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"Navigating the Waters of Large SIRs and Deductibles"

I. Issue: Is There a Duty to Defend Before the SIR is Satisfied?

A. California

In *Evanston Ins. Co. v. American Safety Indemn. Co.*, 768 F. Supp. 2d 1004 (N.D. Cal. 2011), the court held the insurer's duty to defend arose on the day the insured paid the SIR, and not on the date of tender, because the policy expressly stated that payment of the SIR was a "condition precedent" to the insurer's obligation to provide a defense and indemnity.

In *American Safety Indemn. Co. v. Admiral Ins. Co.*, 220 Cal. App. 4th 1 (2013), the court held that if the SIR applies only to indemnity and does not expressly state that satisfaction of the SIR is a prerequisite to defense, the insurer is obligated to defend. The policy stated, "Our total liability for all damages . . . will apply in excess of the insured's self-insured retention (the 'Retained Limit') . . . 'Retained Limit' is the amount shown below . . . and *only includes damages* . . ."

B. Illinois

In *American Safety Casualty Insurance company v. City of Waukegan* 776 F. Supp. 2d 670, 699 (N.D. Ill. 2011), the court held that policy language stating "[t]he self-insured retention [SIR] shall be paid by the insured prior to any obligation on the part of the Company" meant only that the carrier had no obligation to pay any judgment or costs until exhaustion of the SIR. "Consequently, exhaustion of the SIR was not necessary before [the carrier] had a duty to defend the [insured]…the policies do not give any indication that the SIR functions as an exception or exclusion to [the carrier's] duty to defend."

In *Geisler v. Everest Nat. Ins. Co.*, 2012 IL. App. (1st) 103834, ¶ 72, 980 N.E.2d 1170, 1185 (2012), the court held "the language of the SIR provision explicitly states that the coverage does not provide defendant Everest with a duty to defend…")

C. Texas

In *Energy Res., LLC v. Petroleum Solutions Int'l, LLC*, CIV. A. H:08-656, 2011 WL 3648083, at *14 (S.D. Tex., Aug. 17, 2011), the court held the carrier had no duty to defend until exhaustion of the SIR where the policy specifically contained language making exhaustion "a condition to the insurer's duty to defend."

In *U.S. Fire Ins. Co. v. Scottsdale Ins. Co*, 264 S.W.3d 160, 173 (Tex. App. 2008), the court held the carrier had no duty to defend prior to exhaustion because the SIR provisions in the policy expressly provided the duty to defend did not arise until after the SIR had been exhausted.

D. Florida

In *In re Apache Products Co.*, 311 B.R. 288, 297 (Bankr M.D. Fla 2004), the court held the SIR must be exhausted prior to the duty to defend, as the policy language required same.

II. Holding: An Insurer Must Indemnify the Insolvent Insured to the Extent the Covered Claim Exceeds the Amount of the SIR.

A. California

In *Phillips v. Noetic Specialty Ins. Co.*, 919 F. Supp. 2d 1089 (S.D. Cal. 2013), the court held that policy language stating that the insolvency of the insured "will not increase our obligations under the policy" meant that the insurer had an immediate duty under the policy to indemnify the insured for any losses incurred during the policy period regardless of whether the SIR was satisfied. Since the judgment creditor sought the amount of the judgment less the SIR, the judgment creditor's demand did not increase the insurer's obligations under the policy.

In *Travelers Cas. & Sur. Co. v. AISLIC*, 465 F. Supp. 2d 1005 (S.D. Cal. 2006), the court held the insurer's credit to itself of the amount of the SIR in the underlying action satisfied the SIR as to the additional insured in spite of insured's bankruptcy.

B. New York

In *Admiral Ins. Co. v. Grace Indus., Inc.*, 409 B.R. 275 (E.D.N.Y. 2009), the court (applying New York law) held that the insolvent insured was not required to pay the SIR before the insurer's obligations to pay claims was triggered. The court however, held the insurer was not required to "drop down" and fund the first $50,000 of any recovery. In so holding, the court ruled the insurer was only liable to indemnify the insured to the extent any judgment or settlement exceeded the SIR.

C. Illinois

In *In re Vanderveer Estates Holding, LLC*, 328 B.R. 18, 24 (Bankr. E.D.N.Y. 2005), the court held that public policy behind a bankruptcy clause required under Illinois law "prevents insurers from avoiding indemnity obligations where self-insured retentions have not been paid by a bankrupt insured."

D. Texas

In *Pak-Mor Mfg. Co.v. Royal Surplus Lines Ins. Co.*, No. SA-05-CA-135-RF, 2005 U.S. Dist. LEXIS 34683 (W.D. Tex. Nov. 3, 2005), the SIR endorsement provided that actual payment of the SIR was a condition precedent to coverage. While the court held that the insurer had no obligation to pay until the SIR was satisfied, it explained that the insured "may satisfy the self-insured retention by making its payment in whatever form it wants [i.e., a promissory note issued to the creditors] … so long as the

Bankruptcy Court confirms that the payment is performed in a credible and reliable manner." *Id.* at 6-7.

E. Rhode Island

In *Rosciti v. Ins. Co. of Pa.*, 659 F.3d 92 (1st Cir. 2011), the court held that when the insured is insolvent, public policy behind state bankruptcy provision requires insurer to pay for claims above retention, even when retention has not been satisfied.

III. Holding: An Insurer Is Not Obligated to Pay When Insolvent Insured Cannot Satisfy an SIR.

A. Florida

In re Apache Prods. Co., 311 B.R. 288 (Bankr. M.D. Fla. 2004) (applying Alabama law), the court relied upon the plain language of the policy requiring exhaustion of the SIR, and the failure to pay by the insured resulted in no obligation for the insurer. The policy provided, "The terms of this policy including those with respect to the Company's rights and duties with respect to the defense of suits apply in *excess of the application* of the Self Insured Retention." *Id.* at 297. Despite the fact that Alabama had not addressed this direct issue, the court ruled "one could not escape the plain language…. [Insured] must exhaust the SIR" before insurer's duty to defend arises.

B. California

In *General Star Indemnity Co v. Superior Court*, 47 Cal. App.4th 1586 (1996), the court honored the SIR provisions in the insurance policy which stated General Star has "the right but not the duty to assume charge of the defense." Accordingly, the court interpreted this language as providing that General Star was in the position of an excess carrier having no obligations until the SIR was exhausted. *Id.* at 1594. The court held, therefore, that payment of the SIR is a condition precedent before insurer's duty to pay is triggered.

C. Ohio

In *In re Kismet Prods., Inc.*, No. 04-25167, 2007 Bankr. LEXIS 4719 (N.D. Ohio Aug. 28, 2007), the court held the insurer was relieved of obligation to pay where debtor was unable to pay one month's premium as required by the policy.

IV. Holding: Insurer Remains Responsible for the SIR When the Insured Is Insolvent or Files for Bankruptcy.

A. Statutory Law

1. California

California Insurance Code section 11580(b)(1) requires all liability policies to contain a provision stating that "the insolvency or bankruptcy of the insured will not release the insurer from the payment of damages for injury sustained or loss occasioned during the life of such policy."

2. Illinois

Illinois Insurance Code section 388 requires all liability policies to contain a provision which guarantees that the insolvency or bankruptcy of the insured will not release the insurer from payment of damages from injuries or loss occurring during the term of the policy. The statute provides in pertinent part:

> No policy of insurance against liability or indemnity for loss or damage to any person other than the insured, for which any insured is liable, shall be issued or delivered…unless it contains in substance a provision that the insolvency or bankruptcy of the insured shall not release the company from the payment of damages for injuries sustained.… 215 ILCS 5/388 (West 1994).

3. Indiana

Indiana Code section 27-1-13-7 requires insurance policies issued in Indiana to contain a provision preventing the insolvency or bankruptcy of the insured from releasing the insurance carrier from liability under the policy.

4. Louisiana

Louisiana Revised Statute section 22:1269 provides, "The insolvency or bankruptcy of the insured shall not release the insurer from the payment of damages for injuries sustained or loss occasioned during the existence of the policy." This "direct action" statute affords claimants a direct cause of action against insurers precisely so claimants can collect despite the insolvency of the insured.

5. New York

New York Insurance Law section 3420(a)(1) provides that every liability policy must contain a provision stating that the insured's bankruptcy or insolvency or the insolvency of the insured's estate will not release the insurer from the payment of damages for injuries sustained or loss occasioned during the life of and within the coverage of such policy.

B. Case Law

1. Illinois

In *Home Insurance Company of Ill v. Hooper*, 294 Ill. App. 3d 626 (1998), the court first noted that the unambiguous language of the self-insured provision contained in the instant policy would release *Home* from the obligation of payment under the policy due to insured's bankruptcy and that the insured's pending bankruptcy petition will almost certainly make it impossible for insured to pay the SIR. The court held that the insurance company would be liable even in the event the insured was unable to satisfy the retention. The court applied the Illinois statute in support of its ruling that the insurance policy's SIR provision violated section 388 of the Illinois Insurance Code.

2. Florida

In *In re OES Environmental, Inc.*, 319 B.R. 266 (Bankr. M.D. Fla. 2004), the court held that a creditor was entitled to relief from the stay to bring its negligence tort

claim against the debtor as long as the creditor waived its claim against the debtor's estate and sought recovery solely from the debtor's liability insurance policy. The court, citing *Home Insurance*, 294 Ill. App. 3d at 626, held that the insurer was obligated to defend and indemnify the debtor insured for any amount exceeding the self-insured retention, irrespective of the debtor insured's ability to pay the self-insured retention.

V. Who Can Satisfy the SIR?

A. Other Parties May Satisfy SIR if Policy Does Not State Otherwise

1. California

In *Forecast Homes v. Steadfast*, 181 Cal. App. 4th 1466 (2010), the court held that if parties are jointly and severally liable, a co-defendant can satisfy payment of the SIR so as to trigger the carrier's duty to defend unless the policy states otherwise. The *Forecast Homes* court found there to be contrary language in the policy, which stated, "It is a condition precedent to our liability that you [the named insured] make actual payment…." The court noted that "you" was defined in the policy to be the named insured, so it logically followed the named insured must satisfy the SIR before the insurer's liability was triggered. The court found this provision clear and unambiguous.

In *Centex Homes v. Lexington Ins. Co.*, No. SACV-13-00998-DOC, 2014 WL 6673481, at *6 (C.D. Cal. Nov. 24, 2014), the court held "Unless a policy expressly provides otherwise, a retained limit may be satisfied by a co-defendant's payment or by other insurance obtained by the insured."

In *National Fire Ins. Co. of Hartford v. Federal Ins. Co.*, 843 F. Supp. 2d 1011, 1017 (N.D. Cal. 2012) the court held where policy provided that "you must pay all self-insured retention expenses", but did not specifically require the insured to pay money out of its own pocket, the insured could use additional insurance to satisfy the retention.

2. Illinois

Similarly, in *American Nat. Fire Ins. Co. v. National Union Fire Ins. Co. of Pittsburgh, PA*, 343 Ill. App. 3d 93 (1st Dist. 2003), the court strictly analyzed the policy language and applied the terms of the policy in holding that the SIR provision specifically required the named insured to satisfy the payment; thus it could not be satisfied by the additional insured.

3. Texas

In *Continental Casualty Co. v. North American Capacity Ins. Co.*, 683 F.3d 79 (2012), the court held that while the policy did provide that the SIR needed to be satisfied prior to any payment by the insurer, the policy did not specify the insured had to pay the SIR itself. The court held that other carriers had paid in excess of the $250,000 SIR in defense costs on the insured's behalf, thereby satisfying the SIR and triggering the insurer's duty to provide coverage.

4. New York

Additional insured may be responsible for SIR depending on the specific policy language. In *Power Authority of the State of New York v. National Union Fire Insurance Company of Pittsburgh, PA*, 306 A.D.2d 139 (1st Dept. 2003), the court held that the retention applies to all coverage, including that afforded to the additional insureds.

B. SIR Can be Satisfied Through Other Insurance/Other Methods

1. California

In *Vons Companies, Inc. v. United States Fire Ins. Co.,* 78 Cal. App. 4th 52 (2000), the court held that the SIR language in the policy was ambiguous, noting, "Nowhere does the SIR expressly state that Vons itself . . . must pay the SIR amount." *Id*. at 64. The *Vons* court relied significantly on the subordinate language of the SIR endorsement in the Vons policy providing that it was "[s]ubject to the limits of liability, exclusions, conditions and other terms of the policy to which this agreement is attached ..." Because the provision was silent as to who must pay the SIR coupled with the use of the "subordinate" terms of "subject to," the court held the SIR provision could be read "as permitting the use of other insurance proceeds to cover the SIR amount." *Id*. at 63-64.

2. Florida

In *Intervest Const. v. Gen'l Fidelity Ins. Co.*, 133 So.3d 494 (Fla. 2014), the court held that settlement payments made to the insured by a third party could satisfy the SIR. The policy stated that the SIR "will only be reduced by payments made by the insured," but did not specify where those funds must originate from. The court ruled that unless the policy explicitly states that the insured must satisfy the SIR out of its "own account," the insured can apply settlement payments it receives from third parties to satisfy the SIR.

3. Illinois

In *In re Keck, Mahin & Cate*, 241 B.R. 583, 596 (Bankr. N.D. Ill 1999), the bankruptcy court approved a Chapter 11 plan over objection by Debtor's insurance company. Insurance company objected to the treatment of the SIR as all other unsecured debts and requested the court rule it had no duty to pay claims because the bankrupt insured had not satisfied the SIR. The court denied the objection, approved the plan, and held a debtor could satisfy its SIR through treatment in the plan of reorganization.

4. New York

In *Lasorte v. Certain Underwriters at Lloyds*, 995 F. Supp. 2d 1134 (D.Montana 2014) (applying NY law), the court held that the insured's settlement by compromise with the plaintiff satisfied the SIR. The policy required that the SIR be "exhausted" but contained no language requiring that the insured make actual payment of the SIR. The court held that the term "exhausted" was ambiguous, such that the policy did not require actual payment of the SIR by the insured, thus "exhausted" included the insured's settlement by compromise.

5. Texas

In *Pak-Mor Manuf. Co. v. Royal Surplus Lines Ins. Co.*, 2005 WL 3487723 (W.D. Tex. Nov. 3, 2005), the court held the insurer does not have to pay until the policy holder pays the retained limit; however, the SIR does not have to be paid in cash. The debtor can satisfy the SIR by payment in any form, including a non-dischargeable promissory note to the judgment creditor.