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The D&O Diary

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What Happens if Parent Rather than "Named Insured" Subsidiary Pays the Retention?

By Kevin LaCroix on August 13, 2025

In a ruling that is sure to provoke controversy in the insurance community, the Delaware Supreme Court held in a split decision that, because the corporate parent was not a Named Insured under the applicable Commercial General Liability (CGL) policies, the corporate parent's payment of the self-insured retentions (SIRs) did not satisfy the SIR requirements, and therefore that the insurers' coverage obligation was not triggered. As discussed below, there is a lot to say about the Court's decision, which is, in my opinion, a doozy. The Court's August 12, 2025, opinion can be found **here**.

Background

Beginning in the late 90s, Aearo LLC and related entities manufactured a type of earplugs known as Combat Arms Earplugs. In 2008, 3M acquired Aearo and continued to manufacture the earplugs. In 2018, the first of several product liability lawsuits were filed against 3M and Aearo, in which the plaintiffs claimed hearing-related injuries. Eventually more than 280,000 of the lawsuits were filed. The suits were consolidated into a MDL proceeding. In 2023, GM and Aearo reached a

$6.01 billion global settlement of the earplug lawsuits. 3M says that it paid over $370 million in legal fees and defense costs in the earplug lawsuits.

3M and Aearo, seeking coverage for the earplug litigation defense costs from certain of their commercial generally liability (CGL) insurers, initiated insurance coverage litigation against the insurers. Critically for the subsequent insurance coverage litigation, the Named Insured in each of the policies was Aearo LLC. 3M was not a Named Insured.

The coverage litigation involved the question whether the SIR requirements in each of the policies had been satisfied. The insurers argued that the SIR requirements had not been satisfied because the SIR provisions required Aearo, not 3M, to pay the SIR, and Aearo had not done so. Aearo and 3M argued that payments by either Aearo or 3M were sufficient to satisfy the applicable SIRs.

The Delaware Superior Court ruled that under the "express language" of the three policies, "costs paid by 3M do not count towards the SIR." The court reasoned that each policy provides that "you" or the "insured" must pay the SIR, and 3M is not an insured under any of the policies. 3M and Aearo appealed the Superior Court's decision to the Delaware Supreme Court.

The August 12, 2025, Opinion

In a 3-2 majority opinion written by Justice **N. Christopher Griffiths**, the Court agreed with the Superior Court, saying that "the clear meanings of 'you' and 'Named Insured,' and the requirements of the SIRSs do not permit more than one reasonable reading – 3M is not a 'Named Insured' under any policy and cannot satisfy the SIRs." Because "payments made by the parent did not satisfy the retentions, the insurers' coverage obligations had not been triggered."

3M and Aearo had tried to argue that this reading created "unintended and pointless requirements." The appellate court rejected this argument noting, first, that where, as here the relevant policy language is "unambiguous," the court will find the parties' intent "in the plain meaning of the language," and the "language plainly states that the 'Named Insured' under each policy was required to satisfy the respective SIRs." The Court also said that "we respect the separateness of distinct legal entities." Aearo and 3M are "each distinct legal entities, and absent specific circumstances not present here, we will not disregard that distinction."

3M and Aearo had also tried to argue that the SIR requirements are not conditions precedent to coverage, meaning that even if Aearo failed to satisfy the SIR that should not result in a failure to trigger coverage. The insurers countered that the SIR requirements were conditions precedent to coverage, and therefore coverage was not triggered unless and until Aearo satisfied the SIR requirements.

In addressing the conditions precedent issue, the appellate court considered the differences between an SIR and a deductible. Considering the purposes of an SIR, the court concluded that the SIR provision in each of the three policies “functions as a condition precedent to the respective insurer’s coverage obligation.” Interestingly, and as the dissent pointed out, the majority opinion does not address the question of what specifically makes an insurance policy provision a condition precedent, nor did it say what specifically made the SIR provisions in dispute in this case conditions precedent.

Finally, 3M and Aearo had tried to argue that the “maintenance clause,” which specifies how the SIR provisions are to operate in bankruptcy or insolvency, meant that the insurers were entitled only to a setoff in the amount of the SIR, not a denial of coverage. The court rejected this argument, saying that the maintenance clause was only triggered in situations where the insured is in financial distress or where it has not maintained a lower level policy. The clause, the court said, “protects an insurer from dropping down and expanding its coverage obligations to liability not with the specific policy’s purview. The clause does not, as Aearo and 3M suggest, protect the insured by creating a setoff if the insured fails to satisfy the SIR.”

The Dissenting Opinion

In dissent, Justice **Abigail Legrow**, joined by Justice **Gary Traynor**, said that in her view, the critical question for the court to decide is not whether the corporate parent can satisfy the SIR requirements. The critical question, she said, was “whether the satisfaction of the self-insured retention was a condition precedent to the insurers’ coverage obligations and, if so, whether the failure of that condition as a result of the parent’s payment should result in a complete forfeiture of the coverage for which the insured paid premiums.”

Justice Legrow went on to say that “in the absence of unambiguous contractual language creating a condition precedent, our law avoids construing a contract as containing conditions whose nonoccurence results in a forfeiture of a contractual obligation. And when a disproportional forfeiture would otherwise result from the nonoccurence of a condition that is not material, forfeiture may not be excused.”

Discussion

I am going to argue below that the majority opinion got this one wrong, but before I get to that, I think it is important to give the insurers their due and highlight the reason why insurers might well insist on the payment of the SIR being borne by the Named Insured. In its opinion, the Superior Court had expressly addressed this issue by saying that the “purpose of requiring that the insured pay the SIR is so that the insured can partially bear the costs of risk that is being insured.”

That is, the SIR requirements enforce the insurers' expectation that the insured will have some skin in the game and therefore have an incentive to avoid actions that might result in losses under the policy. (Insurance geeks will say that the SIR is there to counter the "moral hazard" that the existence of the insurance might otherwise create.)

While I acknowledge, as I must, this important purpose that the SIR requirements serve, I still cannot suppress the gut reaction that the majority opinion here makes something of a fetish out of the SIR requirement, transforming it into a pointless formality.

OK, so the SIR was paid out of 3M's bank account, rather than Aearo's, so what? What of substance is changed if the two units engaged in a little bookkeeping exercise whereby 3M, rather than paying the legal bills out of its own account, "loaned" the funds to Aearo, and then Aearo paid the bills out of its account? To me, insisting that 3M's payments did not satisfy the SIR requirements elevates form over substance – and does so in a way that effects a complete forfeiture of the insurance for which Aearo paid.

And, by the way, I don't think the avoiding-the-moral-hazard incentives are changed in any way, regardless of which intra-corporate account the money came from. Aearo is a wholly-owned subsidiary of 3M whose financial results are consolidated with 3M's. The usual justification for making sure the Named Insured and only the Named Insured pays the SIR simply doesn't apply in the intra-corporate context.

I think it is important to note that this is not the usual SIR-related coverage dispute. Usually, SIR-related coverage fights are about whether the amount of the SIR was paid. There is no question here that the amount of the SIR was paid. The amount of the "layer" below the insurers' coverage trigger was fully paid. The insurers are not, in effect, being asked to drop down.

The majority opinion also missed (or perhaps side-stepped) an opportunity for the full consideration of these issues. As the dissent noted, in an April 2025 opinion (**here**), the Delaware Supreme Court had held, in the *Thompson Street* case, that under certain circumstances a court may excuse a party's non-compliance with a condition precedent if the party "demonstrates that the condition precedent was not a material part of the agreement and satisfied the requirements of disproportionate forfeiture."

The *Thompson Street* case was decided after the parties in this case had completed their appellate briefing. The majority declined to consider the potential impact of the *Thompson Street* case here essentially because, it said, 3M and Aearo had not taken steps to bring the *Thompson Street* case to the court's attention. Again, this seems like elevation of form over substance to me. I think the dissent got it right in contending that the court should have remanded the case to the Superior Court for consideration of how the *Thompson Street* decision might affect the analysis here.

Finally, I think the dissent also got it right that in saying that the majority opinion failed to appropriately consider whether the SIR provisions were in fact conditions precedent to coverage and failed to consider the fact that the enforcement of the condition would effect a complete forfeiture and therefore that the court should avoid construing the contract that way.

The majority simply said, in conclusory fashion, that SIRs, by contrast to deductibles, are conditions precedent, and that each of the SIRs here "functions" as a condition precedent to the insurer's respective obligations. In my view, saying that a provision "functions" as something is not the same as saying that the provision *is* that thing. The majority neither considered what the requirements are to make a provision a condition precedent nor did it analyze whether the specific SIRs at issue here meet those requirements. And again, the majority did not consider whether the forfeiture that the enforcement of the SIR condition would effect should cause the Court to not construe the provisions that way.

For my colleagues on the policyholder side of the aisle, this is an alarming opinion. The good news for public company policyholders is that many modern public company D&O insurance policies provide, either in the base form or by endorsement, that payment of the SIR may be from any source. However, many private company D&O insurance policies still provide, at least in their base forms, that (as one form puts it) the Insured "shall bear uninsured and at its own cost the amount of any applicable Retention." I suspect that in light of the Delaware Supreme Court's decision in this case, the retention provisions will be the source of a great deal of discussion in the weeks and months ahead.

In my view, the issue with the retention ought to be that it is paid (and therefore the insurer is not being asked to drop down) and not on the question of who pays it.

I welcome contrasting points of view. I encourage anyone with a differing perspective to post their views to this site, using the blog's comment feature.

Special thanks to a loyal reader for supplying me with a copy of the Delaware Supreme Court's opinion.