

# ACI's Second National Forum on Insurance Allocation

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## Allocation of Defense Costs in the D&O Context

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Tweeting about this conference?

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# Discussion Points

- Allocation of defense costs
- Allocation when policy contains an allocation provision
- Allocation between covered and uncovered claims
- How are defense costs and indemnity allocated, if at all?
- Allocation of exclusions
- Possible allocation disputes amongst insureds



# Allocation of Defense Costs

- Why is it sometimes permissible in D&O context
- Duty to defend vs. duty to pay defense costs
- How is an allocation of defense costs determined? Whether certain claims are uncovered? Parties?



# Hypothetical

- Allocation of Defense Costs
- One Defendant -- Covered
- Two Causes of Action
  - One Covered
  - One Uncovered
- \$1 million in Defense Costs



# Allocation Provisions In D&O Policies

## Examples of Different Types and Contexts

- Predetermined Allocation – uses a predetermined formula approach. 80/20, 50/50, sometimes 100%.
- “Best Efforts” Allocation – insured and insurer will use their best efforts to reach an allocation as between covered and uncovered amounts. Some provisions require consideration of “the relative legal and financial exposures of, and relative benefits obtained in connection with the defense and/or settlement of the Claim, by the Insured and others.”
- Alternative Dispute Resolution Allocation – provides for arbitration of other ADR mechanisms to handle allocation disputes. Prior to determination, insurer should be advancing at least amount not in dispute (amount it deems appropriate).

# Allocation when Policy Contains an Allocation Provision

- How do the parties go about agreeing upon a fair and reasonable allocation?
- How do the parties determine the relative exposure of the claims and/or parties?
- What happens if the policy also imposes a “duty to defend” on the insurer?
- What happens if the parties cannot agree to an allocation?



# Allocation When Policy Does not Contain an Allocation Provision

- Is the insurer obligated to defend the entire action?
- May the insurer seek to pay only for those claims that are covered?
- What about fees and expenses incurred that are not covered but are “reasonably related” to the defense of covered claims?
- How should insured’s defense counsel handle the billing for fees and costs that may be argued do not to relate to the defense of covered claims?



# How are Defense Costs Allocated, if at all, Where The Policy Does Not Provide a Methodology?

- Larger Settlement Rule: “[R]esponsibility for any portion of the settlement should be allocated away from the insured party only if the acts of the uninsured party are determined to have increased the settlement.”

*Nordstrom, Inc. v. Chubb & Sons, Inc.*, 54 F.3d 1424, 1432 (9th Cir. 1995)

- Relative Exposure Rule: Parties are required “to allocate the settlement costs between those amounts attributable to the [insured] directors and officers and those attributable to [uninsured] PepsiCo and its accountants.

*Pepsico Inc. v. Continental Cas. Co.*, 640 F. Supp. 656, 662 (S.D.N.Y. 1986).

- Allocate equally between covered and uncovered
- Allocate pro rata between covered and uncovered





# Allocation of Exclusions

- Most D&O policies contain severability provisions with respect to application of certain exclusions
- “Innocent Insured” protection
- Common interests of policyholder and insurer in not having policy proceeds available to “black hats”



# Possible Allocation Dispute Amongst Insureds

- Allocation between one policy year and another
- Insureds are not always passive bystanders
  - Limits can differ
  - Retention or deductible amounts can differ
  - Exclusions and other key provisions may differ

