

Nevada state bans ‘defense within limits’ insurance policy provisions

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In a groundbreaking move, the State of Nevada has become the first US state to prohibit ‘defense within limits’ policies (i.e. limits of indemnity inclusive of defence costs). These limits are found in various liability policies but are especially common in professional liability (e&o) and management liability policies.

Where a defense within limits policy is in place, the policy limit is eroded by amounts incurred by insurers to defend a claim, ultimately reducing the amount available to pay any award for compensation and claimant’s costs.

The new law takes effect in respect of new policies and renewal from 1 October 2023 onwards. The law specifically prohibits any provisions that:

1. reduces the limit of liability stated in the policy by the costs of defense, legal costs and fees and other expenses for claims; or
2. otherwise limits the availability of coverage for the costs of defense, legal costs and fees and other expenses for claims.

The law is limited to policies transacted in Nevada or in respect of policyholders who are residents of Nevada.

Implications

Whilst on the face of it the new law provides additional protection for policyholders as the limit of indemnity is preserved for the settlement of claims. On the other hand, there could be some unintended consequences, such as:

1. increased likelihood of conflicts between insurers and insureds as the continued incurrence of defense costs will not put pressure on the amount available to settle a claim, which could change the dynamics at claims stage; and
2. insurers will no doubt be mindful of the potential increased financial exposures and will look to amend their rating accordingly.

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