

Insurers Have a Duty to Defend at the Outset of Litigation Even If a SIR Has Not Been Exhausted

Insurers providing general liability insurance cannot shirk their duty to defend insureds at the outset of litigation by relying on self-insured retention (SIR) provisions in those policies unless the policies **expressly and unambiguously** make the insurer's duty to defend contingent upon the SIR. So held the Fourth District Court of Appeals in *American Safety Indemnity Company v. Admiral Insurance Company*, __ Cal. App. 4th ___, 2013 Cal. App. LEXIS 779 (2013). The court's decision in *American Safety* is highly favorable to insureds because it substantially limits the ability of insurers to circumvent their obligation to pay first-dollar for the defense of their insured by arguing that the SIR has not been exhausted.

American Safety involves an underlying claim brought by homeowners against several defendants, including a developer and grading contractor, for damages caused by landslides allegedly caused by defendants' grading work done in relation to the construction of new homes. The grading contractor was insured by American Safety Indemnity Company under a commercial general liability policy. The developer was insured by Admiral Insurance Company and was also an additional insured under the grading contractor's policy with American Safety. After American Safety initially rejected the developer's claim for defense costs for the underlying lawsuit, the developer brought a bad faith claim against American Safety. The case ultimately settled and American Safety paid the defense costs of the developer and two of the developer's related entities who were represented by the same law firm.

In the case before the court in *American Safety*, American Safety sued Admiral for equitable subrogation of defense costs alleging that American Safety was entitled to reimbursement of defense costs from Admiral because the developer was insured under the Admiral policy and its related entities were named insured on the Admiral policy. Admiral's primary defense against American Safety's claim was the SIR provision in the policy, which stated "[o]ur total liability for all damages will not exceed the limits of liability as stated in the Declarations and will apply in excess of the insured's self-insured retention (the 'Retained Limit'). 'Retained Limit' is the amount shown below, which you are obligated to pay, and only includes damages otherwise payable under this policy." The "Retained Limit" in the policy was \$250,000. Admiral argued that, because the SIR had not been exhausted, **it owed no duty of defense to the insured entities** and American Safety, by extension, was not entitled to reimbursement of its defense costs. In essence, Admiral asserted that its duty to defend was contingent upon the SIR.

At trial, the district court held that Admiral's duty to defend the insured entities was independent of the SIR, and thus, American Safety was entitled to reimbursement of defense costs paid and interest. On appeal, Admiral again argued that the SIR relieved it of its duty to defend and that it was essentially an excess insurer that owed no duty to the insured entities. The Court of Appeal upheld the trial court's ruling and rejected Admiral's contention. In reaching its decision, the court relied heavily on the holding in *Legacy Vulcan Corporation v. Superior Court* 185 Cal. App. 4th (2010). The court first noted that the face of the Admiral policy identified it as providing primary coverage, and its coverage is excess only when other insurance was available to its insured or "when the insureds are named as additional insured on another party's policy." Citing *Legacy Vulcan*, the court distinguished primary insurance contracts from excess insurance contracts in terms of the reasonable expectations of the insured. Whereas an excess insurer does not have a duty to defend until the primary insurance is exhausted and the insured has no reasonable contrary expectations, insureds under primary policies with a SIR provision *do* have a reasonable expectation that they will receive a defense. The court specifically noted the reasoning behind the *Legacy Vulcan* decision that requiring exhaustion of a SIR "before an insured will have a duty to defend would not ensure that the defense obligation

rests on the insurer receiving premiums for the risk, but instead would result in no insurer providing a defense prior to exhaustion.”

Thus, the court concluded that, a SIR provision does not automatically relieve a primary insurer of its duty to pay first-dollar in defending its insured. Instead, the court affirmed that the policy must **expressly and unambiguously** make the insurer’s duty to defend subject to the SIR. The court found that Admiral’s policy did not make its duty to defend the insured entities expressly contingent upon the SIR. In fact, as the court notes, the Admiral policy does the opposite by expressly stating that the “Retained Limit” only includes damages otherwise payable under the policy. As such, the Court of Appeal found that the trial court had not erred in determining that the insured entities were not required to satisfy the SIR as a condition of receiving a defense from Admiral.

This decision provides an insured with a powerful retort to insurers attempting to deny providing a defense by asserting that SIR provision of their policy has not been met. In the absence of express and unambiguous language in the policy conditioning the provision of a defense on exhaustion of the SIR, insureds are entitled to the insurer’s participation in their defense at the outset of litigation even if the SIR has not been exhausted.