SATISFYING A SELF-INSURED RETENTION

Many liability policies require the satisfaction of a designated dollar amount, usually described as a Self-Insured Retention ("SIR"), before the insurer's duties under its policy are triggered. Some SIRs apply to both the insurer's duty to defend and its duty to indemnify. However, other SIRs apply *only* to the duty to indemnify, and in no way limit or delay an insurer's *immediate* duty to defend an insured. *See Legacy Vulcan Corp. v. Superior Court*, 185 Cal. App. 4th 677, 682 (2010) (unless a policy expressly so provides, an SIR does not relieve an insurer from a first-dollar duty to defend).

Where an SIR does apply to the duty to defend, an insured has an obvious incentive to ensure that every dollar reasonably incurred towards its defense of a third-party claim counts toward satisfying the SIR. An insurer, on the other hand, has a countervailing incentive to delay the satisfaction of an SIR for as long as possible, and thereby limit its exposure to defense costs. It is hardly surprising, therefore, that questions involving SIR satisfaction frequently arise.

1. Who May Satisfy An SIR?

The courts have answered this question by looking at the express provisions of the policy. Thus, for example, courts have recognized that some policies permit *any* insured, *i.e.*, either the Named Insured or an Additional Insured, to satisfy an SIR. *See Centex Homes v. Lexington Ins. Co.*, 13-00998 (C.D. Cal. 2014). Other policies, in contrast, expressly prohibit satisfaction of an SIR by anyone except the Named Insured. *See Forecast Homes, Inc. v. Steadfast Ins. Co.*, 181 Cal. App. 4th 1466, 1476-77 (2010).

2. May "Other Insurance" Satisfy An SIR?

This question arises where multiple policies are triggered by a claim, and the policies have different SIRs, or some of the policies have SIRs while others do not. This scenario is sometimes encountered in continuing loss cases, where multiple policies over several years are triggered by a claim. Or it may simply arise where a claim makes allegations triggering coverage under two or more policies issued in the same year, *e.g.*, both a Directors & Officers policy and an Errors & Omissions policy.

As with most issues related to SIRs, the question of whether defense costs paid out under one policy serve to satisfy the SIR in another policy depends upon the express policy language. Courts recognize that some policies permit satisfaction of an SIR by other insurance. *See Vons Cos., Inc. v. United States Fire Ins. Co.*, 78 Cal. App 4th 52, 63-64 (2000). Other policies, however, expressly disallow the use of other insurance proceeds to satisfy an SIR. *See id.* at n. 4.

3. Do Pre-Notice Defense Expenses Satisfy An SIR?

Most liability policies contain what is commonly referred to as a "No Voluntary Payment" (or "NVP") clause. The NVP clause prohibits an insured from incurring any expense without the insurer's consent, and typically provides that any such voluntarily-incurred expense will be at the insured's "own cost." With limited exceptions, a number of California courts have ruled that the NVP clause bars reimbursement of pre-tender expenses, *i.e.*, defense fees and costs that are voluntarily incurred by an insured prior to tendering a claim. *See, e.g., Tradewinds Escrow v. Truck Ins. Exch.*, 97 Cal. App. 4th 704, 710-712 (2002).

Some insurers, however, have improperly sought to extend this pre-tender rule to defense fees and costs incurred by an insured within an SIR. They will contend that where an insured has incurred defense fees and costs prior to placing the insurer on notice of the claim, such expenses will not be *credited* against the SIR.

This contention overlooks the fact that a typical NVP clause is entirely silent about expenses incurred within an SIR. Moreover, the NVP clause merely provides that voluntarily-incurred expenses are at the insured's "own cost." On its face, therefore, the NVP clause has no application to expenses incurred by an insured within an SIR since such expenses are *already* at the insured's "own cost."

Insurers are, of course, free to include language in their policies that require the insured to obtain consent before incurring fees and costs within an SIR. Absent such language, however, insurers should not be allowed arbitrarily to refuse to credit pre-notice fees against a policy's SIR. *See, Amadeo v. Principal Mut. Life Ins. Co.*, 290 F.3d 1152 (9th Cir. 2002) ("Arbitrary interpretation of insurance contracts is the antithesis of the reasonable dealing required by the covenant of good faith.").

4. Do An Insured's Reasonable Defense Costs Erode An SIR?

This question was the subject of a recent summary judgment order in *KPC Healthcare, Inc. v. Hudson Specialty Ins. Co.*, 16-01483 (C.D. Cal. 2017). In that case, a dispute had arisen over whether an SIR was being eroded by the "reasonable" hourly billing rates that the insured was paying its defense counsel, or as the insurer contended, at the lower *Cumis* billing rates the insurer represented it would pay if and when the SIR was fully satisfied.

Applying California law, the federal district court held that the SIR eroded at defense counsel's "reasonable" hourly billing rates. In so holding, the court noted that the policies in question provided that the SIR was applicable to "defense costs" which the court held has an "ordinary meaning that is obvious to any speaker of the English language." The court further pointed out that the insurer had provided "no authority for the proposition that the *Cumis* rate should apply to the erosion" of an SIR.

The court's reasoning in *KPC Healthcare* is consistent with the point made above in relation to pre-notice expenses. Absent supportive policy language, an insurer should not place arbitrary limitations on how an insured must satisfy its SIR. Provided the defense fees and expenses the insured incurs are reasonable, they should be credited in full against the SIR.

In conclusion, questions about SIR satisfaction are not answered by any set of fixed rules, but instead by reference to the terms and conditions of the particular policy. In this regard, policy forms differ considerably in their treatment of SIR satisfaction. So when confronted by an insurer taking a position that may bear upon satisfaction of an SIR, do not take the insurer's word on faith. Instead, carefully read the policy.