



North Dakota  
**Insurance Department**  
 Adam W. Hamm, Commissioner

**M E M O R A N D U M**

TO: Legislative Council's Administrative Rules Committee

FROM: Sara Behrens, Legal Counsel *Sara R. Behrens*

DATE: March 6, 2015

SUBJECT: Adoption of Administrative Rules (April 2015 Supplement)

- Defense Expenses Within the Limit of Liability Provisions (45-05-09)

Chairman Devlin and members of the Administrative Rules Committee, I am Sara Behrens, Legal Counsel for the North Dakota Insurance Department.

As requested, the following addresses the Administrative Rules Committee's questions regarding recent amendments to Title 45 of the North Dakota Administrative Code adopted by the North Dakota Insurance Department.

The committee requested testimony concerning the following:

1. **Whether the rules resulted from 2013 statutory changes made by the Legislative Assembly.**

Answer: No.

2. **Whether the rules are related to any federal statute or regulation.**

Answer: No.

3. **A description of the rulemaking procedure followed in adopting the rules, e.g., the type of public notice given and the extent of public hearings held on the rules.**

Answer: Notice of the rulemaking and the public hearing was published in all county newspapers as required by law. The Insurance Department also uses a basic mailing list to provide notice of each of its rulemaking projects. Additionally, the Department constructs relevant mailing lists for specific rulemaking. A public hearing was held on November 20, 2014, at the State Capitol, Bismarck, North Dakota. Oral and written comments received were summarized and are contained in the attached

Summary of Comments. The Department's responses to the comments are also included in the attached Summary of Comments, along with the amendments to the rules occasioned by the comments.

4. **Whether any person has presented a written or oral concern, objection, or complaint for agency consideration with regard to these rules.**

Answer: Comments received and action taken to address those comments are summarized in the attached Summary of Comments.

5. **The approximate cost of giving public notice and holding any hearing on the rules, and the approximate cost (not including staff time) of developing and adopting the rules.**

Answer: The Notice of Hearing was published once in all North Dakota official county newspapers which cost approximately \$1,949.58 for the rules which are before the committee today. Approximately 1,400 notices were sent by email to insurance companies and interested parties at no cost. Approximately 250 notices were sent by post office mail and the postage charge for this mailing was approximately \$115.

6. **An explanation of the subject matter of the rules and the reasons for adopting those rules.**

Answer: The chapter is being created in order to provide protection to consumers from misleading policy provisions which could transform a liability policy into a defense expense only policy and to regulate under what circumstances such provisions will be permitted.

7. **Whether a regulatory analysis was required by N.D.C.C. § 28-32-08 and whether a regulatory analysis was issued.**

Answer: A Regulatory Analysis, Small Entity Economic Impact Statement and Small Entity Regulatory Analysis was prepared and a copy is attached.

8. **Whether a regulatory analysis or economic impact statement for small entities was required by N.D.C.C. § 28-32-08.1 and whether that regulatory analysis or impact statement was issued.**

Answer: A Regulatory Analysis, Small Entity Economic Impact Statement and Small Entity Regulatory Analysis was prepared and a copy is attached.

9. **Whether these rules have a fiscal effect on state revenues and expenditures, including any effect on funds controlled by your agency.**

Answer: A Fiscal Note Regarding Proposed rules was prepared and a copy is attached.

10. **Whether a constitutional takings assessment was prepared as required by N.D.C.C. § 28-32-09.**

Answer: A Takings Assessment Concerning Proposed Rules was prepared and a copy is attached.

11. **If these rules were adopted as emergency (interim final) rules under N.D.C.C. § 28-32-03, provide the statutory grounds from that section for declaring the rules to be an emergency and the facts that support that declaration and provide a copy of the Governor's approval of the emergency status of the rules.**

Answer: The rules were not adopted as emergency rules.

I hope that this response adequately addresses the concerns of the committee. I will be happy to answer any questions that you might have.

SB/njb  
Attachments  
cc: Adam Hamm, Commissioner

**STATE OF NORTH DAKOTA**  
**BEFORE THE INSURANCE COMMISSIONER**

<b>In the Matter of the Promulgation</b>	)	<b>SUMMARY OF COMMENTS</b>
<b>of Proposed Rules Regarding:</b>	)	
<b>Defense Expenses Within The Limit of</b>	)	<b>FILE NO. RU-14-486</b>
<b>Liability Provisions</b>	)	

A public hearing to receive comments regarding the proposed rules was held on November 20, 2014, at the State Capitol Building in Bismarck, North Dakota. Insurance Department General Counsel Jeff Ubben presided at the hearing. The public hearing was called for the purpose of allowing all interested individuals an opportunity to submit information concerning the proposed creation of or amendments to the following chapters of the North Dakota Administrative Code:

45-05-09 Defense Expenses within the Limit of Liability Provisions

Written comments were scheduled to be accepted through December 1, 2014.

No oral comments were received on the proposed rules. Seven written comments were received on the proposed rules. The following summarizes the comments received and the Commissioner's action, if any, in response to the comments.

**N.D. ADMIN. CODE CHAPTER 45-05-09**  
**DEFENSE EXPENSES WITHIN THE LIMIT OF LIABILITY PROVISIONS**

1. The proposed rules would provide protection to consumers from misleading policy provisions which could transform a liability policy into a defense

expense only policy and to regulate under what circumstances such provisions will be permitted.

2. Three commenters questioned what “primary coverages” and “secondary coverages” mean. Three commenters requested that the word “admitted” appear before “insurer” to make clear that the chapter does not apply to surplus lines carriers. In response to these comments, definitions have been added to clarify what is meant by each term and to clarify that the chapter applies only to admitted insurers:

**45-05-09-01. Defense expenses within limit of liability prohibited - Exceptions.**

No admitted insurer shall issue or renew a policy of liability insurance in this state that includes defense expenses within the limit of liability unless the policy’s minimum limit per occurrence or the aggregate liability limit for all liability risks and coverages under the policy is at least:

1. One million dollars for primary coverages; and
2. One hundred thousand dollars for secondary coverages.

“Primary coverages” means the main or intended coverage of the policy.

“Secondary coverages” means coverage which is in addition to the main policy by endorsement, rider or additional coverages.

3. Three commenters felt that \$1,000,000 was too excessive for a primary coverages limit and one commenter felt that \$100,000 was too excessive for a secondary coverages limit. Commenters pointed out that New York only requires a limit of \$100,000 for primary coverages. No change was made as the Department believes the limits are appropriate and not excessive. Numerous other states require limits as high as or higher than the proposed limits. The Department’s aim is to protect both insureds and third parties. When the limit of liability is low, it is quickly eroded by the

defense expenses, leaving the insured without further coverage and the third party without payment for damages sustained.

4. One commenter asked that it be clarified whether both Sections 45-05-09-01 and 45-05-09-02 are required to be met. In response to the comment, Section 45-05-09-02 has been amended as follows:

**45-05-09-02. Policies within which defense expenses within limit of liability permitted.**

Defense expenses within the limit of liability provisions are allowed only within the following types of policies or coverages within a policy with the limits of liability as required in 45-05-09-01:

5. Two commenters requested that fiduciary liability be added to Section 45-05-09-02 and two commenters requested that excess policies be included with umbrella policies in Section 45-05-09-02. In response to the comments, Section 45-05-09-02 has been amended as follows:

1. Cyber liability;
2. Fiduciary liability;
- ~~3.2.~~ Directors and officers liability;
- ~~4.3.~~ Errors and omissions liability;
- ~~5.4.~~ Employer practices liability;
- ~~6.5.~~ Medical malpractice liability;
- ~~7.6.~~ Pollution liability;
- ~~8.7.~~ Liquor liability;
- ~~9.8.~~ Nuclear liability;
- ~~10.9.~~ Fidelity bond;
- ~~11.10.~~ Umbrella and excess policies; and

12.44. Other policies permitted within the discretion of the insurance commissioner.

One commenter requested that products completed operations be added to the list. No amendment was made in response to this comment as this is part of commercial general liability coverage which the Department is not including.

6. One commenter requested that there be a blanket exception for large commercial risks. No amendment was made in response to this comment as the Department does not believe that such an exception would be in line with the purpose of the proposed rules.

7. One commenter requested that the list in Section 45-05-09-02 include the policies and coverages where defense expenses within the limit of liability are not permitted instead of the policies and coverages in which these provisions are permitted. No amendment was made in response to this comment. The Department has identified specific policies and coverages in which it believes it is appropriate to allow defense expenses within the limit of liability provisions. The Department is, however, willing to consider other types of policies and coverages where requested by an insurer as stated in number 12 "Other policies permitted within the discretion of the insurance commissioner." This will also address another commenter's concern about consideration of the needs of emerging stand-alone products for certain industries.

8. One commenter asked that there be clarification as to how the "Other policies permitted within the discretion of the insurance commissioner" subsection of Section 45-05-09-02 would be applied. No amendment was made in response to this comment. The manner in which this would be applied will depend on the facts and circumstances.

9. Four commenters indicated that requiring specific language on the declaration page would be burdensome. In response to the comments, Section 45-05-09-03 was amended as follows:

**45-05-09-03. Notice required.**

~~“Defense~~ The fact that defense expenses are within the limit of liability must appear **be disclosed** on the declaration page in at least twelve-point bold print.

10. Five commenters had concerns over the acknowledgment required by Section 45-05-09-04. One commenter stated that it would require a hard copy in order to acquire the initials of the applicant in an age where electronic applications are the norm. One commenter noted that no other state requires an initialed acknowledgment and this would render North Dakota an “outlier.” In response to the comments, the following amendment was made to Section 45-05-09-04:

**45-05-09-04. Acknowledgment.**

~~The application must contain a conspicuous acknowledgment initialed by the~~ The applicant or insured must sign a disclosure form as part of the application or renewal process wherein the applicant or insured acknowledges that the subject policy has limits of liability which may be reduced or completely eliminated by payments for legal defense costs and claims expenses.

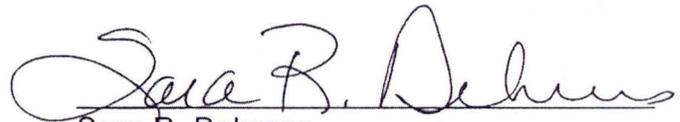
This provision is in line with a number of other states which require a separate signed disclosure or consent form. In fact, one commenter suggested that this would be an option. The Department is not mandating specific language for this disclosure form and most insurers should have such a form they use in other states. The signed disclosure will ensure that the applicant or insured knows, at the time of application or renewal, that the policy or coverage contains a defense expenses within the limit of liability provision and can then ask any necessary questions.

11. Two commenters requested that defense-only policies be exempted from the proposed chapter. The Department recognizes that such policies would be potentially misleading as the sole purpose of the policy is to cover defense costs and not to provide damages to third parties. The concerns behind the proposed rules do not apply to such policies. In response to the comments, the following section has been added to the proposed chapter:

**45-05-09-05. Defense-only policies excepted.**

Defense-only policies are excepted from the requirements of chapter 45-05-09. A defense-only policy is a policy which is purchased solely to provide a legal defense and is not meant to provide indemnification or to be a source of payment for damages to a third-party.

DATED this 4<sup>th</sup> day of December, 2014.



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STATE OF NORTH DAKOTA  
BEFORE THE INSURANCE COMMISSIONER

In the Matter of the Promulgation	)	REGULATORY ANALYSIS, SMALL
of Proposed Rules Regarding:	)	ENTITY ECONOMIC IMPACT
Defense Expenses Within The Limit of	)	STATEMENT AND SMALL ENTITY
Liability Provisions	)	REGULATORY ANALYSIS
	)	
	)	FILE NO. RU-14-486

**I. REGULATORY ANALYSIS**

The North Dakota Insurance Department issues this regulatory analysis as required by N.D.C.C. § 28-32-08. An agency must issue a regulatory analysis if a written request for an analysis is filed by the Governor or a member of the Legislative Assembly or a proposed rule being adopted by the agency is expected to have an impact on the regulated community in excess of \$50,000. *Id.*

The proposed rule may have an impact on the regulated community in excess of \$50,000.

**A. Classes of Persons Who Probably Will be Affected by the Proposed Rule**

The classes of persons who may be affected by the proposed new rule are private persons and consumers who choose to purchase the included types of insurance policies and insurance companies. The consumers will benefit from the new rule and the insurance companies will potentially bear the burden as well as the benefit of the proposed new rule.

**B. Description of the Probable Impact Including the Economic Impact of the Proposed Rule**

The probable impact, including economic impact, on the insurers is expected to be minimal. There may be a slight cost for insurers to include required provisions and bring the policies into compliance with the rules. The purpose of the rule is to protect consumers from unreasonable defense expenses within limits of coverage provisions and to ensure that consumers are aware of, and understand the provisions.

C. **Probable Costs to the Agency of Implementation and Enforcement of the Proposed Rule and Any Anticipated Effect on State Revenues**

The probable cost to the agency of implementation and enforcement is expected to be of minimal impact on the Department's operations and expenditures. The Department currently reviews all insurers' policy forms and will continue to do so under the proposed rule. There will be little, if any, effect on state revenues from the proposed rule.

D. **Description of Any Alternative Methods for Achieving the Purpose of the Proposed Rule That Were Seriously Considered by the Agency and the Reasons Why the Methods Were Rejected in Favor of the Proposed Rule**

The Department considered whether there are any less intrusive or less costly alternative methods of achieving the purpose of the proposed rule. The rule implements current Department practice and its aim is to protect consumers from unknowingly agreeing to defense expenses within limits provisions in their policies. The Department did not identify any alternative method of achieving the purpose which would have been as effective and less intrusive or costly.

II. **SMALL ENTITY ANALYSES**

N.D.C.C. § 28-32-08.1 requires that an agency prepare a regulatory analysis and an economic impact statement of the impact of the rule changes on a small entity. "Small entity" is defined by state law to include small businesses, small organizations, and small political subdivisions. *Id.* "Small business" is defined to mean a business entity, including its affiliates which is independently owned and operated and employs fewer than 25 full-time employees; or has gross annual sales of less than \$2,500,000. *Id.* "Small organization" means any not-for-profit enterprise that is independently owned and operated and is not dominant in its field. *Id.* "Small political subdivision" means a political subdivision with a population of less than 5,000. *Id.*

A. **Small Entity Economic Impact Statement**

1. **Small entities subject to the proposed rule**

The small entities that may possibly be subject to the proposed rule are insurance producers and insurance companies which meet the statutory definition of "small entity."

2. **Administrative and other costs required for compliance with the proposed rule**

The administrative and other costs required for compliance with the proposed rule are expected to be minimal.

3. Probable cost and benefit to private persons and consumers who are affected by the proposed rule

It is possible, but unlikely, that there would be some cost to private persons or consumers since the proposed rule is directed to insurance companies. Any cost to private persons and consumers would be indirect and not capable of measurement. The rule would benefit private persons and consumers by ensuring that they are aware of any defense expenses within limits of liability provisions in insurance policies and limiting the types of policies in which those provisions are allowed.

4. Probable effect of the proposed rule on state revenues

The probable effect of the proposed rule on state revenues is minimal to nonexistent.

5. Any less intrusive or less costly alternative methods of achieving the purpose of the proposed rule

The Commissioner considered whether there are any less intrusive or less costly alternative methods of achieving the purpose of the proposed rule. The purpose of the rule is to protect consumers. The rule codifies current Department practice. Therefore, no less intrusive or less costly alternative method was identified.

**B. Small Entity Regulatory Analysis**

1. Establishment of less stringent compliance or reporting requirements for small entities

There are no reporting requirements found in the proposed rule, therefore, less stringent requirements for small entities are not appropriate.

2. Establishment of less stringent schedules or deadlines for compliance or reporting requirements for small entities

The Commissioner considered less stringent schedules or deadlines for compliance or reporting requirements for small entities and found them not appropriate. The purpose of the rule is the protection of private persons and consumers.

3. Consolidation or simplification of compliance or reporting requirements for small entities

Compliance and reporting requirements are not different depending on the size of the entity. The purpose of the rule is protection of private persons and consumers and distinguishing between entity size is not appropriate.

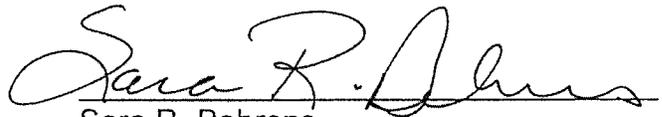
4. Establishment of performance standards for small entities to replace design or operational standards required in proposed rule

Small entities were not given different operational standards or design standards than large entities. This would not be appropriate considering the purpose of the rule is to protect private persons and consumers.

5. Exemption of small entities from all or any part of the requirements contained in the proposed rule

Small entities were not given different standards to comply with than large entities.

DATED this 8 day of October, 2014.



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STATE OF NORTH DAKOTA  
BEFORE THE INSURANCE COMMISSIONER

In the Matter of the Promulgation	)	FISCAL NOTE REGARDING
of Proposed Rules Regarding:	)	PROPOSED RULE
Defense Expenses Within The Limit of	)	
Liability Provisions	)	FILE NO. RU-14-486

The purpose of this fiscal note is to fulfill the requirements of N.D.C.C. § 28-32-08.2 which provides that when an agency presents rules for the Administrative Rules Committee's consideration, the agency shall provide a fiscal note or a statement in its testimony that the rules have no fiscal effect. A fiscal note must reflect the effect of the rule changes on state revenues and expenditures, including any effect on funds controlled by the agency. This fiscal note pertains to proposed amendments to N.D. Admin. Code Title 45.

**1. Statement of Estimated Effect on State Revenues and Expenditures**

The undersigned has determined that the proposed rule concerning Defense Expenses within the Limit of Liability Provisions (N.D. Admin. Code ch. 45-05-09) is not expected to have a significant fiscal effect on state revenues and expenditures during the 2013-2015 biennium.

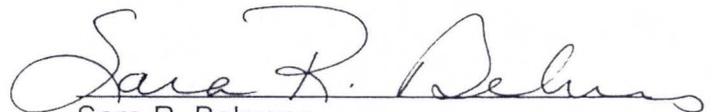
**2. Whether it is a One-Time or Ongoing Effect**

The rule is not expected to have a significant fiscal effect.

**3. Identification of Impact to the Department's Budget**

The rule is not expected to have a fiscal effect on the Department's budget.

DATED this 8 day of October, 2014.



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STATE OF NORTH DAKOTA  
BEFORE THE INSURANCE COMMISSIONER

In the Matter of the Promulgation	)	TAKINGS ASSESSMENT CONCERNING
of Proposed Rules Regarding:	)	PROPOSED RULE
Defense Expenses Within The Limit of	)	
Liability Provisions	)	FILE NO. RU-14-486

This document constitutes the written assessment of the constitutional takings implications of this proposed rulemaking as required by N.D.C.C. § 28-32-09.

1. This proposed rulemaking does not appear to cause a taking of private real property by government action which requires compensation to the owner of that property by the Fifth or Fourteenth Amendment to the Constitution of the United States or N.D. Const. art. I, § 16. This proposed rulemaking does not appear to reduce the value of any real property by more than 50 percent and is thus not a "regulatory taking" as that term is used in N.D.C.C. § 28-32-09. The likelihood that the proposed rule may result in a taking or regulatory taking is nil.

2. The purpose of the proposed rule is clearly and specifically identified in the public notice of proposed rulemaking which is incorporated by reference into this assessment.

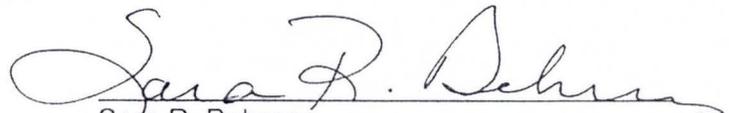
3. The reasons the proposed rule is necessary to substantially advance that purpose is described in the regulatory analysis which is incorporated by reference into this assessment.

4. The potential cost to the government if a court determines that any portion of this proposed rulemaking constitutes a taking or regulatory taking cannot be reliably estimated to be greater than \$0. The agency is unable to identify any application of any portion of the proposed rulemaking that could conceivably constitute a taking or a regulatory taking. Until an adversely impacted landowner identifies the land allegedly impacted, no basis exists for an estimate of potential compensation costs greater than \$0.

5. There is no fund identified in the agency's current appropriation as a source of payment for any compensation that may be ordered.

6. I certify that the benefits of the proposed rulemaking exceed the estimated compensation costs.

DATED this 8 day of October, 2014.



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