Industry custom and practice in the mid-20th century regarding the insurer's duty to defend after exhaustion of liability policy limits is still relevant today as new claims are being made on old policies.

Duty to Defend After Exhaustion of Limits: The CGL and the Role of Lloyd's Before 1966

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Early in the 20th century, business began to recognize a need for public liability insurance. Coverage for bodily injury arising out of premises and operations first appeared as endorsements on employers liability policies. These endorsements evolved into separate public liability policies, including policies for elevator liability, product liability, teams liability, automobile liability, contractual liability, and owners protective liability. An insured might need half a dozen public liability policies, each with its own insuring agreement, defense obligation, terms and conditions, and limit.

In the 1930s, casualty insurers developed the owners landlords and tenants (OL&T) and manufacturers and contractors (M&C) policies, which became known as "schedule policies" because both combined the eponymous coverages into one policy with one insuring agreement that allowed the policyholder to select which hazards and locations to insure.[1] The comprehensive general liability policy (CGL) went a step further by providing automatic coverage for locations and hazards in addition to those "scheduled."

Today's Claims, Yesterday's Policies

Liability (asbestos, environmental, and more) claims continue to be presented against the poli-

cies written many years ago when it was standard to provide coverage for defense costs in addition to the limits of liability. Before 1966, policy forms appeared to provide defense coverage even after the limits of liability were exhausted; that is, they included no "exhaustion limitation." Some argue that the 1955 forms included an exhaustion limitation. This article offers evidence that provides good reason to doubt the effectiveness of the 1955 exhaustion limitation. The article also provides evidence that in the middle third of the 20th century, insurance industry custom and practice was to continue to pay defense costs after exhaustion of policy limits.

These matters are of more than historical interest. Risk managers today, facing long-tail claims based on occurrences in the 1960s or earlier, might be more successful in seeking recovery for defense costs incurred on claims that exhausted the modest limits of the day. Many businesses that had only a limited involvement in the asbestos operations of the earlier time now find themselves dealing with the defense of claims covering 50 years of alleged past liability.

The Standard Provisions

In the mid-1930s, automobile insurance was not standardized, although there was a standard workers compensation policy as well as a standard fire policy. Competition among auto insurers led to considerable differences among policies; for example, the insurer's promise could be to indemnify or to pay on behalf of; the provision (called the omnibus clause) addressing who was insured to drive what car (as well as whether there was coverage if the driver was intoxicated or underage) varied considerably; and substantial variations existed regarding supplementary payments. At the time, rates were structured and controlled by rating bureaus. Consequently, insurers were forced to compete on the basis of policy provisions, leading to the unsatisfactory situation where insurers that were members of the same rating bureau were charging the same premium for different coverages. The first state to require a standard auto policy was West Virginia in 1934.

Standards Began Developing in the 1930s

In 1933, the National Bureau of Casualty and Surety Underwriters (NBCU) and the American Mutual Alliance began approaching the issue of standardized liability provisions. In March 1934, a joint committee was formed, and the American Bar Association was invited to join. In May 1935, the Standard Provisions were presented in six parts: declarations, introductory statement, insuring agreements, exclusions, conditions, and endorsements. The introductory statement and the insuring agreement are of interest in this article.

By 1943, the introductory statement read:

> … does hereby agree with the insured, named in the declarations made a part hereof, in consideration of the payment of the premium and in reliance upon the statements contained in the declarations and subject to the limits of liability, exclusions, conditions and other terms of this policy …

Many businesses now find themselves dealing with the defense of claims covering 50 years of alleged past liability.

Elmer W. Sawyer wrote in 1943 that the purpose of the introductory statement (often referred to as the preamble) is to tell the policyholder that it "is most important that the intent be found by examination of the contract in its entirety." Further, he says that the preamble "is unmistakably controlling upon every provision to which the company agrees in the policy." Thus, Sawyer is saying that the insuring agreement(s) are subject to the limits of liability (and the exclusions, conditions, and other terms). Sawyer makes no specific mention of the obligation to defend after exhaustion of policy limits.[2] Faude, in 1955,[3] and others, in later years, would argue that the preamble had the effect of ending the defense cost obligation at exhaustion of limits. This unsuccessful argument not only is a stretch but is flawed by the absence of any contemporary historical record of intent.

The CGL Defense Clause[4]

The 1936 automobile policy and the 1941 CGL

read as follows:

> It is further agreed that as respects insurance afforded by this policy the company shall
>
> (a) defend in his name and behalf any suit against the insured alleging such injury, sickness, disease or destruction and seeking damages on account thereof, even if such suit is groundless, false or fraudulent; but the company shall have the right to make such investigation, negotiation and settlement of any claim or suit as may be deemed expedient by the company;
>
> (b) pay all premiums on bonds to release attachments for an amount not in excess of the applicable limit of liability of this policy, all premiums on appeal bonds required in any such defended suit, but without any obligation to apply for or furnish such bonds, all costs taxed against the insured in any such suit, all expenses incurred by the company, *all interest accruing after entry of judgment until the company has paid, tendered or deposited in court such part of such judgment as does not exceed the limit of the company's liability thereon*, and expenses incurred by the insured, in the event of bodily injury, sickness or disease, for such immediate medical and surgical relief to others as shall be imperative at the time of accident.

In later years, the independence of the indemnity and defense promises was stretched to limit coverage for defense costs after exhaustion of limits.

> The company agrees to pay the amounts incurred under divisions (a) and (b) of this section in addition to the applicable limit of liability of this policy. (Emphasis added.)

The italicized section in the above quote can be viewed as an exhaustion limitation on the insurer's obligation to pay certain costs of a claim, but the reader will note that no such limitation is attached to the duty to defend.

Sawyer wrote that the words, "It is further agreed that as respects insurance afforded by this policy [under coverages A and B] the company shall …," make it clear that the protection provided is not independent of the policy limits. Note that defense costs are covered in addition to policy limits. Sawyer made no mention of the controversy regarding whether the obligation to pay defense costs ended with exhaustion of policy limits, although he was certainly aware of the topic.

In later years, the independence of the indemnity and defense promises, discussed later, was stretched to limit coverage for defense costs after exhaustion of limits on the grounds that after the indemnity limits are exhausted, further claims from the same accident are "not covered," just as a claim excluded by terms and conditions is not covered. The writer found no evidence in the CGL historical record that a defense exhaustion limitation was contemplated at the time, despite claims to the contrary. Indeed, the presence of an exhaustion limitation on the promise to pay accrued interest is evidence that no exhaustion limitation on defense was contemplated.

The 1941, 1943, and 1947 CGL

The two controlling bureaus, the National Bureau of Casualty and Surety Underwriters and the Mutual Casualty Insurance Rating Bureau (MIRB),[5] introduced the comprehensive general liability policy[6] in 1941. The CGL was designed to provide comprehensive insurance that covers the insured's liability unless coverage is excluded or limited by the declarations or by terms and conditions. The bureaus revised the policy in 1943. Sawyer wrote, "The insuring agreement captioned *Defense, Settlement, Supplementary Payments* follows the standard language applicable to all liability insurance." He goes on to discuss the 1943 revision and standardization of the CGL: "The insuring agreement captioned *Defense, Settlement, Supplementary Payments* was revised to agree with the previous changes in the basic automobile form because this provision is common to all liability insurance."[7] Throughout the period, as regards defense, commentators discussed auto and general liability

cases together and interchangeably.

1943 and 1947 Changes

There were substantive changes in the CGL in 1943 but none pertaining to defense.[8] Supplementary payments were broken out into a third subparagraph. In 1947, there again were substantive changes in the policy but not in the defense and supplementary payments section. As regards defense, the major change was the breaking out of the defense and supplementary payments into five subparagraphs. The content was essentially unchanged.

Changes in Introductory Phraseology

The introductory phraseology changed from (1) "It is further agreed that as respects insurance afforded by this policy …" (1941) to (2) "… as respects such insurance as is afforded by the other terms of this policy …" (1943) to (3) "… as respects the insurance as is afforded by the other terms of this policy …" (1947). An extensive review of the trade literature indicates that these changes were nothing other than editorial. The appearance of the word "such" modifying "insurance" was not afforded any significance by Sawyer in 1943,[9] and the word "such" disappears in 1947, again without note. Very much in contrast, when "such" reappears in 1955, it is claimed to be the insurance industry's means of introducing an exhaustion limitation.

Independence of the Defense Obligation

Whether the defense obligation should be viewed as independent of the indemnity obligation, meaning the insurer must defend even if the claim is not covered, was a controversy during the middle third of the century. Commenting on that period in 1950, Kemper wrote:

> … holdings, that under former policy terms, the promise to defend was an absolute and unconditional promise, have stemmed principally from a view entertained by the Supreme Court of Michigan and cites *Poultry and Egg Co. v. Hawkeye Casualty Co.*, 297 Mich. 509, 298 N.W.[10]

In the years before the Standard Provisions were generally accepted, courts had ruled that the insurer must provide defense even if the claim was not covered by the terms of the policy. Kemper argues that the 1936 lead-in to the defense obligation, "It is further agreed that as respects insurance afforded by this policy," should prevent such interpretations.[11]

McCarthy Supports No Duty to Defend After Exhaustion of Limits

On the last page, almost in passing, Kemper hits upon the exhaustion issue and cites the New Hampshire Supreme Court ruling, *Lumberman's Mutual Casualty Co. v. McCarthy,* 8 A.2d 750 (N.H.) 126 A.L.R. 894, which was widely cited in the 1940s, 1950s, and 1960s as a basis for asserting that there is no duty to defend after the exhaustion of indemnity limits.[12] He offers no specific policy language arguments, however.

In 1948, John P. Faude, then assistant counsel for Aetna Casualty and Surety Company, wrote an article discussing the pre-Standard-Provisions independence issue and the exhaustion topic.[13] Faude wrote, "while the question must have arisen innumerable times in insurance claims practice, oddly enough there is only a solitary reported decision … *McCarthy*." Faude later wrote of *McCarthy* that "the decision has been regarded by many persons in casualty insurance circles as being *contrary to established casualty practice*" (emphasis added).

McCarthy Deemed "Contrary to Established Casualty Practice"

Faude continues, quoting Appleman (8 Insurance Law and Practice Section 4685), which regards the *McCarthy* result as:

> … subject to censure, when we consider that the insurer's duty is both to defend actions and to pay judgments obtained against the insured. Otherwise, where the damages exceed the policy coverage, the insurer could walk into court, place the amount of the policy on the table, and blithely inform the insured that the rest was up to him. This would obviously constitute a breach of the insurer's contract to defend actions against the insured, for which premiums had been paid, and should not be tolerated by the courts.

Clearly, Faude is saying that the *McCarthy* ruling

was a departure from "established casualty practice." He then says *McCarthy* "rests on a very narrow and precise base, will accordingly seldom be invoked, and need not at all be hostile to the liability insurer's traditional role...." This is a remarkable statement because it leads one to infer that it was generally accepted casualty insurance practice to continue defense even after indemnity limits of liability had been exhausted.[14] Faude wrote:

> The rule of the *McCarthy* case related only to the infrequent situation where the applicable limit of liability is exhausted and no claims or suits are then pending against the insured. The New Hampshire court was very careful to so limit the force of the case, stating: 'neither do we mean to hold that an insurer may abandon its defense of a claim within the terms of its policy in mid-course under circumstances which are prejudicial to the rights of the insured.' Where a suit has been commenced and is awaiting trial or is in the course of trial or is pending on appeal, the potential prejudice to the insured may be very real if he is summarily abandoned in the conduct of the defense by his liability insurer. Such would usually be the situation when the applicable limit of liability is exhausted, and it would seem both reasonable and proper that the insurer should continue with the conduct of the litigation already undertaken.

It was not until 1966 that the insurance industry introduced explicit policy language to make an exhaustion limitation effective.

Insurance Industry Embraced McCarthy

The author has dubbed this the "unwritten exception to the unwritten exclusion," because (1) there was little in the insurance contract to indicate that an insurer may exit after exhausting its limits of liability; (2) insurers assert the exhaustion limitation (the unwritten exclusion) because of *McCarthy*, as there is little in the contract to support an exhaustion limitation; and (3) Faude, along with *McCarthy*, further asserts that the insurer may not withdraw if doing so is prejudicial to the insured or if "claims or suits are pending against the insured," which amounts to saying that the insurer must continue existing cases even after limits are exhausted (the "unstated exception"). Perhaps it is a reflection of the innocence of the age that the insurance industry, including Faude, a senior attorney at Aetna in 1948, could build its case on so flimsy a foundation and make no changes in the form.

Some Courts in the 1950s Called McCarthy Flawed

In April 1952, Wilson Anderson cast doubt on the industry position.[15] He cited J. Branch, dissenting in the *McCarthy* case, and *American Casualty Co. v. Howard* (187 Fed. 2d 322), which agrees with J. Branch that the decision, as well as the decision in a 1951 Michigan case, *Hoosier Casualty Co v. Chimes Inc.* (1951 95 F. Supp. 897, 883), was flawed. Anderson wrote that if the insurance industry wanted to stop paying defense costs when indemnity limits are exhausted, the policy language should say so. Yet, it was not until 1966 that the insurance industry introduced explicit policy language to make an exhaustion limitation effective.

The Role of Lloyd's

In the late 1940s, Lloyd's became a major player in the U.S. casualty markets. First, the Lloyd's underwriters entered the primary general liability market by offering CGL coverage in competition with U.S. insurers through a handful of brokers that were authorized to solicit business. The coverage was written using NBCU forms (generally, the 1947 CGL, even, in some instances, after the 1955 forms became available).

Excess and Umbrella Coverage vs. Increased Limits

Lloyd's also developed and began writing umbrella coverage, sometimes over Lloyd's own primary coverage. Excess and umbrella insurance boomed in the 1950s. A corporate buying strategy of purchasing relatively low primary liability limits backed up by excess or umbrella insurance for higher limits developed. This strategy circumvented the domestic insurance industry's tightly structured pricing of "excess limits." (Bureau manuals included tables for pricing excess

limits over basic limits, a percentage markup over basic limit rates.)

Policyholders and their brokers got around the bureaus' pricing by use of excess and umbrella policies atop the bureau OL&T, M&C, or CGL policies. It is apparent that the domestic insurance industry undertook to "get limits up" by contract language changes made in 1966.

Higher Underlying Limits Required in the 1960s

The Northern California Chapter of the Chartered Property and Casualty Underwriters Society (NCCPCU), in 1960, reported after study that the first umbrella policy originated at Lloyd's in 1947. The chapter study referred to the advent of umbrella coverage as:

> … a new method of marketing coverage. The mechanics were to revamp the conventional liability program by depressing the bodily injury limits to $25/50000 or perhaps as low as $10/20000 and to reduce the property damage limits to a similar low level. This procedure was successful in cracking the domestic markets' increased limits. In sum, the insured could reduce its premium and acquire more coverage.[16]

J.J. Graham, an executive of a primary insurer, commented with dismay along similar lines in 1962:

> The blanket excess policy should not be a coverage substitute for a properly designed and underwritten primary insurance program, nor should it operate in lieu of proper limits carried under primary policies. Unfortunately some blanket catastrophe policies have been doing both. As an example, some time ago the author's company was informed by a producer that he was able to save his clients substantial sums of money merely by reducing the limits of liability of primary auto and general liability policies to, say, $25,000 or $50,000, and applying the blanket catastrophe policy in excess of the reduced limits.
>
> The cost of the catastrophe policy was defrayed in many situations to the extent of almost 100 percent, and in some cases over 100 percent, by the offsetting effect of the premium saving derived from the reduction of the primary limits.[17]

Bernard Daenzer reported in 1965 that the Lloyd's market had a setback in 1959 because of losses in the excess market. He writes:

> The technique had been used of reducing the primary liability limits to $25,000 per person and $50,000 per accident, or even less. The idea was to reduce the primary limits sufficiently so that the savings in the reduction of limits would largely pay for the umbrella. The premium level became too thin and the reduction in the limits put the coverage in the working area of frequency of loss instead of the area of catastrophe loss.[18]

Daenzer reports that Lloyd's new policy, LRD 1-60, tightened up terms and conditions somewhat and that underwriters started to demand higher underlying limits.

Buying Strategy Based on CGL Defense Provision

It is clear that the buying strategy worked because of the defense provision in the primary CGL policy. The policyholder could buy modest primary limits and rely on the primary policy for defense. It then could buy excess insurance underwritten on the basis that defense will be covered in the primary, thus making the excess less expensive per unit. The reader should note that all three articles (NCCPCU, Graham, Daenzer) were written after the supposed exhaustion limitation of 1955 had been made.

Signal Companies, Inc. v. Harbor Ins. Co.

An interesting example of the unwinding of the buying strategy occurred in the case of *Signal Companies, Inc. v. Harbor Ins. Co.*, 27 Cal. 3d 359, 369 (1980), reported in *Business Insurance* in 1980. The case involved a dispute between primary and excess insurers in which the primary insurer was seeking contribution for defense. Signal Companies had purchased a $25,000 per occurrence primary CGL from Pacific Indemnity for the rather dramatic price of $106,000 per year (more than four times the limit), for four years, 1962–1965. The case involved a dispute over $95,000 of defense costs.

Pacific Indemnity sought contribution from Harbor Insurance, the excess insurer, which provided $10 million excess of Pacific Indemnity's limit. Richard Kayaian, representing Pacific Indemnity, lamented that "the California Supreme Court ruling validating the industry custom of letting excess insurers off the hook for defense costs can hurt policyholders." He went on to suggest "buyers of small amounts of primary insurance are subsidizing legal costs of giant corporations that purchase layers of excess coverage." *Business Insurance* quoted Mr. Paul Russo, vice president of Fireman's Fund: "Signal was obviously buying legal services" from Pacific.[19]

An important reason that the domestic insurance industry adopted exhaustion language was to encourage higher primary limits.

CGL Defense Coverage Lessens Need for Umbrella Defense Provisions

By 1962, domestic insurers had entered the umbrella market using forms with defense provisions similar to those in the Lloyd's policies, but Lloyd's role at the outset cannot be questioned. In 1959, a Lloyd's committee was considering a policy form change as regards the defense provision of its umbrellas. Eric Squires (chairman) wrote:

> It is true that the primary Third Party policies of the American Companies emphasize the defense provision but the American Companies do not have excess policies as such. In any case the Assured is not very interested in the cost provisions of the excess policy because he is normally protected by the defense provisions of the primary policy and the cost provisions of the Lloyd's excess policy really cover apportionment of costs between Insurers. In fact Condition I of the Lloyd's excess policy stipulates that no cost shall be incurred without the written consent of the Underwriters and only then goes on to lay down rules for the apportionment of costs.[20]

Clearly, Squires is reporting that Lloyd's need not consider defense protection as a selling point in the U.S. market because of the policy language of the CGL.

Viewed in historic context, it is reasonable to infer that an important reason that the domestic insurance industry adopted exhaustion language was to encourage higher primary limits in order to prevent policyholders from relying on the excess markets to the detriment of the primary market insurers. A secondary goal was to apply a stop-loss provision to the insurer's defense obligation.[21] Likewise, insureds anticipated that their primary insurer would be responsible for defense costs. As a consequence, insureds were willing to buy excess insurance either with no defense coverage or with restrictive defense coverage such as that described by Squires, thinking their CGL would continue to pay defense when limits were exhausted. Central, of course, is the language of the CGL.

Industry Custom and Practice: Middle Third of the 20th Century

It is clear that the casualty insurers knew their contracts were, at best, ambiguous as regards the exhaustion limitation. Most insurers that applied an exhaustion limitation relied on either a very strict and one-sided interpretation of the language,[22] or a single court decision, *McCarthy*, which propounded a theory based on a completely wrong-headed public policy argument that misconstrued the lawyer/client relationship.

Custom and Practice Was to Provide Defense Without an Exhaustion Limitation

The casualty insurers' custom and practice was to provide defense without an exhaustion limitation. This is clear from Faude, Anderson, NCCPCU, Graham, Daenzer, and the Signal Companies' insurers' dispute. The fact that there had been only a few cases on point reported, notably *McCarthy*, suggests the industry was paying for defense after the exhaustion of limits, unless one accepts the very unlikely surmise that insureds were forsaking their claims for defense cost coverage when confronted with the ambiguous policy language of the early standard liability policies.[23]

The insurance industry, largely, was not unwilling to defend after exhaustion and, indeed, perhaps

did not wish to be relieved of its defense obligation. Faude refers to "standard casualty practice" to continue defense. Anderson wrote that "there must be numerous accidents resulting in a multiplicity of suits in excess of the insured's coverage yet few apparently have reached our appellate courts."[24] Faude writes of the "infrequent situation where the applicable limit of liability is exhausted and no claims or suits are then pending against the insured."[25] Faude and Anderson are not disagreeing, because *McCarthy*, upon which Faude relies, did not deal with the provision of defense when limits *become* exhausted but rather with entirely new suits brought after limits *have been* exhausted.

No Exhaustion Limitation in the 1947 CGL Changes

Moreover, although the casualty insurance industry had the opportunity to change the policy provisions in 1947, they did not introduce an exhaustion limitation at that time. Indeed, they actually took "such" out of the insuring agreement, the irony of which will become plain later. What inspired the industry to introduce exhaustion limitations were the developments in the excess liability markets commencing at about the same time as the arrival of the 1947 form.

Finally, it is worth noting that Anderson, in 1952, reported in a footnote that some companies had changed the language of their policies to include an exhaustion limitation.[26] Virtually the same thing was written by James Hagler in 1965, when he speaks of the practice "now being followed by many primary insurers and which is becoming more and more common, of limiting the obligation to investigate and defend so as to terminate such obligation once the policy limits have been exhausted."[27] Anderson was talking about the 1947 form, while Hagler was speaking of the 1955 form, which supposedly included an exhaustion limitation.

The 1955 Changes in the Standard Provisions

As the United States entered the second half of the century, the liability insurance environment was changing. The bureaus changed the Standard Provisions in 1955. Precisely, the bureaus changed the introductory clause of the Defense, Settlement, Supplementary Payments section of the policy. In 1947, the policy read:

> … as respects the insurance afforded by the other terms of this policy the company shall (a) defend …

The 1955 clause was changed to read:

> … with respect to such insurance as is afforded by this policy the company shall (a) defend...

Bureau and other industry representatives are often reluctant to say a change is really a change because so doing confirms that the old language was insufficient.

The industry regarded the addition of the word "such" as an exhaustion limitation. Thus, one would read the revised clause as saying that defense is provided only for insurance of a kind and amount specified earlier in declarations. Charles A. Des Champs of Fireman's Fund, an insurance industry executive with access to forms committee minutes, quoted the minutes extensively.28 The minutes refer to the need for an exhaustion limitation. The minutes also referred to other problems that had arisen, such as insurers being required to pay defense costs even if there is no coverage under the policy. One instance cited was the insurer being called upon to defend property damage claims even when the CGL was written to cover bodily injury only, suggesting the independence issue was still a problem.

Bureaus Reluctant to Admit to Change in the Policy

Bureau and other industry representatives are often reluctant to say a change is really a change because so doing confirms that the old language was insufficient and, thus, there was coverage in the old policy. It is unusual that Des Champs and his colleagues would be so forthcoming. They obviously had no idea asbestos and other claims in the billions of dollars were wait-

ing to be presented to the pre-1955 general liability policies. More importantly, they surely could have done a better job. Instead, they did nothing more until 1966. There were contemporary critics of the bureaus' timid change.

On October 10, 1955, the *National Underwriter* reported the opinions of insurance attorneys on the 1955 changes, including Mr. Faude.[29] "Mr. Faude believes that the question will continue to be studied with some thought given to the ultimate desirability and nature of a specific clause which would terminate the defense obligation at a definite time or point in relation to exhaustion of policy limits."

Importance of the 1955 Changes

The 1955 changes met with mixed results in the 1950s and 1960s. It is at best dubious to assert the 1955 changes constituted an effective exhaustion limitation for several reasons.

- The introductory phraseology changed from (1) "It is further agreed that as respects insurance afforded by this policy ..." [1941] to (2) "... as respects such insurance as is afforded by the other terms of this policy ..." [1943] to (3) "... as respects the insurance as is afforded by the other terms of this policy ..." [1947] to (4) "... with respect to such insurance as is afforded by this policy ..." [1955]. If the word "such" is to be accorded significance in 1955, why not in 1943? Did the bureaus introduce an exhaustion provision in 1943, repeal it in 1947, and reintroduce it again in 1955? Here is the fatal flaw in the industry's 1955 exhaustion arguments. In an extensive review of the trade literature, the writer has found no indication that the 1947 and 1943 changes were anything but editorial. The appearance of the word "such" modifying "insurance" was not afforded any significance by Sawyer in his 1943 article and no comment whatever has been found regarding the removal of "such" in 1947.

- The casualty bureaus apparently believed that they had fixed the CGL in 1955, but the record shows they did little to educate the commercial insurance market (as distinct from the legal community) and enhance understanding of the change. Richard H. Elliott, then manager of the general liability division of the NBCU, speaking at the Institute of Oregon Underwriters seminar at Eugene, June 19, 1957, went on at length on the new 1955 forms but did not mention the "such language." James C. O'Conner, executive editor of *Fire, Casualty, and Surety Bulletins* and the *National Underwriter,* spoke at length on the new CGL at the Mutual Insurance Forum in Atlanta on November 20-22, 1957, and said nary a word about defense and limit exhaustion or the "such language."

- In September 1956, the family auto policy (FAP) was put into use. One must distinguish FAP from the standard auto policy (SAP), a monoline liability policy that included the 1955 standard provisions. Norman Risjord, vice president, and June Austin, assistant to the general counsel, of Employers Reinsurance, writing in 1957, discuss the FAP; they say: "The defense and settlement provisions ... have been made a part of the same sentence as includes bodily injury and property damage liability. This was done to further reinforce the expression of intent (partially accomplished in the 1955 revision [of the Standard Provisions]) that the obligation to defend suits against the insured is confined to those suits which allege facts which are within the policy coverage."[30] This would tend to suggest that as early as 1956, the bureaus had doubts about the efficacy of the 1955 change.[31]

- The author's opinion is that the custom and practice of the casualty insurance industry was to continue to defend after indemnity limits became exhausted. He found no indication that the custom and practice changed after 1955 and before 1966. Indeed, the Squires, Daenzer, NCCPCU, and Graham articles all were written after the 1955 change. The *Signal Companies* dispute was about an insurance program put in place after 1955.

- Anderson reported in 1948 that some insurers had introduced their own exhaustion language in deviating policy forms, and Hagler in 1965 reported the same. Both perceived a need for an exhaustion provision.[32]

The 1966 Changes

The 1966 changes included an exhaustion limitation. The minutes of the Joint Forms Committee

of the NBCU and the MIRB, dated October 20-22, 1965, reveal that the exhaustion topic was discussed.[33] There was consensus that additional contractual language was necessary. The new language appeared in the 1966 CGL:

> … and the company shall have the right and duty to defend any suit against the insured seeking damages on account of such bodily injury or property damage, even if any of the allegations of the suit are groundless, false, or fraudulent, and may make such investigation and settlement of any claim or suit as it deems expedient, but the company shall not be obligated to pay any claim or judgment or to defend any suit after the applicable limit of the company's liability has been exhausted by payment of judgments or settlements.

This is a clear statement of insurer liability for defense costs in addition to the policy limits, with very explicit exhaustion language such as that called for by J. Branch in dissent of *McCarthy* in 1939 as well as by Faude, Bennett, and Edison.

Although the bureau continued to insist that the 1966 changes were simply editorial and not a change in defense coverage,[34] the reaction in the policyholder community was much more intense. It is probable that few understood the significance of the "such language" in the old policy. The 1966 change was received with seriousness and, by many, considerable consternation.[35]

Conclusions and Implications

It has been 40 years since the 1966 explicit exhaustion limitation was added. Today, claims continue to be made seeking recovery for injuries covered under the earlier standard liability policies. Given the record outlined here, any argument that an insurer can abandon its defense obligation with the exhaustion of indemnity limits on pre-1966 policies (and even more so on pre-1955 policies) is frail indeed. Yet, this is the stance most insurers must continue to take, as there are billions of dollars of defense costs being sought.

Insurers claim that it is obvious and self-evident that the insurer has no more duty to defend when limits are exhausted and that it has always been that way. This clearly is not so. Evidence presented herein shows that "standard casualty practice," to use Faude's term, is to continue defense on cases in litigation when limits become exhausted but not to provide defense for cases that arise after limits are exhausted. Is this the insurance industry position as respects policies written in the 1940s and 1950s? Or is the industry applying the position, adopted after 1966, of walking away as soon as limits of earlier policies become exhausted, even as the industry asserts that the 1966 change was editorial only?

It is true that casualty insurers have enjoyed some success in litigation. The evidence herein presented as regards industry custom and practice is particularly important because it belies the "it has always been that way" argument.[36]

Endnotes

1. It is useful to note that the OL&T, M&C, and CGL were designed to indemnify for bodily injury. All three treated product, property damage, and contractual liability as optional coverages. The first bureau standard CGL appeared in 1941, but it was not until 1955 that the bureaus developed a standard OL&T and M&C. Before 1955, the OL&T and M&C were offered by insurers on company forms, even as, at the same time, the bureau manuals provided specific rates and classifications for these (differing) coverages.
2. Sawyer, E.W., *Comprehensive Liability Insurance*, (New York: Underwriting and Printing Co., 1943). Elmer W. Sawyer was a prominent scholar, recorder, and practitioner of the era. In his 1936 book, he identifies himself as a member of the Massachusetts Bar. In the Preface to that book, he indicates that he had access to the "notes made at the meetings," what would in later years come to be referred to as drafting history. He is unclear as to whether he was a member. In his 1943 book, he identifies himself as attorney for the National Board of Casualty Underwriters and, clearly, was involved in forms development. He was frequently quoted by Kulp, Magee, and other textbook authors. His name continued to appear in the trade press as well as the scholarly literature throughout the 1940s and 1950s.
3. Faude, J.P., "The New Standard Automobile Policy," *The Insurance Law Journal* (June 1955): 647.
4. The Standard Provisions were developed for automobile insurance when a standard bureau policy was first introduced in 1936. These became standard in the first bureau CGL in 1941.

5. In 1940, mutual and stock insurers were much more distinct than they are today. The watershed *South-Eastern Underwriters* case (1944), which found its way to the Supreme Court and led to passage of the McCarren-Ferguson Act, involved serious disputes, including boycott and intimidation, between the mutual and stock sides of the business. Each side of the business had a casualty bureau and a fire bureau. By the mid-1960s, the names had evolved to the National Bureau of Casualty Underwriters and the Mutual Insurance Rating Bureau. By 1973, these organizations had merged and become the Insurance Services Office (ISO).
6. The policy adopted in February 1941 was called the Comprehensive General Liability policy. In 1986, ISO changed the name to the Commercial General Liability policy, retaining the initials CGL.
7. Sawyer's reference to standard provisions applicable to all insurance policies (auto and general liability) remained accurate until 1986. In 1966, the standard provisions were codified in the form of the "jacket" without the defense provisions (first moved to the insuring agreement in the 1956 family auto policy) but including the "preamble" and supplementary payments as well as other terms and conditions.
8. For a discussion of the changes, see Flanigan, George, "CGL Policies of 1941 to 1966: Origins of Product Liability," *CPCU eJournal* (August 2005).
9. Sawyer, E.W., *Weekly Underwriter* (February 6, 1943).
10. Kemper, W.L., "Avoiding the Hazard of Excess Liability and the Expense of Defense by Settlements for Policy Limits," *Insurance Counsel Journal* (April 1950): 145. Note that the author of the article you are reading is not an attorney and has very limited experience in the proper citation of legal cases. This article is not a review of legal cases but, instead, is a discussion of articles, books, and reports written in the middle of the 20th century. Among articles that review the legal decisions on the duty to defend and the early CGLs, the reader might consult Zulkey, E.J., and M.A. Pollard, "The Duty to Defend After Exhaustion of Policy Limits," *For the Defense* (June 21, 1985), which provides complete and accurate citations of many of the cases referenced herein.
11. It is interesting to note that the forms-drafting committee was still concerned about the problem, as reported by Des Champs. He wrote that the 1955 change obviated the "necessity of providing a defense for property damage even where no limits for such coverage had been provided." Part of the problem was that policies written before the Standard Provisions often included four totally separate insurance agreements: (1) to pay indemnity, (2) to serve, meaning to investigate and settle, (3) to defend, and (4) to make supplementary payments. None made reference to the limits nor to each other, thus leading to the inference that the four were independent.
12. Francis X. Bruton of Aetna Life and Casualty observed, in the context of commenting upon the 1966 CGL changes:

    > This language is at least the third attempt by underwriters to make their intent known. Prior to 1955, the defense obligation was stated separately, thus leading some courts to the conclusion that it was not written subordinate to the primary obligation of the insurer to indemnify. In 1955, the language was changed to make the obligation to defend apply only with respect to *such* insurance as is afforded by the policy [Bruton's emphasis]. Today's version should avoid holdings such as that by the New York Court which decided that the pre-1955 language was 'clear and unambiguous' and 'if the insurer intended to withdraw counsel and cease to defend such actions as might be pending after the total amount of indemnity was paid or to refuse to defend any new action commenced after such payments, it was under a duty to so state in the policy.' (Bruton, Francis X., *Insurance Law Journal* [June 1972]).
13. Faude, J.P., "What is Meant by the Insurer's Duty to Defend," *Insurance Counsel Journal* (October 1948): 331.
14. Faude goes on to discuss the public policy issues. *McCarthy* raised the conflict of interest issue; i.e., if the insurer has no stake in the outcome, it will not put forth its best effort to defend, skimping on lawyers and generally serving the insured poorly. Indeed, the argument becomes that, for the sake of the policyholder, the insurer must be relieved of defense responsibilities because the insurer will do a bad job. In the modern world, it is difficult to sustain this viewpoint, which overlooks legal malpractice issues and insurer bad faith and places emphasis on *right* to defend and little on *duty* to defend.
15. Anderson, Wilson, "Liability of Insurer to Defend After Payment of Full Policy Limits," *Insurance Counsel Journal* (April 1952): 167.
16. Northern California Chapter of CPCU, "Umbrella Liability Insurance Origins," *Annals of CPCU* (1960): 143.
17. Graham, J.J., "Large Line Packages in Casualty Insurance," *Annals of CPCU* (Spring 1962): 67.
18. Daenzer, Bernard, "Excess Liability, Umbrella, Aggregate, and Deductibles," *Property and Liability Insurance Handbook*, ed. J.D. Long and D.W. Gregg (Chicago: Richard D. Irwin, 1965): Chapter 40.
19. *Business Insurance* (August 4, 1980).
20. Squires, Eric, Memorandum, "Policy Revision: Excess Liability and/or Property Damage and/or Products Liability:

USA and Canada" (November 19, 2007).

21. Put another way, it is arguable that the changes in the 1955 and 1966 forms were undertaken for marketing and underwriting purposes as much as for claims settlement purposes, another suggestion that the industry in the middle third of the century was not anxious to abandon its traditional unlimited defense obligations.
22. Kemper, ibid.
23. Anderson (ibid.) reports that the American Casualty court very trenchantly commented on another dimension, writing that the fact that although the insured can readily secure all needed [indemnity] protection by purchasing and paying for a policy with a high limit of liability, he is presented with no opportunity to purchase greater amounts of defense. Anderson presents this as further evidence. Since the insured has no option to buy as much defense coverage as he likes, the defense obligation must be unlimited.
24. Anderson, ibid.
25. Faude, ibid.
26. The custom and practice was for bureau members to use bureau forms. Many independent companies subscribed to the bureau and, if permitted by state regulation, might change provisions of the bureau forms for their own use. This was common in the Pacific region. California did not regulate rates or forms. The tantalizing footnote in Anderson's paper (ibid.) has inspired a search for policy forms by the writer, as yet to no avail.
27. Hagler, James, *National Underwriter* (November 26, 1965).
28. Des Champs, Charles A., "The Obligation of the Insurer to Defend Under Casualty Insurance Policy Contracts," *Insurance Counsel Journal* (October 1959): 580.
29. *National Underwriter* (October 10, 1955).
30. Risjord, N.E., and J.M. Austin, "Standard Family Automobile Policy," *The Insurance Law Journal* (April 1957): 199.
31. The writer reviewed the 1956 FAP. It has no explicit exhaustion limitation, but the defense obligation became affixed to the duty to indemnify, including the words "any suit alleging such bodily injury or property damage and seeking damages which are payable under the terms of this policy." The homeowners policy of the period follows the FAP, while the workers compensation and CGL policy retained the 1955 Standard Provisions.
32. Anderson, Wilson, ibid.; Hagler, ibid.
33. The minutes of ISO meetings are referred to as "drafting history." The documents are stamped "confidential," but they are frequently subpoenaed. I acquired the documents discussed here from a library. ISO committees consist of representatives of various companies as well as professional staff. In recent years, ISO has permitted nonindustry personnel to serve on committees.
34. In addition to the above-referenced minutes, see also Elliott, R.H., "The New Comprehensive General Liability Policy," *Best's Fire and Casualty News* (1966): 32; and Nachman, Norman, "The New Comprehensive General Liability Policy," *Annals of the CPCU* (October 1966). Both were members of the bureau staff. See also Katz, George, "Changes for Editorial or Clarification Purposes or in Conditions of the Policy," presented at a CPCU-sponsored event at the Sheraton Boston Hotel (November 11, 1965). Katz was a member of the forms committee.
35. Bland, R.W., "An Insured Examines The Liability Contract In Terms of Basic Concepts," *The National Insurance Buyer* (March 26, 1968); Andrews, Haywood, "Impact of the Comprehensive General Liability on the Corporate Insurance Buyer," *The National Insurance Buyer* (January 1968): 34.
36. The research presented herein was conducted in a lengthy and time-consuming process. Indices and bibliographies are of limited value because a kernel of knowledge often is lodged deep within an article. For example, the 1948 Faude article argued that the defense obligation should end at exhaustion (on basis of *McCarthy*), but it included the reference to "standard casualty practice." In addition, many of the publications are no longer in print, for example, *The Weekly Underwriter* and *The Insurance Law Journal*. The research was gathered in a page-by-page review of the original volumes in university and corporate libraries. An obvious direction for further research might be to study in depth those cases where the central question has been litigated and evaluate what expert opinion, if any, was considered. As a scholar, it has been a very rewarding experience.

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