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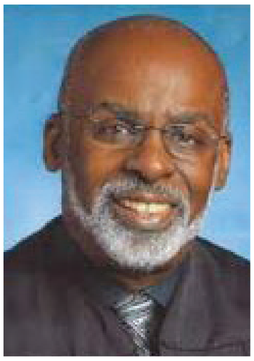

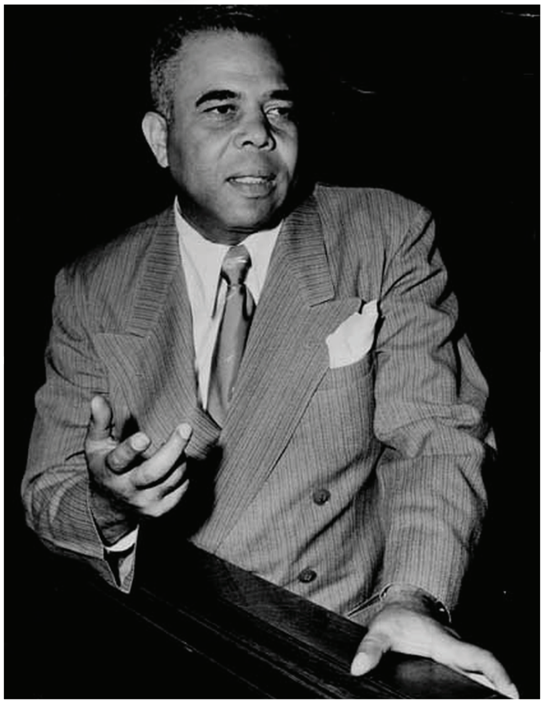
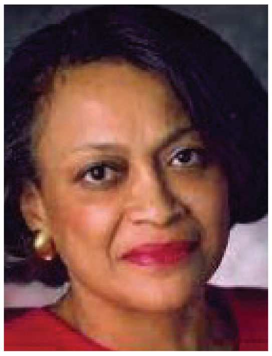

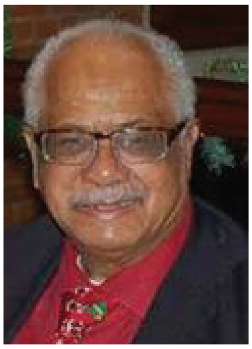

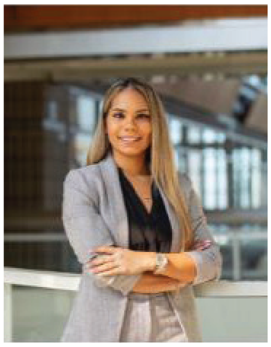


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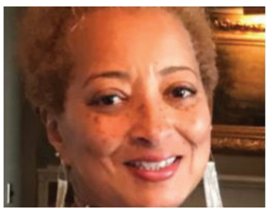

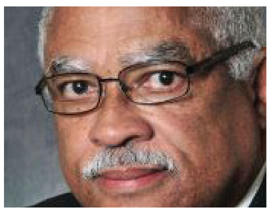

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SATISFYING POLICY RETENTIONS OR DEDUCTIBLES WITH OTHER PEOPLE'S MONEY

BY NICK BONAMINIO & MATT CHIRICOSTA

Simply stated, insurance policy deductibles or retentions are a dollar threshold that must be satisfied before an insurer will pay any defense or indemnity costs on a claim.[1] Many insureds seek to contain their insurance premium costs by purchasing policies with substantial six to nine-figure retentions or deductibles. Unsurprisingly, insurers tend to charge lower premiums if the insured is willing to retain more dollar risk for itself through retentions or deductibles.

That sounds good to everyone on the front end — until a big claim is asserted against the insured. When that unwelcome time comes, disputes often arise between insurers and insureds over precisely ***how***, or even ***whether***, the insured must pay the substantial deductible or retention before the insurer must step up and pay to defend or settle the claim against the insured.

These disputes often arise because savvy insureds with sophisticated risk management practices frequently have multiple third-party sources of coverage for a claim — ranging from different types of insurance policies to contractual indemnity agreements with other third parties. Insureds benefiting from this menu of options will often try to line up these various sources in a way that allows the insured to secure full reimbursement for defense and settlement of a claim while minimizing or eliminating the insureds' own out-of-pocket exposure for these costs.

For example, an insured might tender a lawsuit against it to two different insurance policies. One policy might have no deductible, but fairly strong coverage defenses. Because the insurer's duty to defend is broader than its duty to indemnify, this insurer may defend the insured against the claim notwithstanding the strong coverage defenses. But because the insurer's duty to indemnify is much narrower, the insurer will likely resist paying much (if anything) toward settling the claim because of those strong coverage defenses. In contrast, the other policy might have a large retention, but weak or no coverage defenses. On top of that, the insured recognizes that the language of this latter policy expressly states that defense costs count against and erode the large retention.

Recognizing that the foregoing features of these two policies each pose different coverage challenges, a savvy insured will position this claim so that the insurer with the low deductible picks up the defense of the claim from the outset. The savvy insured recognizes that the insurer on this first policy probably won't offer much money to pay a settlement when the time to negotiate one arrives. So, when that moment in the case finally comes, the insured will plan to tell the insurer with the high retention that the retention has already been satisfied by the other insurer's payment of defense costs (which the high retention policy expressly credits against the retention) and ask the insurer with the high retention to step up to settle the claim.

Predictably, insurers faced with such a request in this situation tend to reflexively assert that the insured must use its own funds, and cannot use funds from other insurers or third-party indemnitors, to satisfy a retention. Based upon that theory, the insurers will demand the insured contribute the full retention amount to settlement before extending any settlement authority, even if third parties already paid an amount equal to or exceeding the retention. The insurers frequently justify this by claiming that retentions or deductibles are supposed to be insureds' personal "skin in the game." Importantly, while this might accurately state the insurers' subjective expectation in some cases, the applicable policy language often undermines this claim.

When faced with this demand, an insured should not hastily cave to its insurer's insistence that the insured satisfy the retention with its own dollars. Instead, savvy insureds should carefully analyze the language of the policy's deductible or retention provisions to determine whether they actually support the insurer's position. Indeed, most courts that have addressed this question hold that unless the policy language ***clearly requires*** the insured to pay the deductible or retention from its own funds, the insured is perfectly entitled to use funds from other insurance policies or other third-party sources to satisfy a retention or deductible.

So — just how precise does the insurer's policy language need to be to preclude the use of other parties' funds to satisfy a retention or deductible? Courts typically require very strong, explicit language. For example, courts have held that language such as "payments by others, including but not limited to additional insurers or insureds, do not serve to satisfy the self-insured retention" or "the retention shall remain uninsured by any other policy of insurance" explicitly precludes the use of other insurance proceeds to satisfy a retention. But short of such explicit policy language, courts typically hold that the insured can satisfy the retention or deductible using other insurance policies, indemnitors' payments, or any other source.

When you zoom out and think about it, the courts' approach to this issue makes perfect common sense. In underwriting, the insurer likely took into account the retention amount (among many other factors) when it priced the premium. Against that backdrop, it shouldn't make a dime's bit of difference to the insurer ***how or from where*** the insured satisfies the retention amount. Regardless of the source, the insurer receives the benefit of its contractual bargain with the insured whether the funds come from the insured, other insurance policies, or other third-parties. A slightly different fact pattern underscores this. Imagine that instead of using other insurance or indemnitor money, the insured gets a bank loan for the retention amount and then pays it using the loan proceeds

deposited into the insured's account. It would be absurd for the insurer to contend that this isn't good enough to satisfy the retention. Absent precise policy language to the contrary, the same should be — and is — true of money derived from other insurance or indemnitors. In the end, all that matters is that the insurer gets appropriate ***dollar credit*** against the retention or deductible amount it factored into the pricing of the insured's premium.

> "An insured should not hastily cave to its insurer's insistence that the insured satisfy the retention with its own dollars."

The bottom line is that many deductible and retention provisions do not allow insurers to prevent insureds from satisfying the retention or deductible amount with other insurance or third-party payments. Consequently, insureds should not just take their insurers' words that deductibles or retentions must be satisfied from the insureds' own funds. Oftentimes, the policy language explicitly refutes such a contention, leaving the creative insured and their coverage counsel significant flexibility to argue that the retention has been satisfied.

[1] There are important legal distinctions between retentions and deductibles, but they are beyond the scope of this article. Suffice it to say that both retentions and deductibles are loss-shifting mechanisms which shift away from the insurer a portion of the loss otherwise covered by an insurance policy.

As a member of Calfee's Policyholder Insurance Coverage practice group, Nick litigates on behalf of policyholders to recover insurance assets. In addition to his insurance practice, Nick assists publicly traded and privately held companies in a wide range of business disputes and is a member of Calfee's White-Collar Defense and Investigations group, where he represents publicly and privately held clients in internal investigations and state and federal government investigations. Nick can be reached at (216) 622-8470 or nbonaminio@calfee.com.

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