Lowenstein Sandler's Insurance Recovery Podcast: Don't Take No For An Answer

Episode 107:
When Words Matter: Lessons from 3M's Self-Insured Retention Fight
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AUGUST 2025

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Eric Jesse: Welcome back to *Don't Take No for an Answer*. I'm Eric Jesse, a partner in Lowenstein Sandler's Insurance Recovery Group, and I'm pleased to be joined by my colleague, Alex Corson, today. We're going to return to an issue we looked at in August of last year, which is the 3M self-insured retention decision that's in the Delaware State Courts. If you listen to our earlier episode, you'll recall that the Delaware Superior Court had held that 3M was required to engage in a pointless formality to realize the benefits of its subsidiaries' legacy insurance policies. Now the Delaware Supreme Court has weighed in, and we're here to walk through the main takeaways and also share some practical tips to help policyholders avoid the type of hyper-technical defense that was raised in this case.

Alex Corson: Thanks, Eric. Yeah. There's a lot to unpack here, especially given how close the decision was in the Supreme Court. Spoiler alert.

Eric Jesse: Absolutely. Let's start by just providing some background for anyone who missed our last episode. All right. Back in 2008, 3M acquired a company named Aearo Technologies. The legacy Aearo commercial general liability policies had a $250,000 per occurrence self-insured retention. The policy language stated that the retention shall not be reduced by any payment made on your behalf by another.

Alex Corson: Yeah. That uncommon language from a standpoint of our modern sensibilities was the crux of the dispute. When you fast-forward to a products litigation that started years later, 3M, and not Aearo itself, paid approximately 372 million in defense costs and then sought reimbursement under the Aearo policies. Well, the Aearo policies' insurers denied on the grounds that Aearo, the named insured, did not pay the

defense costs itself, but rather 3M, its parent, had done so. As we discussed last time, the Superior Court sided with the insurers holding that only the named insured, Aearo, could satisfy the SIR under the plain meaning of that policy language that you just read. The court was unmoved by the argument 3M advanced that this was a poor, pointless formality. "Who cares where money came from, which bank account it was in the name of, it's all 3M at the end of the day," they said.

Eric Jesse: Yep. Absolutely. All right. Alex, here's the big question. What did the Delaware Supreme Court do with that Superior court ruling?

Alex Corson: Well, this is where things get interesting. The Supreme Court affirmed the decision in a deeply divided 3-2 split. The dissent was almost half as long, if not more than that, than the majority opinion. The majority opinion focused on two points. Again, they agreed with the insurer and the Superior Court policies that are not ambiguous. You means you. In this case, you is the named insured, so payments made by 3M, they fall outside the SIR's condition that the payment be made by the named insured, agreed that the words “payments by another” was unambiguous reinforced that. The court also had some interesting reasoning turning on the difference between a self-insured and a deductible.

Now, in a lot of our cases, a self-insured and a deductible are functionally the same thing, right? Both amounts represent money that the policyholder is required to pay before the insurer. But the court explained that unlike a deductible, a self-insured retention operates as a condition precedent because the insured must pay the SIR, the self-insured retention, before the insurer's obligation under the policy is triggered, whereas a deductible is an amount that the insurer must pay from dollar one subject to the right to recoup that from the insured. In other words, true deductible policy, the insurance company pays from dollar one. They have a right to recoup the deductible, whereas the way that the wording in a true self-insured retention policy works, they don't have any obligation to pay until after that's been satisfied.

Eric Jesse: Yeah. Alex, and I think the deductible can also eat into the policy limit as well if it's a deductible policy as well. But we digress.

Alex Corson: Precisely. Yes. Many distinctions, but that was the one that the court was focused on. 3M advanced another argument that the court was not convinced on. There was a maintenance clause, they called it, which is a provision making clear that the insured doesn't get off the hook because of a bankruptcy or insolvency of an insured. The majority said, "Look, that's not what happened here. The subsidiary remains solvent." The problem was that the self-insured retention clause as it was worded in the policy, it wasn't satisfied. To use the court's words, "These so-called

savings clauses say nothing about crediting the payments of a third party to the satisfaction of the SIR."

Eric Jesse: I think it's really important to recognize that this was a close call. You have the dissent that was authored by Justice LeGrow and joined by Justice Traynor, where they strongly disagreed with the approach that the majority took here. They argued that the majority was elevating form over substance and that the strict reading of the policy language led to a forfeiture of coverage, even though the risk was actually borne by the policyholders corporate family and the insurers risk profile. Did it change here? The dissent also emphasized that Delaware law avoids interpreting insurance contracts in a way that would result in a disproportionate forfeiture, especially when the policyholders' reasonable expectations and the realities of modern corporate structures are at stake.

Alex Corson: Exactly. The 3-2 split demonstrates that even when the words on the page are crystal clear, as they arguably were here, courts are reluctant to enforce these types of hyper-technical conditions that, as 3M said so many times, amounts to a pointless formality. The dissent's view recognizes that the practical reality in this case is that the insurance company was not being asked to pay a single dollar more than they had agreed to pay. Ultimately, they enforced what I would call a windfall recovery for the insurer based on what amounted to an internal accounting decision by the policyholder, which bank account should the amounts be paid to defense counsel.

Eric Jesse: Yep. Yep. Form over substance, indeed. All right. That's the legal landscape. Let's shift and talk about practical implications, which we often like to do here on *Don't Take No*. The key lesson for risk managers and in-house counsel is this, the words matter, which is a very common theme for us here on *Don't Take No for an Answer*. If your policy says only the named insured can satisfy the SIR, the 3M decision shows that courts will enforce that language, however pointless that requirement may seem. Again, just review policy language carefully. Always read your insurance policies thoroughly, paying attention to definitions, conditions, and any requirements for triggering coverage.

Alex Corson: Yeah. Additional takeaways beyond the words matter. We talked last time about the importance of doing your due diligence in an M&A deal. Oftentimes M&A deals, the legacy subsidiaries might not have cash on hand or active bank accounts. In that type of a situation, this condition in 3M might be a real problem so making sure that in deals, you're doing a thorough review of the target's insurance policies. Get copies of the policies. Don't just take a certificate of insurance or a summary. Take a look at that language, especially if that target has potential legacy liabilities. I think that looking after 3M, that type of non-market can't be

satisfied by another language should be on every deal. Well, here's due diligence checklist.

As we talked about last time also, conduct regular policy audits. Just make it a habit. Periodically review your program. Look at new policies that you're acquiring, not just in a deal, but also as a regular course. Make sure that you have the gold standard, especially if you're paying a pretty penny in premiums. I think that if the market standard language, which is allowing satisfaction of self-insured retention by any source had been used in the policies in this case, that the whole case never would've happened, right? 3M would've just satisfied that. Then lastly, there's a hidden lesson to be learned here, which applies I think across the board, not just to 3M case, and that's submit your bills for credit early against the self-insured retention.

Part of the problem here is that 3M had paid hundreds of millions of dollars before the question was called, had they satisfied the SIR, and so they didn't get the carrier's position until $372 million in. On every case where there is a self-insured retention, we always counsel policyholders to get those bills submitted, get the carrier's position on whether the self-insured retention has been satisfied. You may face cuts. You may face denials. You may face something hyper technical like this. Even if it was impractical or impossible for 3M to have reviewed the policy language or spotted this issue given its unusual language, getting the carrier's position and getting that credit after the first $250,000 might have avoided a big dispute over the technical language.

Eric Jesse: Absolutely. All good advice and things to think about. All right. I think in summary here, the Delaware Supreme Court didn't really create a new rule, but it did highlight a risk. 3M assumed that it did not necessarily matter where the money was coming from, especially because it was in the corporate family and ultimately paid the price here. Although this was a 3-2 decision, and many courts would agree with the dissent about the need to avoid forfeiture even if the majority adhered to the strict policy language in the case.

Alex Corson: Right. An assumption and overconfidence I think can be a policyholder’s undoing on a claim like this, right? It seemed clear as day to 3M that the self-insured retention and who has to pay it, that's a pointless formality. Look, the insurers felt differently. They convinced the majority of the Supreme Court of Delaware that the self-insured retention is a bargained-for condition precedent, and you got to satisfy that. This is something that our premiums are based on. That's where the court went with this, so recommend that policyholders give careful thoughts to the language in the policy early in the claims process. And if necessary, engage coverage counsel to help spot issues early on. You don't want to find yourself in the

same position as 3M where you're several hundred million dollars in on defense costs and then you can't recover because they were paid from the wrong bank account.

Eric Jesse: All right. Thank you, Alex, for a riveting discussion as we continue to fight the good fight here on *Don't Take No for an Answer*. I hope our listeners found this case to be informative and a cautionary tale. Until next time, don't take no for an answer, especially when it's hidden in the fine print.

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