

WHITE PAPER

Choosing a Path Forward

Duty to Defend or Reimbursement?

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Introduction

When a business owner decides which insurance coverage to purchase to help protect the company, there are different paths forward that must be successfully navigated.

One such decision is whether an insurance policy will be Duty to Defend or Reimbursement. While there are layered significances to this distinction, focus on how each form responds to claim, who selects the lawyers and what items an insured should consider when making this decision.



How Does Each Insurance Policy Form Respond To A Claim?

Generally speaking, insurance policies provide two types of coverage – defense and indemnity. Defense refers to the selection, retention and payment obligations towards defense counsel. Indemnity refers to payment towards resolving a matter/claim/dispute. This discussion focuses on the defense portion of insurance coverage. **Regarding the defense aspect of a claims-made policy, there are two basic ways a policy may be written: Duty to Defend and Reimbursement.**

Duty to Defend means the insurance company is obligated to provide legal defense for the insured in a lawsuit, even if the claim might not be fully covered. With a Duty to Defend policy, the insurance company selects and pays for the insured's legal counsel and largely controls the defense strategy.

Reimbursement means the carrier will only pay back the insured for reasonable defense costs incurred. This requires the insured to first pay for their own legal representation and then seek reimbursement from the company if the claim is deemed covered. When compared side-by-side, each has advantages and challenges.

Insurance companies assume the responsibility of defending the insured when a policy is written on a Duty to Defend basis. They will have a panel of law firms with pre-negotiated agreements for services at reduced hourly rates. Insureds often prefer this because the carrier will pay costs directly as they are incurred, and it helps create clarity between the carrier and the law firm chosen to defend, since they work together regularly. "Panel" firms are typically organized by both geographic location and practice area specialization and are well established in their practice. On the other hand, the insured has less control over the defense strategy when a covered claim occurs.

On a Reimbursement defense basis, there is more flexibility for an insured when it comes to choosing their legal representation and defense strategy; however, there is a financial burden that should be considered. A Reimbursement policy will usually have higher retentions enforced, increasing the cost for an insured from the start. When a covered claim occurs, the insured will be responsible for managing and paying all defense costs and will have to seek reimbursement from the carrier after the fact for covered claims (allocation). This can take time, and there is a possibility of disputes over which costs are reimbursable. In addition, carriers may only reimburse up to a reasonable rate, which could be lower than the chosen counsel's standard rate.

Options and Timing For Lawyer Selection



As discussed, the insurance company selects lawyers under the Duty to Defend, and the insured selects lawyers under the Reimbursement policy forms. Understanding the importance of the decision, an insured has an opportunity to negotiate their choice of counsel with the carrier. While this can be requested at any point during a policy term, it is most successfully negotiated at a policy renewal. If a Duty to Defend policy form is being considered, the insured should initiate conversations to have a desired firm approved by the carrier. For example, if there is a firm that an insured prefers to work with that is not on the carrier's pre-approved panel list, the carrier will need to review the following information at a minimum to consider endorsing the choice of counsel on the insured's policy:

- **Industry specialization:** the carrier will need to confirm that the requested firm specializes in the industry and litigation type the insured is selecting them for (Employment Practices Liability, Directors & Officers Liability, etc.) and that they practice in the appropriate region for the insured.
- **Counsel rates:** the carrier will need to know the typical rates at the chosen firm; however, that does not mean they will approve those rates. More often, the carrier will put a rate cap on the endorsed choice of counsel that is more aligned with rates on their existing panel. This can often significantly decrease the chosen firm's rates, making it hard for specialized firms to accept them. Rates can often be further negotiated upon with the carrier; however, it is important to also discuss the agreed-upon rate with the chosen firm, as they may be willing to adjust on their end as well for the guaranteed business should a claim occur.
- **Continuity of representation:** it can often help throughout the negotiation process to understand why the insured has selected this specific counsel. For example, if the insured has worked with this firm for a number of years and has a long-established relationship. Perhaps the firm has a strong track record of settling cases swiftly with the insured. Additional details and context will be helpful in building a request with the carrier.

Some carriers have an extensive approval process that includes approval by their full legal department, so it is important to negotiate any choice of counsel at the beginning of a policy term rather than at the time of a claim. While this can be done at the time of a claim, it does take time and can significantly delay the claim process. In addition, if this is done at the time of a claim, there is no guarantee or requirement that the carrier agree to the choice of counsel desired by the insured.

Considerations For Paving a Path Forward

While there are benefits to both the Duty to Defend and Reimbursement defense options, it is important to understand the difference between the two forms, as there are trade-offs to each. Selecting and seeking early approval for choice of counsel is key to ensuring that an insured's defense is set up to the insured's expectations at the time a covered claim occurs.

An insured faced with this decision can consider the following items:

- Is there a law firm that the company will want to use if a claim arises?
 - » If yes, does that firm have attorneys with experience handling the types of claims likely faced by the company?
 - » If yes, does that firm have geographic coverage that mirrors that of the company?
- Does the company have the desire and level of legal sophistication to defend claims under a Reimbursement policy form?
- Does the difference in retention/deductible make a substantive difference to the company between the two types of forms?
- Does that company understand the differences in coverage between the two coverage forms?

As is the case with many business and/or legal questions facing company leaders, there is no right or wrong choice between Duty to Defend and Reimbursement coverage forms. However, given your company's circumstances, there may be an option that better suits your needs. It is vital that your chosen path is selected after measured consideration.





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