

**Chapter III -- POLICY AND CERTIFICATE PROVISIONS**  
**Subchapter B. -- Property and Casualty Insurance**  
**Part 71. -- Legal Defense Costs in Liability Policies**  
**(Regulation 107)**

*Updated with all regulations adopted through **March 10, 2004.***

**11 NYCRR 71.0**

**Preamble**

(a) Prior to the original promulgation of this Part in 1983, the Insurance Department had approved a limited number of personal injury and property damage liability insurance policies in which legal defense costs were permitted to reduce the stated limits of liability when such legal defense costs were incident to a claim of legal liability covered under the policy. Further, the Department had also approved certain policies that permitted legal defense costs to be applied against the deductible.

(b) Other than those limited circumstances, personal injury and property damage liability insurance policies generally provided that legal defense costs incident to a claim of legal liability and incurred in defending a claim of legal liability under the policy were covered by the policy independent of the stated limits of liability. Those policies placed no limit on defense costs and the stated limits of liability were used solely to pay the amount of damages, up to those liability limits, as ultimately determined by judgment or settlement. In such policies, any deductible was also applied only against the amount of a judgment or settlement.

(c) This Part was originally promulgated to provide rules restricting the lines of business wherein legal defense costs could be offset against the liability limits or against the deductible, and to provide for adequate disclosure to the insured in such cases. At that time, the Department was advised by insurers that legal defense costs for directors and officers liability and media, publishing and advertising liability, where reputational interests are of significant concern to the insured, were relatively high compared with actual loss payments. With the legal defense cost offset, insurers could more easily estimate their maximum potential losses, provide such specialized coverages, and determine appropriate rates for such coverages.

(d) Subsequent amendments to this Part arose out of this Department's concern with the proliferation of liability policies containing legal defense cost offset provisions for other types of risks. While these policies contained the required notification to insureds, the Department was concerned with the escalating use of these legal defense cost offset provisions, for the following reasons:

(1) Widespread usage of legal defense cost offset provisions represented a substantial change in traditional insurance coverage, whereby the insurer generally has a duty to defend any liability suit covered under the policy in which damages are sought. This duty to defend typically had been separate and apart from the obligation to pay damages under the policy and, accordingly, an insurer was obligated to provide a proper defense regardless of cost. The duty to defend is broader than the duty to pay and extends to any action, even if groundless, false or fraudulent, in which facts are alleged within the coverage of the policy.

(2) In the majority of the policies containing legal defense cost offset provisions filed with the Department, insureds were offered neither the option of selecting the defense attorney nor the right to consent to any settlement. Insureds were unable to control how legal defense costs were spent, despite the insured's potentially large financial risk in view of the possibility that legal defense costs may have approached, or even exceeded, the stated liability limits. In such instances, the insured would become responsible for legal defense costs, as well as for damages on the liability claim itself, that exceed policy limits. As respects the deductible, depending on its size, a significant portion of initial legal defense costs could have become the insured's responsibility.

(e) The superintendent concluded that the public interest demanded that legal defense cost offsets against liability limits or deductibles be permitted only with respect to such lines, sublines, classes or subclasses where: (1) legal defense costs represented a significant portion of monies paid out by insurers; (2) the need to incorporate legal defense costs within liability limits could be demonstrated; and (3) such offset provisions were approved by the superintendent.

(f) In amending this Part, the superintendent considered such factors as: (1) industry-wide experience detailing legal defense costs expended in proportion to actual loss payments; (2) availability and type of coverage; (3) ability to establish appropriate rates for the coverage; (4) rate impact of the offset; (5) degree to which reputational interests of the insured are at stake; and (6) level of sophistication of the insured.

(g) These amendments set forth limitations on the type of risk or coverage for which legal defense costs would be permitted to be offset against liability limits or policy deductibles, as well as the dimensions of any such offset, and specified minimum liability limits for any policy containing these offsets.

(h) Large insureds, as evidenced by their financial size or the level of insurance coverage obtained, tend to be more knowledgeable insurance consumers than smaller, usually less sophisticated insureds and, therefore, are more typically in a better position to protect themselves or to negotiate protections for themselves from their insurers. Given their larger size and greater sophistication, these insureds should be more able to respond to claims out of their own resources if their insurance coverage is depleted by defense cost offsets. In turn, insurers warrant more flexibility in tailoring their policies to the individual needs of larger, more sophisticated insureds in order to provide coverage to them efficiently and effectively. In recognition of these factors, amendments to this Part exempt policies issued to large insureds from a number of the requirements of this Part, thus permitting defense cost offsets in liability policies in the event that the insured exceeds specified size criteria set forth in section 71.3(e) of this Part.

(i)(1) Federal Environmental Protection Agency ("EPA") financial responsibility requirements, for owners and operators of underground storage tanks ("USTs"), took effect in April 1991 for those with 13 to 99 USTs, and are scheduled to take effect December 31, 1993 for those with less than 13 USTs. Under these federal UST requirements, insurance policy limits must be fully available for first-party clean-up as well as third-party liability, and cannot be reduced by defense costs. Given the potential for high defense costs, however, insurers have been unable or unwilling to provide pollution liability policies unless defense costs are somehow limited.

(2) In order to encourage the availability of insurance within these federal mandates, while at this same time allowing a finite limit on insurers' defense obligations, this Part authorizes policies containing defense limits separate from liability limits, subject to the standards set forth in section 71.4 of this Part, for environmental impairment and pollution liability policies issued to UST owners or operators in order to meet EPA financial responsibility requirements.

(j) Marketplace developments since this Part was originally adopted have resulted in the widespread use of policies with defense costs offset against the limits of liability and the increase in knowledge and sophistication of insureds and insurance agents and brokers with respect to this type of policy. Accordingly, this Part is amended to add employment practices liability to the list of coverages that may be written on a defense within limits basis; lower the financial threshold requirements for large commercial insureds; and allow for alternative disclosure statement requirements.

## **11 NYCRR 71.1**

### **Definitions**

For purposes of this Part, the following definitions shall apply:

(a) "Legal defense costs" mean allocated attorney and all other litigation expenses that can be separately identified as arising from the defense of a specific claim.

(b) "Liability insurance policy" means any insurance policy covering liability, even if it also contains other types of coverage.

(c) "Issue" shall include issue for delivery.

(d) "Commercial risk insurance" means insurance as defined in section 107(a)(47) of the Insurance Law.

(e) "Public entity" has the meaning contained in section 107(a)(51) of the Insurance Law.

(f) "Not-for-profit organization" means a corporation, association, organization or trust described in Section 501(c)(3) of the United States Internal Revenue Code.

(g) "Large commercial insured" means a commercial risk policy insured that:

(1) has a net worth of at least \$7,500,000, as determined by an independent certified public accountant, as of the insured's fiscal year end immediately preceding the policy's effective date;

(2) has gross assets exceeding \$25,000,000 and a net worth of at least \$1,500,000, as determined by an independent certified public accountant, as of the insured's fiscal year end immediately preceding the policy's effective date;

(3) is a for-profit business entity that generates annual gross revenues exceeding \$25,000,000, and has a net worth of at least \$1,500,000, as determined by an independent certified public accountant, as of the insured's fiscal year end immediately preceding the policy's effective date;

(4) is a for-profit business entity that has gross assets exceeding \$25,000,000 and generates annual gross revenues exceeding \$25,000,000, as determined by an independent certified public accountant, as of the insured's fiscal year end immediately preceding the policy's effective date; or

(5) is a not-for-profit organization or public entity with an annual budget exceeding \$50,000,000 for each of its three fiscal years immediately preceding the policy's effective date.

## **11 NYCRR 71.2**

### **General prohibition**

(a) No liability insurance policy, except as specified in this Part, shall be issued or renewed in this state containing a provision that:

- (1) reduces the limits of liability stated in the policy by legal defense costs;
- (2) permits legal defense costs to be applied against the deductible, if any; or
- (3) otherwise limits the availability of coverage for legal defense costs.

(b) Notwithstanding any other provisions of this Part, no liability insurance policy shall be issued or renewed in this state if it contains the limitations specified in subdivision (a) of this section for:

- (1) motor vehicle liability;
- (2) medical malpractice liability, except hospital medical malpractice liability as otherwise permitted by this Part; or
- (3) any liability risk or coverage subject to section 3425 of the Insurance Law.

(c) No liability insurance policy shall be issued or renewed in this state unless legal defense costs are incident to a claim of legal liability covered under the policy.

## **11 NYCRR 71.3**

### **Exceptions to general prohibition**

(a) A liability insurance policy which contains a provision that reduces the limits of liability stated in the policy by the costs of legal defense may be issued or renewed in this state only for the types of risks or coverages, and minimum limits, specified in subdivision (d) of this section. Unless the policy provides the insured with control of the defense, as specified in subdivision (c) of this section, legal defense costs charged against the stated limits of liability shall not exceed fifty percent (50%) of such limits and, except for the offset against the deductible authorized by subdivision (b) of this section, the insurer shall assume any legal defense costs over the amount or percentage specified in the policy.

(b) A liability insurance policy which contains a provision permitting legal defense costs to be applied against the deductible may be issued or renewed in this state only for the types of risks or coverages, and minimum limits, specified in subdivision (d) of this section. Unless the policy provides the insured with control of the defense, as specified in subdivision (c) of this section, the legal defense costs assumed by or charged to the insured shall not exceed fifty percent (50%) of such deductible and, except for the offset against the policy limits authorized by subdivision (a) of this section, the insurer shall assume any legal defense costs over the amount or percentage specified in the policy in regard to such deductible.

(c) The percentage limitation specified in subdivisions (a) and (b) of this section may be omitted if the policy provides that the insured shall have the option to: (1) select the defense attorney or to consent to the insurer's choice of defense attorney, which consent shall not be unreasonably withheld; (2) participate in, and assist in the direction of, the defense of any claim; and (3) consent to a settlement, which consent shall not be unreasonably withheld.

(d) A legal defense cost offset provision as specified in subdivision (a) or (b) of this section may be included in a liability policy only for the following types of risks or coverages, and only where the per occurrence liability limits for all liability risks and coverages under the policy are at least:

(1) \$100,000;

(i) employee benefit liability;

(ii) fiduciary liability; and

(iii) employment practices liability.

(2) \$500,000:

(i) environmental impairment and pollution liability;

(ii) directors and officers liability;

(iii) media, publishing and advertising liability;

(iv) architects and engineers liability;

(v) errors and omissions liability; and

(vi) professional liability, other than medical malpractice liability.

(3) \$1 million: hospital medical malpractice liability, for renewals only, if the expiring policy contained approved legal defense cost offset provisions.

(e)(1) A liability insurance policy containing a provision that reduces the limits of liability stated in the policy by the costs of legal defense, or permits offsets against the deductible by the costs of legal defense, and which meets the requirements of paragraph (2) of this subdivision, may be issued or renewed in this state if the policy:

- (i) insures a large commercial insured;
  - (ii) provides primary coverage of at least \$5,000,000 per occurrence;
  - (iii) provides umbrella or excess coverage of at least \$1,000,000 per occurrence, where the underlying limits are at least \$2,000,000 per occurrence; or
  - (iv) is written with a deductible, or over a self-insured retention, of at least \$100,000 per occurrence.
- (2) Any policy issued or renewed pursuant to this subdivision must comply with all the provisions of this Part except:
- (i) subdivisions (a), (b), (c), and (d) of this section; and
  - (ii) subdivisions (b)(1), (2) and (3), (c) and (d) of section 71.5 of this Part.
- (f) Legal services insurance that is a part of a policy of liability insurance that contains a provision reducing the limits of liability by the costs of legal defense, in accordance with the provisions of this Part, may reduce the per claim or aggregate liability limits of the liability policy if the policy limits are not reduced by greater than 25%.

**11 NYCRR 71.4**

**Separate defense limit**

- (a) A liability insurance policy that provides for payment of legal defense costs under a separate defense limit, as specified in subdivision (b) of this section, may be issued or renewed in this state.
- (b) The policy shall provide coverage for pollution liability or environmental impairment and shall be issued or renewed to an owner or operator of underground storage tanks in order to satisfy the financial responsibility requirements promulgated by the federal environmental protection agency.
- (c) The policy shall provide that:
  - (1) There shall be a per claim liability limit, and there may be an annual aggregate limit, subject to the following minimum limits:

Type of Insured	Monthly Facility Throughput (Gallons)	No. of Tanks	Minimum Per Claim	Limits Annual Aggregate
Petroleum Non-marketer	10,000 or less	100 or less	\$ 500,000	\$1,000,000
	10,000 or less	101 or more	\$ 500,000	\$2,000,000
	10,001 or more	100 or less	\$1,000,000	\$1,000,000
	10,001 or more	101 or more	\$1,000,000	\$2,000,000
Petroleum Marketer	N/A	100 or less	\$1,000,000	\$1,000,000
	N/A	101 or more	\$1,000,000	\$2,000,000

- (2) The per claim liability limit and any annual aggregate limit shall not be reduced by the payment of legal defense costs.
- (3) The separate defense limit shall:
  - (i) apply to each claim in an amount at least 50% of the per claim liability limit applicability to such claim;
  - (ii) for policies without an annual aggregate limit, apply to all claims in an amount no less than the per claim liability limit; or
  - (iii) for policies with an annual aggregate limit, if the insurer simultaneously offers the insured the option of purchasing a separate defense limit in an amount at least 50% of the annual aggregate limit, apply to all claims in an amount equal to the greater of 25% of the annual aggregate limit or \$500,000.

(4) If the per claim liability limit or any annual aggregate limit becomes exhausted, the insurer shall pay no further defense costs even if the separate defense limit has not been exhausted.

(d) If legal services insurance is a part of the policy, then the separate defense limit may not be reduced by greater than 25%.

## **11 NYCRR 71.5**

### **Required notification**

(a) Any policy issued or renewed in this state permitted pursuant to this Part must print a conspicuous notice of its defense cost offset provisions on the face of the application for insurance and on the face of the policy.

(b)(1) Except as provided in paragraph (4) of this subdivision, any policy containing legal defense cost offset provisions specified in section 71.3(a) of this Part must contain a statement signed by the insured acknowledging that the insured is aware that the limits of liability contained in the policy shall be reduced up to the amount or percentage stated in the policy by legal defense costs and, in such event, the insurer shall be liable for legal defense costs (except those due to any offset against the deductible) exceeding that amount or percentage.

(2) Any policy containing the legal defense cost offset provisions specified in section 71.3(a) where the percentage limitation may be omitted pursuant to section 71.3(c) must contain a statement signed by the insured acknowledging that the insured is aware that the limits of liability contained in the policy shall be reduced, and may be completely exhausted, by legal defense costs and, to the extent that policy limits are thereby exceeded, the insurer shall not be liable for legal defense costs or for the amount of any judgment or settlement.

(3) Any policy containing the legal defense cost offset provisions specified in section 71.3(b) must contain a statement signed by the insured acknowledging that the insured is aware that legal defense costs that are incurred shall be applied against the deductible up to the amount or percentage stated in the policy and, in such event, that the insurer shall be liable for legal defense costs (except for those due to any offset against liability limits) exceeding that amount or percentage.

(4) Any policy containing the separate defense limit provisions specified in section 71.4 of this Part shall contain a statement signed by the insured, describing the separate defense limit, and acknowledging that the insured is aware that the amounts available for the payment of legal defense costs are limited and may be exhausted and, in that event or in the event that the separate liability limits are exhausted, the insurer shall not be liable for any further legal defense costs.

(5) Any policy issued pursuant to subparagraphs (ii) through (iv) of section 71.3(e)(1) of this Part shall contain a statement signed by the insured, acknowledging that the insured is aware of the extent to which legal defense costs that are incurred shall be offset against the limits of liability or the deductible and, if such limits or deductible can be completely exhausted by the payment of legal defense costs, that the insurer in the event of such exhaustion shall not be liable for further legal defense costs or for the amount of any judgment or settlement.

(c) The signed statement required by subdivision (b) of this section shall be attached to, and made a part of, the policy.

(d) In lieu of the signed disclosure statements required by subdivision (b) of this section, an insurer may include the following in the notice required by subdivision (a) of this section:

(1) The notice shall specify the amount or percentage by which legal defense cost will reduce the limits of liability or deductible. If the limits of liability may be completely exhausted by legal defense costs, the notice must state that the insurer shall not be liable for legal defense costs or for the amount of any judgment or settlement after exhaustion of the liability limit.

(2) If the notice applies to a policy containing separate defense limits as specified in Section 71.4 of this Part, the notice shall describe the separate defense limit and shall specify that in the event that either the separate defense limit or the liability limit is exhausted, the insurer shall not be liable for any further legal defense costs.

## **11 NYCRR 71.6**

### **Accounting**

(a) Where a liability insurance policy is issued or renewed pursuant to this Part, the insurer shall notify the insured of the insured's right, upon written request, to an accounting of legal defense costs actually expended.

(b) Any policy issued or renewed pursuant to section 71.4 of this Part shall provide that, if 50% or more of the separate defense limit is utilized, written notification of the amount of defense coverage remaining under the policy shall be provided to the insured as soon as practicable, and the insurer shall again provide such notification at the 75% and 100% utilization levels.

**11 NYCRR 71.7****Cost offset**

The premium and rate for any policy issued or renewed in this state permitted pursuant to this Part shall be commensurate with the coverage provided.

**11 NYCRR 71.8****Exemptions**

(a) This Part shall not apply to aircraft liability policies, fidelity and surety policies, nuclear liability policies, marine protection and indemnity policies, or policies issued or renewed pursuant to section 1116 of the Insurance Law respecting prepaid legal services plans.

(b) No policy issued or renewed pursuant to section 71.4 of this Part shall qualify for exemption from filing under section 6301 of the Insurance Law.