

“Defense Costs within Limits” Provision in Law Enforcement Liability Policy Held Invalid under Louisiana Law

January 2001

A Louisiana state appellate court recently held that a "defense costs within limits" provision in a law enforcement liability insurance policy was against public policy, and that the insurer therefore could not rely on this provision to deduct defense costs and expenses from the policy limits. *Edwards, et al. v. Daugherty, et al.*, No. 00-696, 2000 La. App. LEXIS 3242 (La. App. 3d Cir. Dec. 6, 2000).

This appeal arose out of a judgment rendered against the sheriff of a Louisiana parish and his insurer, Sphere Drake, and others. The insurance policy at issue was an excess law enforcement liability insurance policy issued to the participants in the Louisiana Sheriffs Risk Management Program ("LSRMP"). It provided a limit of \$1 million. In the trial court, where it was a party to the tort action against its insured under Louisiana's direct action statute, Sphere Drake was held jointly and severally liable with the sheriff "subject to the terms of its policy." After the judgment became final, Sphere Drake deposited \$334,000 into the trial court registry alleging that, because of payments for defense costs and payments to other claimants in accordance with the terms of the policy, this was the full amount remaining under the applicable limits. The plaintiffs challenged this assertion.

In its analysis, the appellate court acknowledged that under the terms of the policy, the \$1 million limit was reduced by payments on other claims and defense costs associated with those claims. Sphere Drake contended that, pursuant to these policy terms, its liability was reduced by payments for defense costs and expenses it paid in connection with the litigation. The plaintiffs countered that the deduction of defense costs and expenses from the policy limits was against Louisiana public policy and therefore could not be deducted from Sphere Drake's liability limits.

In its analysis, the court referenced a Louisiana insurance regulation, in effect during the applicable policy period, that expressly provided that liability insurance policies for directors and officers, architects, engineers and certified public accountants that include "defense costs within limits" provisions would be "considered for approval" by the Insurance Commissioner. (This regulation was repealed effective October 20, 1997, and a new regulation was issued that deleted references to specific types of policies.) Thus, the court noted that approval of such policy provisions was discretionary only with respect to those four types of policies. The court

further noted that, with respect to other policies not expressly referenced in the regulation, information disseminated from the state insurance department for use in the review of forms submitted for approval stated that "an insurer may not include 'cost-of-defense within the limits of liability'" provisions. Next, the court rejected Sphere Drake's argument that it was not subject to the regulations promulgated by the Louisiana Department of Insurance because its policy was issued under "the excess and surplus lines statute." Therefore, because the policy issued by Sphere Drake was not one of the types of policies enumerated in the regulation and Sphere Drake was not exempt from state insurance regulations, the appellate court concluded that the " 'defense costs within limits' provision of the Sphere Drake policy was against public policy when it was issued to the LSRMP."