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Seven Things About Professional Liability Coverage, Part 5: Self-Eroding Policies

By Andrew B. Downs

This is the fifth in a series of posts from the Federation of Defense & Corporate Counsel's (FDCC) Blog on issues arising under professional liability policies. The aim of this series is to provide sufficient background information to allow the defense attorney to identify relevant issues frequently raised by professional liability policies and to formulate a plan for addressing them. This is not a treatise on how different jurisdictions view professional liability issues. For that, the reader should review the DRI's 2012 publication *Professional Liability Insurance: A Compendium of State Law*. There are, of course, other issues of importance not discussed here.

Minimizing the Risks Created by Self-Eroding Policies

Most professional liability policies include defense costs within the limit of liability. In other words, they are "self-eroding" because every dollar spent on defense costs reduces by a dollar the available limit of liability for future defense and indemnity payments. For defense counsel, the presence of a self-eroding policy places a premium on early resolution; accurate budgeting; advance discussion with the insured and the insurer of litigation decisions that will affect the cost of defense; and accurate disclosure of the remaining policy limits at critical points in the suit. Also, if there is a substantial self-insured retention, the insured, not the insurer, will be responsible for paying defense costs until that retention is satisfied.

The benefits of early resolution should be self-evident. The less money spent on defense, the more available to pay settlements and judgments. The cases which present the greatest difficultly in this respect are those in which the plaintiff has substantially overvalued his or her case. Defending the case through trial may erode the limits to a point where an adverse judgment is guaranteed to exceed the remaining policy limits. The insured, who should always be involved in settlement discussions when there is a risk of an excess judgment, the insurer, and defense counsel need to have a full and frank discussion of the costs, risks and benefits of continuing to defend as opposed to settling. Sometimes that discussion may lead to a decision to pay more to settle early even though a vigorous defense might substantially reduce the settlement value.

Some jurisdictions require the disclosure of liability insurance during discovery, including policy limits, or permit interrogatories on that subject. With a self-eroding policy, defense counsel must disclose the self-eroding nature of the policy and should expect later inquiries by settlement judges, mediators, and opposing counsel regarding the remaining limits. Disclosure of the remaining limits presents a particular risk to counsel and the insurer because defense counsel must disclose not only the amounts already paid by the insurer, but defense counsel's accounts receivable, his or her unbilled time, unbilled disbursements, unbilled expert witness expenses and the future costs of completing any settlement negotiated at that moment. If the defense attorney omits any of these items and then negotiates a settlement for an amount all believe are the "remaining limits," he or she may not be paid for those defense costs in excess of the limits after the settlement is taken into account.

Another way professional liability policies differ is the insurer may not have a traditional duty to defend. In many professional liability policies the insurer does not contractually assume any

duty to defend. Rather, the insurer's duty is to reimburse the insured for the defense costs incurred. In some circumstances, the insurer reserves the right to appoint defense counsel, while in others, the choice belongs to the insured in the first instance.

Next up: A discussion of cases seeking restitutionary relief.