the Fifth Circuit U.S. Court of Appeals has held that when an insured fails to consult with its insurer about a potential settlement within the insured's SIR, the insurer is materially prejudiced *as a matter of law* by virtue of "los[ing] a valuable settlement right."[23] In the case of *Clarendon National Insurance Co. v. FFE Transportation Services, Inc.*, insurer Clarendon sought reimbursement of money spent on a post-verdict settlement. Clarendon had issued a policy with liability limits of $2 million and an SIR of $1 million to FFE. Under the policy, FFE had a duty to provide Clarendon with "prompt notice" of any "accident, claim, suit or loss." An endorsement to the policy also required FFE to provide Clarendon with "immediate notice" of (1) "any claim in which the requested damage exceed[ed]" the SIR, or (2) any injury, death, or disease paid or reserved for 25 percent or more of the amounts stated in the schedule of underlying insurance. The policy provided Clarendon would not be liable to indemnify FFE if the notice provisions were not followed and Clarendon was prejudiced, and Clarendon also would be entitled to reimbursement by FFE of any amounts paid on claims involving a breach of the policy. Clarendon had the right under the policy to investigate, defend, and settle any claim at its discretion.

One of FFE's vehicles was involved in an accident that resulted in several claims. All but one of the claims were settled by FFE for a total of $219,861.99. The remaining claim against FFE went into suit, but FFE did not give Clarendon notice of the suit or the underlying accident until *after* the case went to trial. Sometime prior to trial, the plaintiff in that case offered to settle with FFE for $700,000. FFE rejected the settlement demand without notifying Clarendon, and the jury later returned a verdict of $1.1 million for the plaintiff and against FFE. About 3½ months later, FFE finally notified Clarendon of the verdict and the underlying accident. After reserving its right to seek reimbursement from FFE, Clarendon took part in post-judgment settlement discussions that resulted in a

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[21] See *Berkley Reg'l Ins. Co. v. Philadelphia Indem. Ins. Co.*, 690 F.3d 342, 349 (5th Cir. 2012) (applying Texas law); Ins. Co. of the State of Pa. v. Roman Catholic Archbishop of Los Angeles, 227 Fed. Appx. 643, 644 (9th Cir. 2007) (applying California law); *Ramos v. Northwestern Mut. Ins. Co.*, 336 So. 2d 71, 75 (Fla. 1976).

[22] See, e.g., *Clarendon Nat'l Ins. Co. v. FFE Transp. Servs.*, 176 Fed. Appx. 559, 562 (5th Cir. 2006) (applying Tex. law); *Ramos*, 336 So. 2d at 75. See also *Lexington Ins. Co. v. Rowland*, 746 S.E.2d 924, 926 (Ga. Ct. App. 2013) (Branch, J., dissenting) ("The question of whether the failure to cooperate is so substantially prejudicial as to release the insurance company of its obligation is ordinarily a question of fact, but under some circumstances, particularly where the facts are admitted, it may well be a question of law.").

[23] See *FFE Transp. Servs.*, 176 Fed. Appx. at 562; *Motiva Enters., LLC v. St. Paul Fire & Mar. Ins. Co.*, 445 F.3d 381, 386-86 (5th Cir. 2006) (same). See also *Rowland*, 746 S.E.2d at 926 (Branch, J., dissenting) (opining that under Florida law, there was an issue of fact remaining as to whether insured's failure to pay its SIR toward settlement constituted a "failure to cooperate" under applicable policy).

settlement of $1 million. FFE paid about $780,000 toward the settlement, which brought FFE's total combined expenditures on the claims arising from the accident to $1 million, the amount of the SIR. Clarendon contributed the remainder of the settlement (roughly $220,000) and then sought to recover that amount from FFE, which refused to pay.

Clarendon sued FFE, contending the failure to notify Clarendon of the plaintiff's settlement offer prevented the insurer from exercising its absolute right to settle. FFE argued Clarendon could not show "actual prejudice" from the lack of notice because Clarendon could not establish it *would* have accepted the offer if FFE had provided proper notice. The Fifth Circuit rejected FFE's argument and held Clarendon had shown actual prejudice due to FFE's failure to convey the plaintiff's settlement offer to Clarendon.[24] The court noted it was undisputed that the policy gave Clarendon the right to require FFE to accept the plaintiff's offer and that Clarendon would not have incurred any expense in connection with the claims arising from the accident if Clarendon had done so.[25] Accordingly, Clarendon was materially prejudiced, without any need to show what it actually would have done if it had been faced with the settlement offer, and Clarendon was entitled to require FFE to reimburse the portion of the settlement Clarendon had paid.[26]

By contrast, at least one court has held that absent explicit language in the policy reserving to the insurer the right to control settlement, the insured may ***unilaterally*** enter into a settlement *for more than the amount of the SIR*.[27] In that case, the policy at issue gave the insured, Powell, the unfettered right to settle a claim or suit and provided the insurer, National Union, with only the right to "participate" in the settlement or defense of a claim or suit arising under the policy. National Union contended the insured, Powell, only had the right to control settlements within the SIR, but the court disagreed:

> If National Union wanted a different arrangement for controlling the settlement of claims made under the Policy, and specifically with respect to settlements that involve funds within National Union's $1,000,000 limit of exposure above the Retained Limit, it was free to include such provisions in the Policy. As for the language that does appear in the Policy, the court can find no ambiguity. Powell had the right to settle claims under the Policy, so long as the settlement did not expose National Union to liability beyond the Policy limit, and so long as National Union participated in the settlement.

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[24] *Id.* at 561.

[25] *Id.* at 561-62.

[26] *Id.* at 562. See also *Motiva Enters.*, 445 F.3d at 386-87 ("An insurer's right to participate in the settlement process is an essential prerequisite to its obligation to pay a settlement. When…the insurer is not consulted about the settlement, the settlement is not tendered to it and the insurer has no opportunity to participate in or consent to the ultimate settlement decision…the insurer is prejudiced as a matter of law.").

[27] See *Powell Elec. Sys. v. Nat'l Union Fire Ins. Co.*, 2011 U.S. Dist. LEXIS 96848, *15-24 (S.D. Tex. Aug. 29, 2011).

National Union had no contractual right to insist that a settlement of the [lawsuit] be accomplished only with its consent.[28]

The court noted National Union could have reserved the "discretion" to settle claims, "which would be enforced by Texas courts as an explicit grant of authority to control settlement of third-party claims."[29]

For that reason, it is fairly typical for a liability policy with an SIR to include a provision specifically precluding the insured from binding the insurer to pay any settlement made in excess of the SIR without the insurer's permission.[30] It should be noted, however, that where an insured wants to accept a settlement offer of an amount greater than the SIR, many policies condition the insurer's right to reject the settlement on the insurer assuming the defense and all expenses from that point forward.[31]

Several courts have held that absent explicit policy language to the contrary, an insured does not owe its *excess* insurer a duty to settle within the SIR.[32] The rationale for this holding is that an excess insurer charges a premium "based on [the excess insurer's] calculation of the probability that [the insured] might be exposed to a liability beyond the primary layer" of insurance coverage, and by accepting payment of the premium, the excess insurer accepts the risk of that exposure.[33] Courts reaching that conclusion have noted that "[i]f an excess carrier wishes to insulate itself from liability for an insured's failure to accept what it deems to be a reasonable settlement offer, it may do so by appropriate language in the policy."[34] However, an excess insurer may have the right to pursue a claim of equitable subrogation against a primary insurer for unreasonable failure to settle within primary limits.[35]

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[28] *Id.* at *23-24.

[29] *Id.* at *21, citing *Dear v. Scottsdale Ins. Co.*, 947 S.W.2d 908, 913-14 (Tex. Ct. App. 1997).

[30] See, e.g., *Comsys Info. Tech. Servs.*, 130 S.W.3d at 191 (policy provided no insured was permitted, "except at [its] own cost, [to] make or agree to any settlement for a sum in excess of the 'self-insured retention' without our consent").

[31] See *Id.* (policy provided if insured was willing to accept settlement offer, insurer would "have the right to litigate in lieu of such settlement and [would] bear all 'claim expenses' subsequently incurred and any damages in excess of the amount for which the 'claim' could have been settled").

[32] See, e.g., *Comm. Union Assur. Co. v. Safeway Stores, Inc.*, 610 P.2d 1038 (Cal. 1980); *Twin City Fire Ins. Co. v. Super. Ct. of Ariz*, 792 P.2d 758, 760 (Ariz. 1990); *Int'l Ins. Co. v. Dresser Indus., Inc.*, 841 S.W.2d 437 (Tex. Ct. App. 1992); *Employers Mut. Cas. Co. v. Key Pharmaceuticals, Inc.*, 871 F. Supp. 657, 666 (S.D.N.Y. 1994) (applying New Jersey law).

[33] *Dresser Indus.*, 841 S.W.2d at 444.

[34] *Twin City Fire Ins. Co.*, 792 P.2d at 760, quoting *Safeway Stores*, 610 P.2d at 1043.

[35] See generally *Hartford Cas. Ins. Co. v. N.H. Ins. Co.*, 628 N.E.2d 14, 16, n.7 (Mass. 1994); Kent D. Syverud, *The Duty to Settle*, 76 Va. L. Rev. 1113, 1203-04 (Sep. 1990) ("Almost every state now permits the excess insurer to litigate the reasonableness of a primary insurer's failure to settle; a few have suggested that primary insurers have a direct fiduciary duty to excess insurers to act with the utmost good faith in handling claims."); Paul B. Butler, Jr. & Robert V. Potter, Jr., *The Primary Carrier Caught in the Middle with*

As these cases make clear, an insured with an SIR must be well-versed in the specific provisions of the insured's policy, including those pertaining to notice, cooperation, and settlement, as a failure to comply with those provisions can diminish or completely destroy coverage under the policy. Perhaps the easiest way to forfeit coverage under an insurance policy, regardless of whether it is subject to an SIR, is failing to satisfy the policy's notice provisions. Although this can happen under a policy with a deductible as well, it is probably more likely to occur where an SIR is in play, since the insured may not want to involve the insurer (or risk the insurer requiring the insured to settle) where the value of a case appears to be well within the insured's SIR. Insurers generally will want to limit their expenses in handling, analyzing, and defending claims, so the safest course for an insured, as a general rule, is probably to err on the side of notifying the insurer where a claim or case arguably triggers a notice requirement under the policy.

Insurers, on the other hand, should make sure they write policies with appropriate language to accomplish their desired allocation of control over settlement authority. It appears that if a policy includes the right language, an insurer can reserve essentially unfettered discretion with regard to settlement of a claim or suit, even within the insured's SIR. By the same token, an insurer can help ensure its right and ability to protect its insured interest by including strong, unambiguous notice requirements in the policy.

IV. Which Types of Expenditures by an Insured Will Apply Toward Exhausting the SIR?

Another area where insurers and insureds often disagree is what types of expenditures by the insured will apply toward satisfying the insured's SIR. For example, where an insured faces a lawsuit alleging claims covered under the applicable policy and claims that may not be covered, there may be a dispute whether the costs of defending and/or resolving the non-covered claims will apply toward exhausting the insured's SIR.

The majority rule regarding apportionment of defense costs between insurer and insured in general appears to be that "[a]n insurer must bear the entire cost of defense when there is no reasonable means of prorating the costs of defense between the covered and the not-covered items," but "[w]here the distinction can be readily made, the insured must pay its fair share for the defense of the non-covered risk."[36] Some jurisdictions, however, have

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Bad Faith Exposure to its Insureds, Excess Carriers and Reinsurers, 24 Tort & Ins. L.J. 118, 125 (1988) ("[M]any cases can be found which discuss the primary carrier's duty of good faith to an excess carrier…").

[36] *Ins. Co. of N. Am. v. Forty-Eight Insulations, Inc.*, 633 F.2d 1212, 1224-25 (6th Cir. 1980) (internal quotation omitted). See also *Gulf Chem. & Metallurgical Corp. v. Assoc. Metals & Minerals Corp.*, 1 F.3d 365, 371 (5th Cir. 1993) (quoting and adopting reasoning of *Ins Co. of N. Am. v. Forty-Eight Insulations* decision); *Enron Corp. v. Lawyers Title Ins. Corp.*, 940 F.2d 307, 311 (8th Cir. 1991) ("We note that courts have taken a strong stand against holding insurers liable for the defense costs of claims their policies do not cover, even when those claims are joined with covered claims."); *Okada v. MGIC Indem. Corp.*, 823 F.2d 276, 282 (9th Cir. 1986) (holding that "[i]f an action against the [insureds] incorporates both covered and uncovered claims, the parties must apportion the costs so [the insurer] need only pay for amounts generated in defense of covered claims"). See also *Stonewall Ins. Co. v. Asbestos Claims Mgmt. Corp.*, 73 F.3d 1178, 1219 (2nd Cir.

held that while indemnity funds may be apportioned between covered and non-covered claims, defense costs may not be apportioned.[37] In jurisdictions allowing apportionment of defense costs between covered and non-covered claims, there does not appear to be any reasonable basis for following a different rule to determine when defense costs will be applied toward exhausting an insured's SIR.

Unless a policy is unambiguously excludes a particular cost or expense from being applied toward exhausting the SIR, however, it will be difficult for an insurer to succeed in attempting to exclude any reasonable cost or expense when calculating whether the SIR has been exhausted. Indeed, some courts have held costs incurred by an insured in defending a lawsuit and paying an eventual judgment entered against the insured as to non-covered claims *did* count toward exhausting the SIR because the applicable insurance policy did not contain language unambiguously excluding such expenditures from being applied to exhaust or diminish the SIR.[38] At least some courts have held an insured's SIR is "subject to exhaustion by any commercially reasonable 'defense costs' (as defined in the [applicable insurance policy]) expended by [the insured]…without regard to whether those costs are traceable to potentially covered claims."[39] And the Supreme Court of Florida very recently held an insured could use indemnification payments made by a third party (a subcontractor) to satisfy the insured's SIR.[40] As with most other potential areas of disagreement between insurer and insured, the only way for an insurer to be certain it will have a right to apportion defense costs between covered and non-covered claims for purposes of exhaustion of an SIR is to make sure the policy explicitly requires it.

1995) (holding that under insurance policy imposing duty to reimburse defense costs but not duty to defend, insurer had duty to reimburse defense costs for covered claims but not for claims only potentially falling within the policy's coverage); *Harborside Refrig. Servs., Inc. v. IARW Ins. Co.*, 759 F.2d 829, 831 (11th Cir. 1985) (holding that "[w]here the apportionment of costs between uncovered and covered claims is not practicable…the insurer bears the full cost of defense").

[37] See *Perdue Farms, Inc. v. Travelers Cas. & Sur. Co. of Am.*, 448 F.3d 252 (4th Cir. 2006) (holding insurer was not entitled to apportionment and reimbursement of defense costs by insured for defense of non-covered claims but insurer was entitled to apportionment of settlement between covered and non-covered claims for indemnity purposes); *Charter Oak Fire Ins. Co. v. Hedeen & Cos.*, 280 F.3d 730, 738 (7th Cir. 2002) (holding "an insurer generally bears the entire expense of conducting its insured's defense even though its duty to indemnify is limited to so much of the judgment or settlement as was fairly allocable to the claims that were covered by the policy" (internal punctuation and quotation omitted)).

[38] See, e.g., *State Nat'l Ins. Co. v. White*, 2011 U.S. Dist. LEXIS 133679, *8-11 (M.D. Fla. Nov. 18, 2011), aff'd, 482 Fed. Appx. 434 (11th Cir. 2012); *Bordreaux, Inc. v. Am. Safety Ins. Co.*, 186 P.3d 1188, (Wash. Ct. App. 2008) (holding as to satisfaction of SIR, "[n]o right of allocation exists for the defense of non-covered claims that are reasonably related to the defense of covered claims"); *In re Feature Realty Litigation*, 634 F. Supp. 2d 1163, 1171-74 (E.D. Wash. July 25, 2007); *Taco Bell Corp. v. Continental Cas. Co.*, 2003 U.S. Dist. LEXIS 4289, *39-41 (N.D. Ill. Mar. 12, 2003), rev'd in part on other grounds, 388 F.3d 1069 (7th Cir. 2004).

[39] *Taco Bell Corp.*, 2003 U.S. Dist. LEXIS 4289 at *41.

[40] *Intervest Constr. of Jax, Inc. v. Gen. Fid. Ins. Co.*, 2014 Fla. LEXIS 568, *23, no. SC11-2320 (Fla. Feb. 6, 2014).

V. How Many Times Do I Have to Pay This SIR? Multiple Claims or Lawsuits Arising from the Same or Similar Circumstances and Losses that Extend Across Multiple Policy Periods

Disputes also arise as to whether an SIR must be satisfied more than once where either (1) multiple claims or lawsuits arise from the same or similar circumstances, or (2) a single loss extends across multiple policy periods. There is an inherent tension between insurer and insured in these situations: the insurer wants the insured to pay a separate SIR for each incident and/or policy period, while the insured does not want to have to expend separate defense, indemnity, or claim-handling costs on handling similar incidents or claims. Similarly, where an insured is faced with a potentially high-dollar claim or series of claims over a number of years, the insurer may prefer the insured to pay a separate SIR for each applicable policy period, while the insured will prefer to pay only one SIR if possible.

Some insurance policies contain so-called "batch clauses," which have the effect of causing several claims that might otherwise be considered multiple, separate occurrences to be considered a single occurrence under the policy.[41] Where a "batch clause" is included, only a single SIR (and a single set of liability limits) will apply to all claims considered part of the "batch." Absent such a provision, however, litigation often arises between insurer and insured as to whether a single or multiple SIRs apply to multiple claims or injuries. The results in those cases have varied widely from one jurisdiction to the next. In one such case, *Sunoco, Inc. v. Illinois National Insurance Co.*, the insurer contended that its insured was required to satisfy a separate $250,000 per-occurrence SIR for each of 77 cases in which plaintiffs alleged injuries resulting from hazardous manufacture of gasoline containing a particular additive and resulting groundwater contamination.[42] Although the cases "allege[d] contamination in different geographic regions, … resulted from a variety of sources including gas tank leaks and accidental spills from pipelines, and [involved] plaintiffs vary[ing] from individuals to governmental entities," the court held that those cases arose from a single occurrence because the plaintiffs' alleged injuries all arose from "expos[ure] to the same general harmful condition."[43] In the single remaining case, by contrast, the court explained, "it [wa]s not the dangerous nature of [the gasoline additive] that g[ave] rise to the complaint, but a gasoline product that contaminated the ground

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[41] See, e.g., *Am. Ins. Co. v. St. Jude Med., Inc.*, 2010 U.S. Dist. LEXIS 98415, *3-4 (D. Minn. Sep. 20, 2010). The "batch clause" in the policy at issue in that case amended the definition of "occurrence" in the policy as follows, in pertinent part:

> [A]ll losses arising from a single "batch" of your product will be considered to be one "occurrence." Therefore, when multiple losses are considered to be one "occurrence" you must only meet a single "self insured retention" amount. Likewise, our limit of liability due to "bodily injury"...is limited to that of a single "occurrence[.]" … All claims made by persons or organizations seeking damages because of "bodily injury"…will be deemed to have been made at the time of the first of those claims is made against you."

[42] 226 Fed. Appx. 104, 107-08 (3rd Cir. 2007).

[43] *Id.* at 108.

water surrounding [a] hotel."[44] Accordingly, the Third Circuit held that 76 of 77 cases were subject to a single SIR and the remaining one was subject to a separate SIR.[45]

The Ninth Circuit U.S. Court of Appeals reached a different conclusion in a case involving multiple recurrences of alleged molestation of the same individual over several years. In the case of *Interstate Fire & Casualty Co. v. Archdiocese of Portland*, the underlying plaintiff's claims against the archdiocese had been settled and the archdiocese's excess insurer contended that the archdiocese needed to satisfy its SIR and primary policy limits for each of four policy periods in which it was undisputed that molestation had occurred due to the archdiocese's negligence.[46] The Ninth Circuit agreed, holding that "because each policy covers only damages stemming from [the plaintiff's] exposure to Father Laughlin occurring during the policy period, and because the parties do not contest that [the plaintiff] was exposed to the negligently supervised priest in each of the four policy periods," the plaintiff's claim constituted separate occurrences during each of the four applicable policy periods.[47] Accordingly, the insured's SIR and the primary policy limits had to be satisfied four times before the excess policy would apply -- which, in effect, meant that the excess insurer had no duty to provide indemnity in the case.[48]

In *Lennar Corp. v. Great American Insurance Co.*,[49] the Texas Court of Appeals reached a similar result as to a homebuilder's repair and replacement of defective stucco on hundreds of homes built over a four-year period. In that case, the appellate court was called on to decide whether a homebuilder's several insurers were required to indemnify the homebuilder for costs incurred in repairing and replacing defective exterior insulation and finish system ("EIFS") stucco on over 400 homes built between early 1996 and late 1999. One of the homebuilder's primary policies had liability limits of $1 million per occurrence with an SIR of $250,000 per occurrence. The insurers contended each home repaired was a separate "occurrence," meaning no indemnity was due under the policy as the insured had not spent more than $250,000 on repairing any single home during the policy period. The builder, Lennar, contended the sole "occurrence" was failure of the EIFS and continued entrapment of water, regardless of the location or the specific home involved.

The Texas Court of Appeals applied the "cause analysis" to determine whether the claims at issued were a single occurrence or multiple occurrences under the policy.[50] Based on that analysis, the court sided with the insurers:

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[44] *Id.*

[45] *Id.*

[46] 35 F.3d 1325, 1327 (9th Cir. 1994).

[47] *Id.* at 1331.

[48] *Id.*

[49] 200 S.W.3d 651 (Tex. Ct. App. 2006).

[50] *Id.* at 682 ("Under the 'cause' analysis, the proper focus in interpreting 'occurrence' under a liability policy is on the number of events that cause the injuries and give rise to the insured's liability, rather than

> The fact that EIFS is generally a defective product that traps water would not have resulted in Lennar's liability to each homeowner absent application of EIFS to each home. Lennar was not the designer or the manufacturer of EIFS. Rather, Lennar's liability stemmed from the fact that it built and sold homes with EIFS. Thus, Lennar's liability to a particular homeowner stemmed from the application of EIFS, and the resulting damage, if any, to his or her particular home. Further, there was not one entrapment of water that caused damage to all the homes. Instead, the EIFS's entrapment of water on a particular home caused the damage to that home only. Therefore, Lennar was exposed to a new and separate liability for each home on which EIFS was applied.[51]

Since the damage to each home was a separate "occurrence" to which the SIR applied, no coverage was triggered and the insurers were entitled to summary judgment.[52]

As these examples make clear, whether multiple claims or losses constitute a single occurrence requiring satisfaction of one SIR or multiple occurrences requiring satisfaction of multiple SIRs is highly fact-specific, and the answer varies greatly from one jurisdiction to the next.[53]

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the number of injurious effects."), citing *Ran-Nan, Inc. v. Gen. Accident Ins. Co. of Am.*, 252 F.3d 738, 740 (5th Cir. 2001).

[51] *Id.* at 682-83.

[52] *Id.* at 683-84.

[53] See, e.g., *Archdiocese of Portland*, 35 F.3d 1325 (9th Cir. 1994); *Lennar Corp.*, 200 S.W.3d 651 (Tex. Ct. App. 2006); *State Nat'l Ins. Co. v. Lamberti*, 362 Fed. Appx. 76, 82-83 (11th Cir. 2010) (holding under Florida law, arrest and detention of multiple protestors by sheriff's department constituted multiple "occurrences" under applicable policy requiring payment by insured of multiple SIRs, because "each interaction with the individual officers [was] the cause of the claim, and [was] distinguishable in time and space"); *Socy. of Roman Catholic Ch. v. Interstate Fire & Cas. Co.*, 26 F.3d 1359, 1364-66 (5th Cir. 1994) (holding under Louisiana law, molestation of 31 children by two priests over several years was one occurrence *per child*). Compare *Sunoco, Inc. v. Ill. Nat'l Ins. Co.*, 226 Fed. Appx. 104, 107-08 (3rd Cir. 2007) (see pp. 22-23, supra); *Chemstar, Inc. v. Liberty Mut. Ins. Co.*, 41 F.3d 429, 431-33 (9th Cir. 1994) (holding insured's supplying of defective lime plaster in 28 homes constituted single occurrence); *Champion Int'l Corp. v. Cont'l Cas. Co.*, 546 F.2d 502, 504-06 (2nd Cir. 1976) (holding insured's sale of defective paneling to 26 vehicle manufacturers resulting in damage to 1,400 vehicles was one occurrence); *Colonial Gas Co. v. Aetna Cas. & Sur. Co.*, 823 F. Supp. 975, 983-84 (D. Mass. 1993) (holding insured utility's use of faulty insulation in 390 homes was one occurrence); *Uniroyal, Inc. v. Home Ins. Co.*, 707 F. Supp. 1368, 1380-87 (E.D.N.Y. 1988) (holding manufacturer's numerous deliveries of Agent Orange to the military were single occurrence); *Transp. Ins. Co. v. Lee Way Motor Freight, Inc.*, 487 F. Supp. 1325, 1327-31 (N.D. Tex. 1980) (holding under Oklahoma law, insured's employment discrimination against multiple victims at four different locations was one occurrence); *Household Mfg., Inc. v. Liberty Mut. Ins. Co.*, 1987 U.S. Dist. LEXIS 1008, *4-7 (N.D. Ill. Feb. 11, 1987) (holding insured's sale of defective plumbing systems installed in multiple homes constituted single occurrence).

Another issue that may arise between insurer and insured deals not necessarily with multiple claims or recurring injury or damages, but rather multiple insurance policies. Under certain circumstances, an insured may obtain multiple primary-level liability insurance policies, more than one of which could apply to a particular claim or suit. In those circumstances, an insured may contend that its expenditures in defense or settlement could be used simultaneously to exhaust the SIR on more than one of the insured's primary policies. Absent specific policy language to the contrary, the insured may be right -- at least one court has held that the same defense dollars can be applied to satisfy the insured's SIRs under more than one insurance policy.[54]

VI. The Solution: Unambiguously Define the Parties' Rights and Responsibilities in the Policy and Know the Terms of Your Policy

There are a number of issues that can arise between insurer and insured as the value of a claim approaches the insured's SIR. While different jurisdictions may handle these issues differently, almost every court will enforce unambiguous policy language as it is written. If a policy contains specific, unambiguous language, whatever the policy says will most likely be enforced. Where left to chance by the use of ambiguous policy language (or where the policy is completely silent on one of these issues), though, it is tough to predict how a policy will be interpreted by a court or arbitrator. Since underwriters and risk managers alike rely on being able to forecast and predict risk, the best possible advice for anyone issuing or insured under a policy that incorporates an SIR is twofold: (1) make sure your policy contains specific, unambiguous language on each of the important issues outlined above, and (2) be familiar with the specific provisions of your policy.

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[54] See, e.g., *Bordreaux*, 186 P.3d at 1193 (holding defense costs of $105,399 paid by insured satisfied two different $100,000 SIRs under two different insurers' policies because the policies "sa[id] nothing about whether or not [the insured]'s obligation to pay [one policy's] SIR is satisfied when [the insured] fulfills a similar obligation under another policy").