

DUTY TO DEBATE NEW YORK'S DUTY-TO-DEFEND MANDATE

When New York State insurance officials issued an opinion mandating duty-to-defend provisions and granting insurers the right to control the selection of defense counsel in Directors & Officers (D&O) policies last October, they may have had little idea of the stir they would cause in D&O circles. They certainly know now. While the ruling will primarily impact only New York-based public companies, any organization wanting to keep current with D&O issues should consider the debate taking place in New York's insurance community.

The key issue for policyholders is whether the broader coverage provided by the duty-to-defend mandate (i.e., no allocation of defense costs between covered and non-covered matters) plus the benefit of having defense costs applied outside the limit of liability outweighs the loss of control over selection of counsel. For many companies, this is not an easy choice to make.

ISSUE

The Office of General Counsel of the New York State Insurance Department (NYSID) issued an opinion on October 16, 2008 stating, among other things, that a D&O policy cannot put the duty to defend upon the insured. Put another way, the opinion mandates that D&O policies issued in the admitted market in New York place a duty-to-defend requirement on the *insurers* – flying in the face of how public company D&O policies typically work. The opinion underscored the point by referencing a regulation prohibiting any Liability policy from:



- Reducing the limit of liability stated in the policy by the amount of the legal defense costs
- Permitting legal defense costs to be applied against the deductible
- Otherwise limiting the availability of coverage for legal defense costs

The scope and impact of the opinion as it stands now is quite limited. It should *not* affect any current policies admitted in New York, any policies issued outside of New York, or any policies exempt from filing requirements because they are sold in the New York Free Trade Zone. Furthermore, a significant number of D&O policies for privately held companies and nonprofit organizations already impose a duty to defend on

insurers. The mandate mostly impacts new or renewing D&O insurance for New York public companies where no such duty currently exists.

IMPACT

On one hand, this may be welcomed as good news by some New York public companies. The change is significant, as it implies a broadening of coverage due to at least two factors. Defense costs would be applied outside the limit of liability and there would be no allocation of defense costs between covered and non-covered matters. On the other hand, the increase in coverage comes at a cost that some public companies may be reluctant to pay: a loss of control over the selection of defense counsel and the settlement process.

Usually, the party with the duty to defend D&O claims gets to select defense counsel and to some extent control the defense strategy, including when to settle a claim. The right to choose defense counsel in high-profile, complex D&O litigation is crucial, to the point where some companies might prefer that right to any potential expansion of coverage that results from the opinion. The change in policy, then, may be a cause for concern rather than celebration.

The matter is not entirely settled. NYSID invited interested parties to its office on January 27 and acknowledged the strong reaction the opinion inspired. Officials indicated they would consider revising the opinion with input from various constituents and possibly addressing the issues through regulation.

ACTION

Risk managers for New York public companies, in particular, must recognize the complexity and potential importance of these issues. The firm's general counsel should be involved and kept abreast of the ongoing discussion. Companies outside of New York, though not directly affected, may want to take a moment to be sure they understand the duty-to-defend language that appears in their own D&O coverage, and the potential ramifications that language may have in handling claims.

The Willis HRH Executive Risks Practice is currently engaged with the NYSID in discussions about how we can both achieve our mutual goal of representing the best interests of policyholders. We invite organizations to contact their Willis HRH Client Advocate or local Executive Risks Practice representative to see how they may be impacted by the duty-to-defend debate.

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