

INSURANCE
DEPARTMENT OF BANKING AND INSURANCE
OFFICE OF PROPERTY AND CASUALTY

Commercial Lines Insurance: Policy Form Standards

Defense Costs Within Policy Limits

Adopted Amendment: N.J.A.C. 11:13-7.3

Proposed: March 3, 2008 at 40 N.J.R. 1062(a)

Adopted: October 2, 2008 by Steven M. Goldman, Commissioner, Department of Banking and Insurance

Filed: October 6, 2008 as R. 2008 d. 330, without change.

Authority: N.J.S.A. 17:1-8.1, 17:1-15e and 17:29AA-1 et seq.

Effective Date: November 3, 2008.

Expiration Date: February 28, 2013

Summary of Public Comments and Agency Responses:

The Department of Banking and Insurance (Department) timely received written comments from the following:

1. The Medical Society of New Jersey;
2. The American Insurance Association;
3. MDAdvantage Insurance Company of New Jersey;
4. Princeton Insurance Company;
5. NJ Physicians; and
6. ProSelect Insurance Company

COMMENT: Several commenters supported the proposed amendment to permit medical malpractice liability insurance policies to include defense costs within policy limits, and believed

that benefits associated with offering such an option will outweigh any concerns related thereto. One commenter stated that one benefit would be a reduction in overhead and the potential reduction in litigation and its associated costs. This commenter stated that both a plaintiff and defendant may be more willing to consider settling a case when legal costs could impact the “bottom line.” Another commenter stated that it will provide greater flexibility to healthcare providers in New Jersey to seek additional choices for coverage products and pricing.

One commenter also stated that it did not believe that plaintiff attorneys would be more inclined to sue for a physician’s personal assets in that New Jersey has a system whereby a majority of the risks of an excessive jury award falls on the company, and not on the individual, and that the amendment should have little impact on that issue. The commenter also stated that a physician should not be more inclined to settle a non-meritorious case, which some are concerned could result in additional physician reporting and premium increases, in that concerns about reporting requirements and increased scrutiny by regulators make it unlikely that this will occur. The commenter stated that, alternatively, it may be easier to resolve potentially meritorious cases more quickly if the physician’s “safety net” continues to deplete over time.

The commenter also did not believe that defense attorneys would face additional billing scrutiny from insureds who will now have a direct interest in the costs of a defense, in that defense attorneys are already required to justify all of their expenses in order to receive proper reimbursement from insurers.

This commenter also suggested that the Department require that carriers use a separate form to detail the potential risks and benefits of the change in coverage and suggested that all physicians consult with independent attorneys or advisors prior to making the selection.

RESPONSE: The Department appreciates the support of its proposal. With respect to the suggested changes, the Department does not believe they are necessary. N.J.A.C. 11:13-7.3(d)3 provides, as a condition of offering a policy that includes defense costs within policy limits, that the insurer secure a certification signed by the applicant confirming that a policy with defense costs outside of policy limits was offered and declined, and that the applicant is aware that the amount of coverage available for payment of a liability claim will be commensurately reduced based on defense costs. The Department believes that this provides sufficient notice of the risks and benefits involved in such a choice. The Department also does not believe that it should formally suggest by rule that a physician consult with an attorney prior to making such a coverage option. Physicians, and any insureds, can be called upon to make sophisticated coverage choices. Such insureds should seek such advice as they deem appropriate.

COMMENT: One commenter, while supporting the amendment, suggested that N.J.A.C. 11:13-7.3(d) be revised to read “In lieu of compliance with (c) above” rather than “Notwithstanding that they do not conform with (c) above.”

RESPONSE: The Department has determined that no change is required. The change suggested is more stylistic and does not change the substance of the provision.

COMMENT: One commenter objected to the change in N.J.A.C. 11:13-7.3(a)1 that provides “[r]egardless of whether the policy form provides defense costs within or outside policy limits no defense costs shall be charged against any deductible amount.” (Additional language is underlined). The commenter believed that insurers should be able to offer an option to

policyholders to have defense costs satisfy their deductible. The commenter stated that such an option would benefit policyholders by providing the opportunity to reduce the indemnity deductible. The commenter stated that the proposed amendment removes a beneficial option that insurers may wish to provide to their policyholders and that an insurer should be able to offer deductible options whereby defense costs may or may not be used to satisfy a deductible.

RESPONSE: Upon review, the Department has determined not to change this provision. The Department notes that the language in N.J.A.C. 11:13-7.3(a)1 continues the existing prohibition that defense costs may not be charged against any deductible amount. The Department also does not believe that it would be appropriate to permit defense costs to be charged against deductibles for the following reasons. All claims incur defense costs, while only a small percentage incur indemnity costs. Thus, if defense costs were permitted to be applied to the deductible, insureds who have opted for deductibles would be required to bear the burden of reimbursing the insurers some amount on every claim, no matter how small the amount. Likewise, insurers would have the additional administrative and financial burden of having to recoup the deductible amounts from the insureds. The Department believes that the additional accounting and financial costs, often relating to relatively small sums of money, would not benefit insureds or insurers.

COMMENT: One commenter expressed concern with the amendment in that with predicted severity of claims continuing to increase, and defense costs rising, the physician will have less resources to pay claims, creating an undue leverage on the physician to settle otherwise defensible lawsuits. The commenter stated that, in the alternative, close cases that are

vigorously defended may increase the frequency of deficiency judgments. The commenter further stated that liability insurance and various policy forms are not well understood by physicians, and that with rising practice costs and shrinking reimbursements physicians will be unduly influenced by price differences rather than by a rational evaluation of risk.

RESPONSE: Upon review, the Department has determined that no change is required. The purpose of the amendment is to provide an additional coverage option that may be offered by insurers. Providers will have to make a judgment, based on their assessment of the risks and benefits involved, whether to purchase a policy that provides defense costs within policy limits. The Department notes that insurers must also offer identical limits providing defense costs outside of policy limits. If a provider has concerns, such as those described by the commenter, the provider may continue to purchase coverage with defense costs outside of policy limits.

COMMENT: Several commenters expressed concern with the amendment because it alters the parameters in minimum amounts of liability coverage for physicians pursuant to N.J.A.C. 13:35-6.18. One commenter stated that while pricing is certainly a key component in the purchasing process, so too is the ultimate protection provided by a policy. The commenter stated that under the amendment, it is conceivable that, in certain situations, an insured's limits could be more rapidly exhausted leading to a higher exposure to claims for the insured on a personal basis. Accordingly, this commenter saw little or no benefit for the New Jersey marketplace and its participants.

Another commenter stated that the amendment appears to violate the Legislative intent of requiring \$1 million minimum insurance under N.J.S.A. 45:9-19.17. The commenter stated that

it is possible for defense costs in complex cases to approach \$200,000, which would result in a remaining limit of \$800,000 for indemnity payment. The commenter also noted that the statute provides that only if liability coverage is not available may the New Jersey Board of Medical Examiners permit a physician to practice medicine without insurance and then only if a bond is posted for at least \$500,000. The commenter stated that this indicates that the Legislature only delegated the power to lower the protection provided to citizens to the Board of Medical Examiners, and then only if insurance were not available.

RESPONSE: The Department disagrees. As noted in the Response to the previous Comment, the amendment provides an additional option for the purchase of this coverage, of which providers may or may not avail themselves. The Department also does not believe that the provision is inconsistent with applicable law cited by the commenter in that the minimum limits that must be provided are \$1 million. It is expected that providers will purchase coverage with higher limits if they believe it necessary or prudent.

Federal Standards Statement

A Federal standards analysis is not required because the adopted amendments are not subject to any Federal requirements or standards.

Full text of the adoption follows:

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