

An Uncharted Frontier: Nevada First State to Prohibit Defense-Within-Limits Provisions

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Nevada recently became the first state to prohibit defense-within-limits provisions in liability insurance policies. Defense-within-limits provisions—resulting in what’s called “eroding” or “wasting” policies—reduce the policy’s applicable limit of insurance by amounts the insurer pays to defend the policyholder against a claim or suit. These provisions are commonly included in errors and omissions (E&O), directors and officers (D&O) and other management liability policies. This is in contrast to other policies, most commonly commercial general liability policies, which provide defense “outside of limits” where defense costs do not reduce the policy’s limit.

Nevada’s new law, which goes into effect on October 1, 2023, amends Chapter 679A to add the following new section:

Notwithstanding any other provision of law, an insurer, including, without limitation, an insurer listed in NRS 679A.160, shall not issue or renew a policy of liability insurance that contains a provision 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 applies to insurers that transact the business of insurance in Nevada and issue liability insurance products for Nevada residents. The new law does not apply to any insurance policies existing on October 1, 2023, but it applies to the renewal of any such policies.

Prohibiting defense-within-limits provisions may be a double-edged sword. On the one hand, the provisions preserve coverage for settlements and judgments because costly litigation will not reduce the policy’s limits. On the other hand, where a policy’s limits are not reduced by defense costs, it could lessen the incentive for claimants to settle early in litigation to avoid the risk of eroding liability limits by defense costs. The incentive for claimants and policyholders to settle early is heightened when the exposure to the policyholder exceeds the policy limit. Removing this shared goal of avoiding protracted litigation may drive up costs of defense even more if there are fewer settlements or if settlements are reached later in the litigation.

The new law also creates uncertainty in the insurance marketplace. Nevada policyholders may see increases in premiums and other changes to the structure of their liability insurance products to mitigate the increased risk to insurers because of the new law. Insurers may even be less likely to offer E&O, D&O and other liability insurance products to Nevada policyholders. Some commentators have predicted that certain insurers will withdraw from the Nevada marketplace entirely.

Nevada policyholders should be aware of the new law and its potential effect on them. Experienced coverage counsel can assist with navigating this new frontier for Nevada policyholders.

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