

FEB 13 1987

DEPARTMENT OF INSURANCE

DEPARTMENT OF INSURANCE

By *M.P.*

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

In the Matter of: )  
POLICY FORMS WITH DEFENSE COSTS )  
WITHIN LIMITS OR AGGREGATE. )

Docket No. 6219  
O R D E R

In recent months a variety of proposed policy forms which contain provision for defense costs to be included within the limits of the policy or within the aggregate of the policy (DWL/DWA) have been submitted to the Department of Insurance for approval. Because this issue is being raised simultaneously throughout the nation; because it represents a radical departure from traditional liability coverage; and, because the issues raise significant public policy considerations, a public hearing was held by the Department on December 2, 1986. Following the hearing the record was kept open until December 31, 1986 to permit submission of documentary statements to augment the testimony taken at hearing. Based on the totality of the record, the Director FINDS:

1. That two distinct traditions have been identified in the admitted market regarding liability insurance: one in which the purchasers of liability insurance have an absolute expectation that if a claim is made, the insurer will honor the limits of the liability policy and will also provide and control defense of the claim; and, one in certain limited areas of liability coverage where specific peculiar interests of the insured have resulted in enhanced negotiation, frequent relinquishment of control over the defense of claims by the insurer and an informed

1 and bargained for inclusion of defense costs within the limits of  
2 the policy.

3 2. That recognition of this bifurcation in traditional  
4 liability insurance practice is essential to a complete under-  
5 standing of the competing interests of both insurers and insureds  
6 in the State of Arizona.

7 3. That, historically, difficult-to-place or totally  
8 unavailable coverages have been accommodated by the surplus lines  
9 market; but, that the current record is silent on whether insurers  
10 would be willing to write, on a surplus lines basis, any of the  
11 lines for which the Department has been asked to approve forms  
12 containing DWL/DWA or whether the surplus lines market would have  
13 any appreciable impact on the availability of those lines of  
14 liability insurance coverage.

15 4. That the general rule that policy limits will not be  
16 reduced by the costs of defense is reflected not only in the  
17 expectations of policyholders and liability claimants but also in  
18 statutory provisions such as mandatory automobile insurance and  
19 others which set required limits without contemplating potential  
20 reduction of those limits based on the cost of defending claims.

21 5. That an attempt to change the nature of the bargain  
22 between insurer and insured simply by changing the policy form  
23 would constitute a significant and currently incalculable change  
24 in the contemplated risk and would result in confusion, uncer-  
25 tainty and diminished protection for the public as a whole.

26 6. That the credible evidence produced at hearing fails  
27 to provide a factual basis upon which to conclude that unless  
28 DWL/DWA is extended generally to non-traditional applications in

1 liability insurance, the availability of such insurance will be  
2 adversely affected.

3 7. That the record reveals no evidence that extension  
4 of DWL/DWA provisions to non-traditional lines would lead to rate  
5 reductions, change in the traditional control by insurers of  
6 defense selection or direction or a manageable procedure to  
7 minimize the enhanced opportunity for conflicts between insurers,  
8 insureds and defense counsel.

9 8. That evidence presented regarding the increase in  
10 defense costs to insurers is inclusive: financial data supplied  
11 does not indicate or demonstrate the causes of the alleged  
12 increases, the role of settlement practices by insurers, the  
13 dollar amounts of such costs, the numbers of such cases or other  
14 critical information required to make informed judgments.

15 9. That in those limited areas where DWL/DWA provisions  
16 have been traditionally included in the coverage bargained for, a  
17 failure to permit such provisions would substantially affect the  
18 availability of liability coverage.

19 10. That the National Association of Insurance  
20 Commissioners (NAIC), following extensive consideration of  
21 industry efforts to extend DWL/DWA provisions in liability  
22 policies resolved, in December 1986, to recommend that individual  
23 state insurance regulators reject such efforts at this time; that  
24 the NAIC consideration of this issue will continue and will,  
25 hopefully, result in an information base that will prove useful  
26 in future monitoring of this issue.

27 11. That because of the potential impact on the  
28 liability insurance marketplace in general and on individual

1 policyholders in particular, The Department of Insurance should,  
2 within one year, review the issues raised herein and, at that  
3 time, reassess the use of DWL/DWA provisions in policies issued  
4 by admitted insurers in this state.

5 CONCLUSIONS OF LAW

6 Based on the record in this matter and a review of  
7 applicable law, the Director concludes, as a matter of Law:

8 1. That in deciding whether or not to permit  
9 fundamental change in the nature of insurance transacted in the  
10 State of Arizona, the Director must be guided by the purposes  
11 contained in Laws 1980, Ch. 230, § 1:

12 "The objectives of the department of insur-  
13 ance are to administer the state insurance  
14 laws, protect the citizens of this state who  
15 purchase insurance, provide a better response  
16 to the needs of persons who purchase insurance  
17 and stimulate the insurance market by  
18 encouraging competition."

19 2. That policy forms providing for DWL/DWA in the  
20 following types of policies are consistent with the objectives  
21 stated above because they have traditionally formed a part of the  
22 insurance bargain negotiated between insurer and insured, have  
23 regularly permitted the insured rather than the insurer to  
24 control defense of claims and are the result of informed, arms-  
25 length negotiation:  
26  
27  
28

- a) Professional Liability insurance
- b) Directors and Officers liability insurance, including fiduciary liability insurance
- c) Libel and Slander insurance
- d) Aviation insurance
- e) Marine and inland marine insurance
- f) Umbrella policies and policies which provide excess limits.
- g) Errors and Omissions policies

3. That extension of DWL/DWA provisions beyond the areas listed above would constitute a form of public deception which would mislead the public generally and which would violate Laws 1980, Ch.230 § 1 and the more specific provisions of A.R.S. § 20-1111 which mandate disapproval of misleading or deceptive policy forms.

ORDER

IT IS THEREFORE ORDERED that policy forms currently approved which provide coverage in areas listed in Conclusions of Law 2. above are, and remain, approved.

IT IS FURTHER ORDERED that policy forms submitted to the Department which provide coverage in areas of liability insurance listed in Conclusions of Law 2. above and which are consistent with this order may be approved even though they contain provisions for DWL/DWA.

IT IS FURTHER ORDERED that policy forms for liability insurance submitted to the Department which contain provisions for DWL/DWA and which do not fall within the limited exceptions listed in Conclusions of Law 2. above are disapproved.

1 IT IS FURTHER ORDERED that the issues covered by this  
2 Order be reviewed by public hearing no later than one year from  
3 the date of this Order.

4 DATED this 13th day of February, 1987.

5   
6 S. DAVID CHILDERS  
7 Director of Insurance

8   
9 MICHAEL R. SURR  
10 Chief Hearing Officer

11 COPIES of the foregoing mailed this  
12 13th day of February, 1987 to:

13 Susan Callinger, Deputy Director  
14 Deloris E. Williamson, Supervisor  
15 Rates and Regulation Division  
16 Emil Barberich  
17 Department of Insurance  
18 801 East Jefferson  
19 Phoenix, Arizona 85034

20 Honorable Edward J. Muhl  
21 Maryland Insurance Commissioner  
22 Department of Licensing & Regulation  
23 Insurance Division  
24 501 St. Paul Place  
25 Baltimore, MD 21202

26 Honorable John E. Washburn  
27 Insurance Director  
28 Illinois Department of Insurance  
320 West Washington St.  
Springfield, IL 62767

Honorable Gil McCarty  
Commissioner of Insurance  
Kentucky Insurance Department  
229 West Main St.  
P. O. Box 517  
Frankfort, Kentucky 40602