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presents

Excess Insurance Disputes Among Policyholders and Primary and Excess Insurers

Allocating Multiple Layers of Coverage in the Wake of Qualcomm

A Live 90-Minute Teleconference/Webinar with Interactive Q&A

Today's panel features:

John D. Green, Partner, **Farella Braun + Martel**, San Francisco
Michael Conley, Principal, **Offit Kurman**, Philadelphia
John T. Harding, Partner, **Morrison Mahoney**, Boston

Thursday, December 17, 2009

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10 am Pacific

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A Different Perspective

Excess Insurance Disputes Among Policyholders and Primary and Excess Insurers

Section I: Primary, Excess and Umbrella Coverage—General Rules of Allocation

Thursday, December 17, 2009

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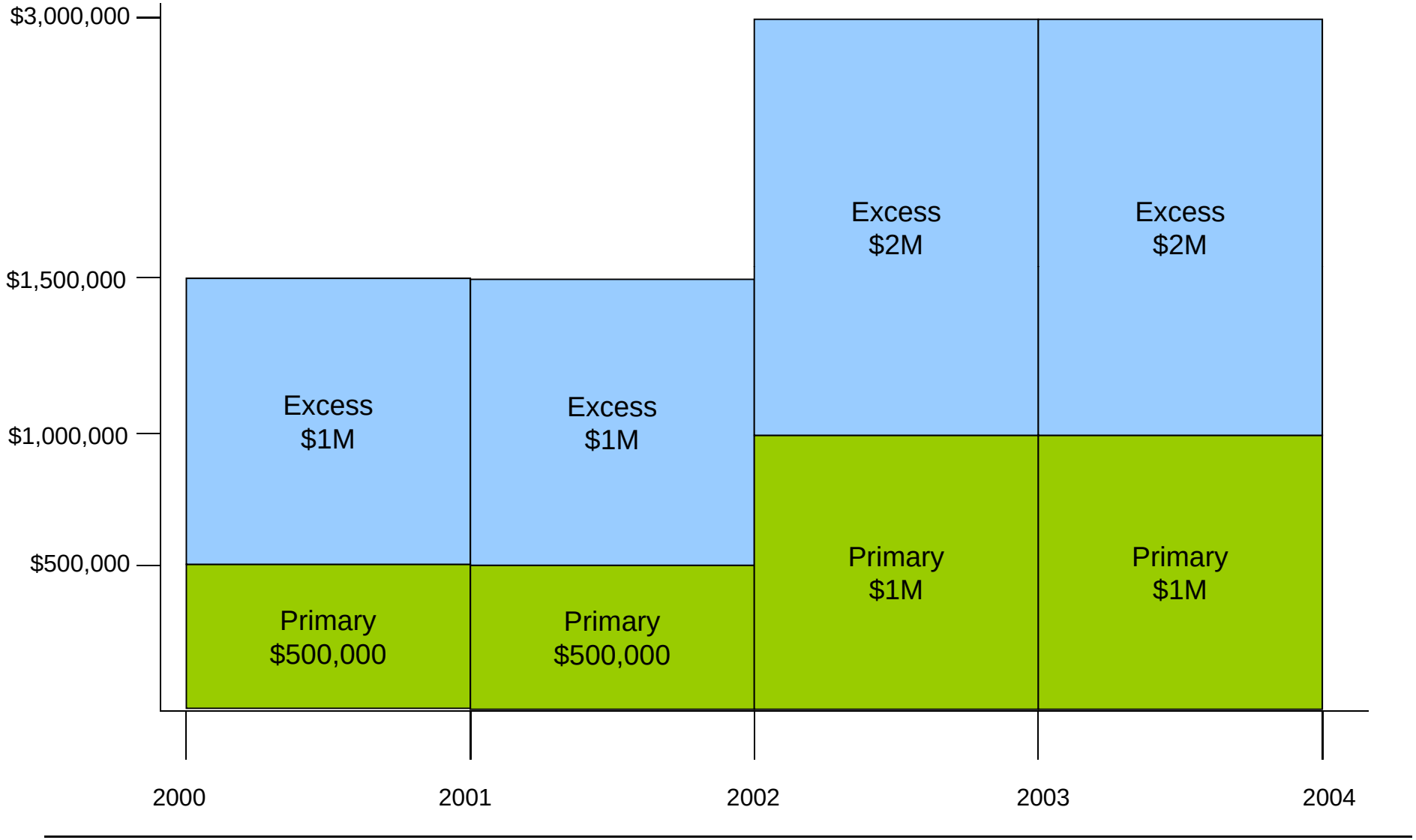
Primary and Excess Insurance

- Primary Insurance
- Excess
- Umbrella

Sample Coverage Chart



Allocation Approaches

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- Pro-Rata
- All Sums
  - Stacking or Anti-Stacking

Specific Allocation Rules

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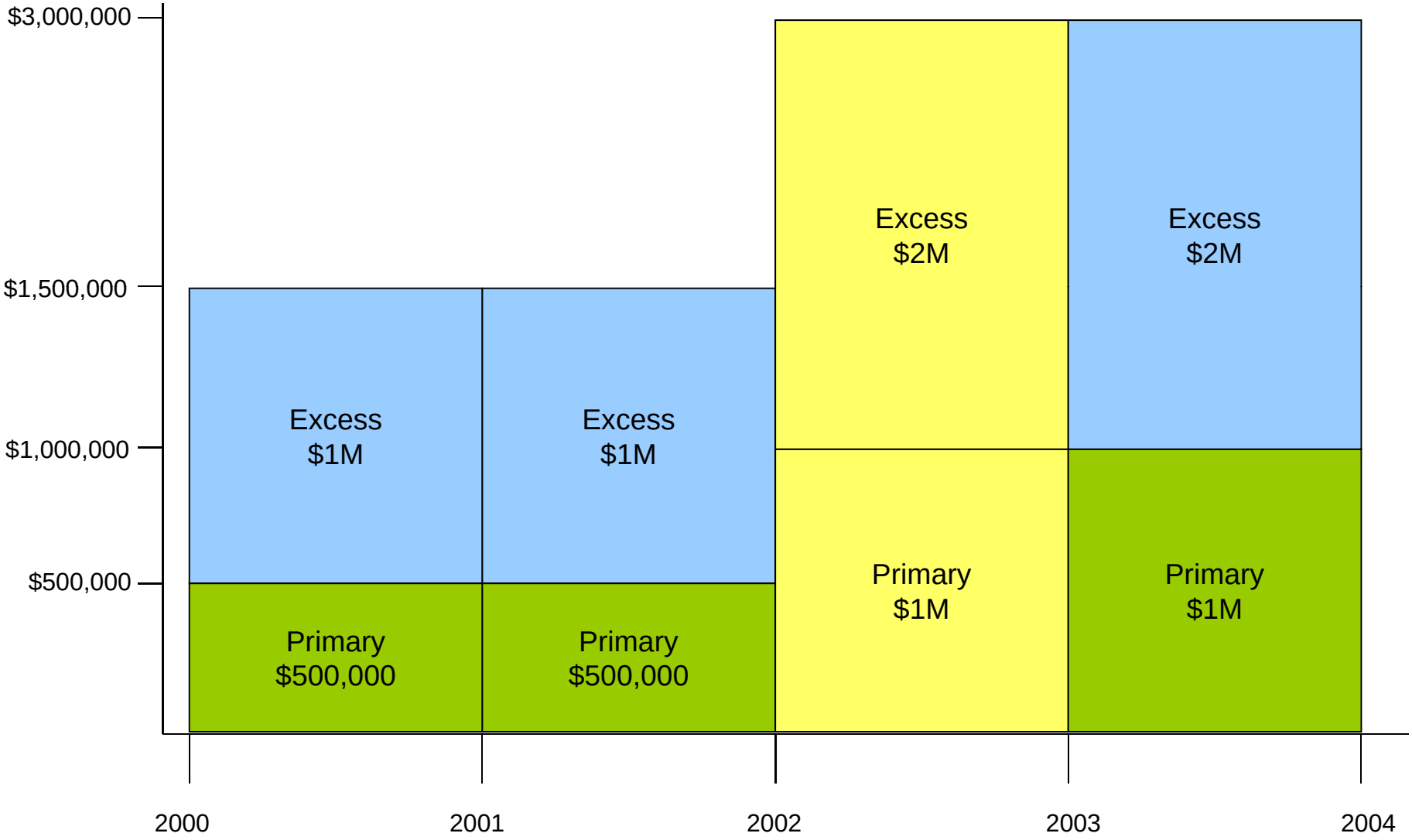
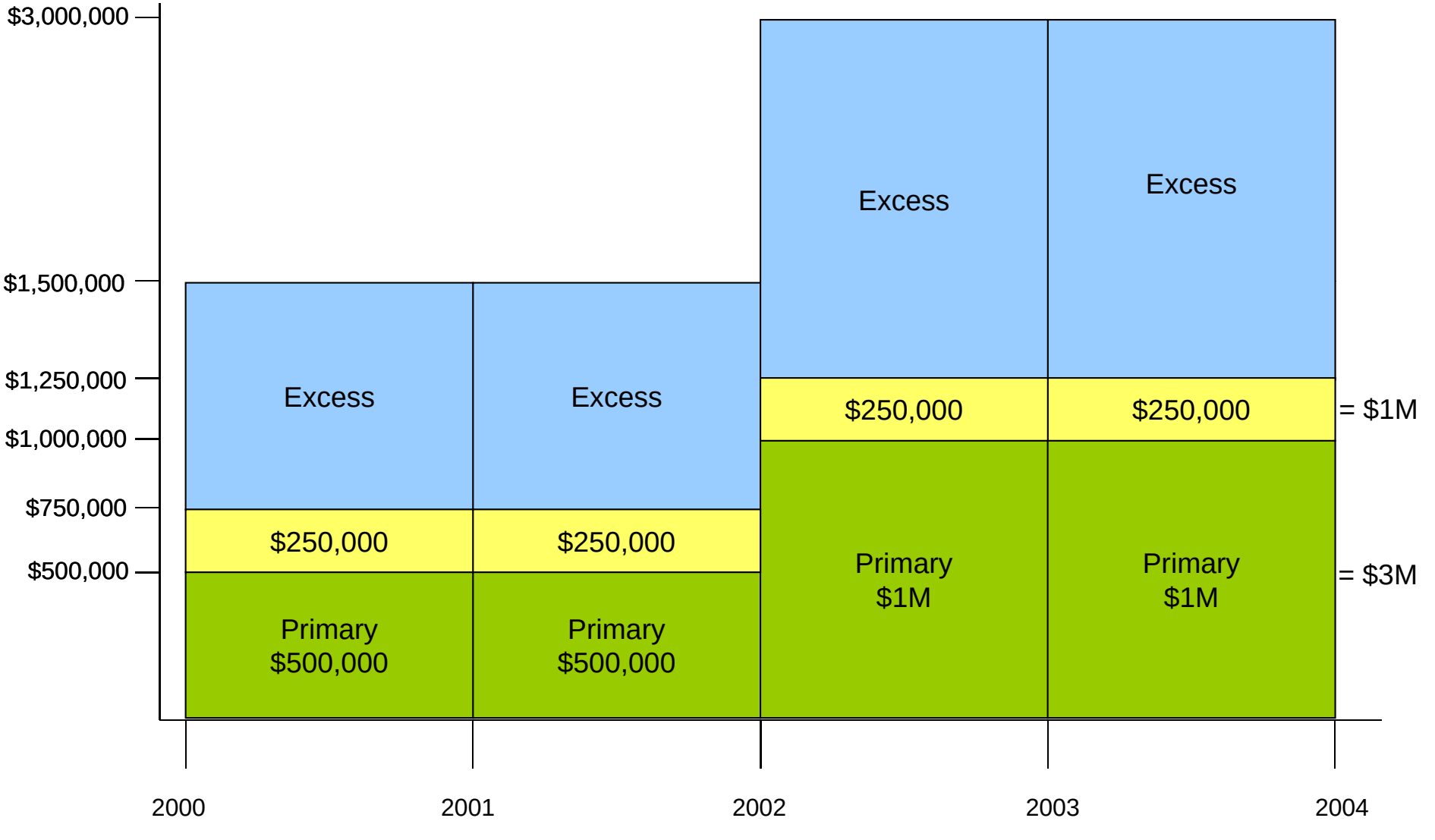
- Horizontal
- Vertical
- Depends on “scheduled” vs “all underlying” language

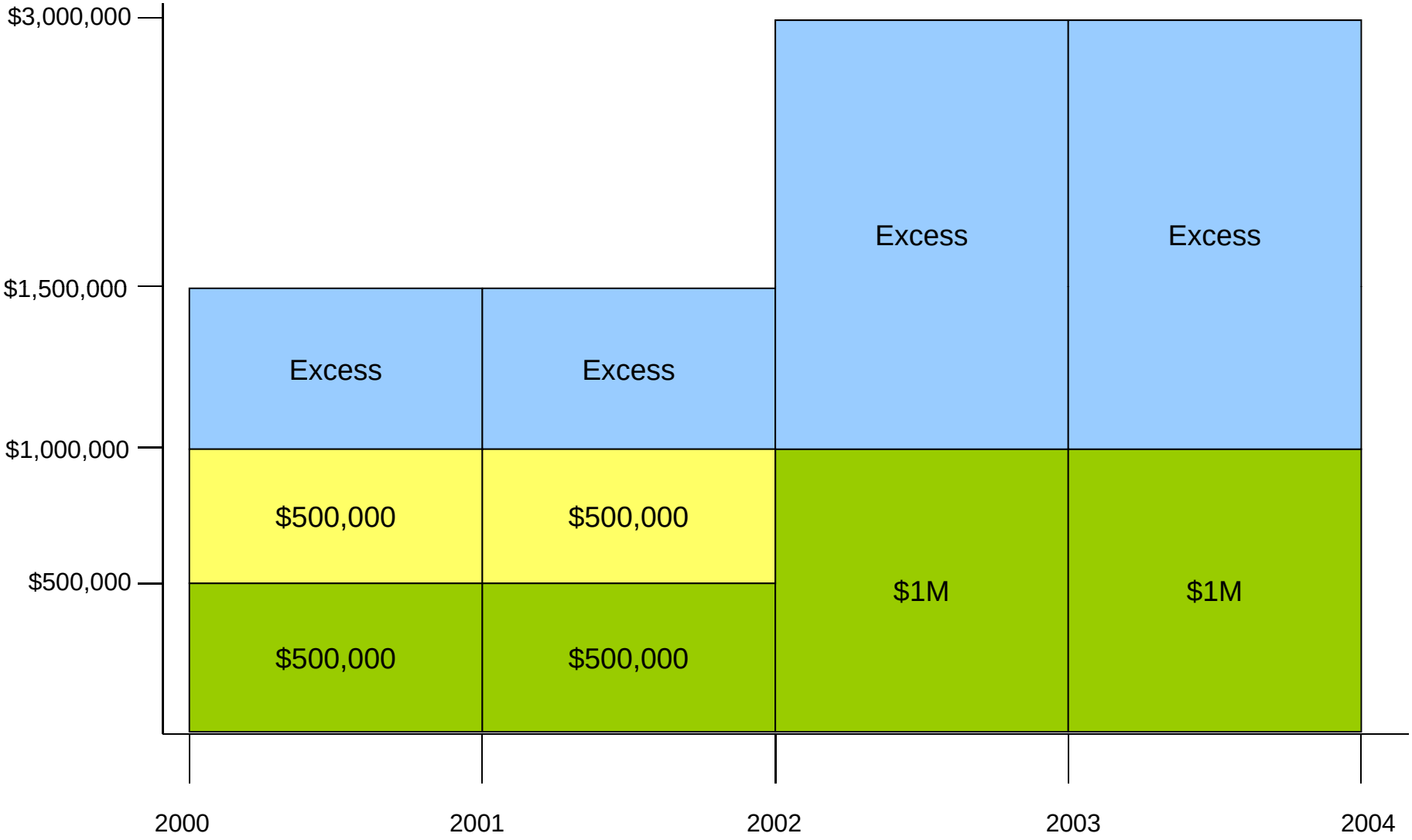
Vertical Exhaustion



Horizontal Exhaustion



Policies with “Scheduled Underlying” Language



Settlement issues

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- Partial settlements in multi-year, multi-layer case
- Global settlements
- Policy language addressing *Qualcomm* issue

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Excess Insurance Disputes Among Policyholders and Primary and Excess Insurers: Allocating Multiple Layers of Coverage in the Wake of Qualcomm

Thursday, December 17, 2009 from 1-2:30pm Eastern/10-11:30am Pacific.

Qualcomm – How did we get here and where are we going?

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In The Beginning, There Was *Zelig*

A policyholder can settle with the primary, pay or forego the difference between the settlement and the primary limits, and seek coverage from the excess insurance company for amounts in excess of the primary policy.

Zelig v. Massachusetts Bonding & Ins, Co., 23 F.2d 665 (2d Cir. 1928)

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How it Works

- Claim is $15 million
- Primary Limits - $10 million
- Excess Limits - $10 million
- Policyholder settles with primary carrier for $9 million
- Policyholder contributes $1 million and asks the excess insurer to pay remaining $5 million of claim.

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Zelig's Reasoning – Contract Interpretation

"The clause provides only that it be 'exhausted in the payment of claims to the full amount of the expressed limits.' The claims are paid to the full amount of the policies, if they are settled and discharged, and the primary insurance is thereby exhausted. There is no need of interpreting the word 'payment' as only relating to payment in cash. It often is used as meaning the satisfaction of a claim by compromise, or in other ways. To render the policy in suit applicable, claims had to be and were satisfied and paid to the full amount of the primary policies. Only such portion of the loss as exceeded, not the cash settlement, but the limits of these policies, is covered by the excess policy".

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Zelig's Reasoning – Public Policy

"The defendant argues that it was necessary for the plaintiff actually to collect the full amount of the policies for $15,000, in order to 'exhaust' that insurance. Such a construction of the policy sued on seems unnecessarily stringent. It is doubtless true that the parties could impose such condition precedent to liability upon the policy, if they chose to do so. **But the defendant had no rational interest in whether the insured collected the full amount of the primary policies, so long as it was only called upon to pay such portion of the loss as was in excess of the limits of those policies.** To require an absolute collection of the primary insurance to its full limit would in many, if not most, cases involve delay, promote litigation, and prevent an adjustment of disputes which is both convenient and commendable. A result harmful to the insured, and of no rational advantage to the insurer, ought only to be reached when the terms of the contract demand it". (Emphasis added).

Qualcomm – Policy Language

"Underwriters shall be liable only after the insurers under each of the Underlying policies have paid or have been held liable to pay the full amount of the Underlying Limit of Liability."

Offit | Kurman
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Qualcomm – The Court's Holding

"In our view, the phrase 'have paid . . . the full amount of [$ 20 million],' particularly when read in the context of the entire excess policy and its function of as arising upon exhaustion of primary insurance cannot have any other reasonable meaning than actual payment of no less that the $20 million underlying limits."

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Qualcomm – Public Policy Considerations, or Lack Thereof

Enforcement of policy language – yep that's it.

Post-*Qualcomm*

- *HLTH Corp. v. Agricultural Excess & Surplus Insurance Co., 2008 WL 3413327 (Del. Super.* Ct. July 31, 2008)
- A policyholder can accept settlements with primary insurer for less than limits and seek coverage from its excess insurers for amounts exceeding the underlying policies.
- Notwithstanding excess policy stating "paying . . . in legal currency" the underlying limit, the Court expressly declined to accept the reasoning of *Qualcomm.*
- "The excess insurance company could not possibly claim to have a stake in whether the insured actually received all the underlying insurance limits."

Post-*Qualcomm*

- *Trinity Homes LLC v. Ohio Cas. Ins. Co.,* 2009 WL 3163108 (S.D.Ind. Sept. 25, 2009).

- "The availability of an underlying policy turns on whether the applicable limits of that underlying policy have been exhausted, or merely reduced, by payment of claims. With this distinction, the contract clearly requires that the underlying insurance 'be exhausted or depleted by the actual payment of losses by the underlying insurer.' . . . In other words, under the terms of the Cincinnati Policy, only full exhaustion, and not mere reduction, suffices to render the underlying insurance unavailable.

Now What Do We Do?

- Jurisdiction, Jurisdiction, Jurisdiction (for policyholders, don't get jumped in a DJ Action).
- Equities, Equities, Equities.
- Claims Handling – bring excess in early and often. Remind them of fiduciary obligation and potential for bad faith if they leave a policyholder exposed to a possible excess verdict.
- Policy Selection.

EXCESS
The New Frontier

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Emerging Excess Issues

- What Are The Duties Of Excess Insurers?
- What Defenses May Excess Carriers Raise?
- What Rights Do Excess Carriers Have?

KEY AREAS OF DISPUTE

- Drop Down
- Duty to Defend
- Duty to Settle
- Exhaustion

Drop Down:

Current Issues

The Problem of Long Tail Losses

- Must an umbrella carrier pay a portion of defense costs where only the ***immediately*** underlying primary policy is exhausted?
- Policy wordings may control issue:
  - Is policy excess of "all available insurance"
  - *or* just excess of the primary policy listed in Schedule of Underlying Insurance in the umbrella policy?
- Effect of Horizontal Exhaustion Doctrine
  - Exhaustion in one year doesn't trigger coverage if insured has primary insurance left in other years.
  - Followed in California, Illinois, Indiana, Maryland

Watch Out For Non-Concurrent or Manuscripted Coverages!

- Likelihood of excess carriers being required to drop down may be greatly increased by use of non-standard wordings, especially with excess or surplus lines policies.
- Problem exacerbated by the recent proliferation of add-on endorsements for niche coverages:
  - Pollution Liability
  - Employment Practices Liability
  - Mold

Sub-Limit Issues

- Many primary policies contain endorsements adding sub-limits for risks for which insurer wants to confine its exposure.

- In such cases, is umbrella carrier excess to the sub-limit or the overall policy limit?
  - *West Bend Mut. v. Rosemount Exposition* (Ill. App. 2007)(insured couldn't trigger umbrella after exhausting primary EPL limits).

Involuntary “Direct” Coverages

- Insolvent underlying policies (drop down)
- Solvent but non-paying underlying policies

--“Drop Down” Issues

- Umbrella carriers have a duty to “drop down” to provide “Dollar One” coverage where primary insurance is unavailable.

- Should primary insurance be deemed “unavailable” if:
  - Primary insurer is now insolvent? or
  - Primary insurer is solvent but declines to pay?

Insolvencies

- Umbrella insurer may also sometimes be obligated to “drop down” in cases where primary insurer is insolvent.
- Cases tend to turn on excess wordings
  - Excess of coverage that is “collectible” or “recoverable”: **BAD**
  - Excess of limits in schedule of underlying insurance: **GOOD**
- Since the first wave of insolvencies in1980s, insurers have added anti-drop down language to their policies.
- Recent case law has been favorable to carriers:
  - *Caldwell Freight v. Lumbermens Mut.* (Miss. 2007)
  - *Barrett Paving v. Continental* (1st Cir. 2007)
  - *Premcor v. American Home* (7th Cir. 2005)

Solvent But *"Non-Paying"* Insurance

- Does umbrella carrier have a duty to "drop down" to defend where primary insurer has declined coverage on grounds that would also apply to the excess carrier?
- Does this issue depend upon whether umbrella carrier agrees with primary insurer's coverage position?
- Umbrella carriers have been required to defend in cases like this in Georgia, Minnesota, North Dakota, Oregon, Washington and Wyoming.
  - Live issue in Wisconsin: *Johnson Controls* (Wis. 2009)

Duties of Excess Insurers

Duty to Respond
Duty to Defend
Duty to Settle

Johnson Controls v. London (Wis. 2009)

- Long-running pollution dispute.
- Primary insurer (Wausau) refused to defend, citing coverage defenses.
- Insured tendered defense to excess.
- Supreme Court now considering:
  - Is duty to defend "imported" by excess insurer's "follow form" language?
  - Does excess insurer have duty to defend where primary limits aren't yet exhausted?

Duty to Respond

- Excess carrier may have duties to respond to a claim, even if all of the conditions precedent (*e.g.* exhaustion) have not yet been satisfied.
  - Insurer has a duty to acknowledge coverage.
  - Insurer may have a duty to participate in mediation or settlement discussions.
- Do no harm

Reserve or Deny?

- If excess insurer believes that claim is not covered, should it deny coverage at the outset or merely reserve rights?
- Estoppel concerns?
- What level of investigation required?

What Duties Do Excess Insurers Owe?

- Duty to “drop down” where primary insurance isn’t paying?
- Duty to contribute to defense costs?
- Duty to contribute to settlements?

Duty to Defend?

- Unlike primary policies, excess policies generally lack “duty to defend” language.
  - *Cotter Corp. v. American Empire* (Colo. 2004)
- Not incorporated by “follow form” terms
  - *Lexington Ins. v. General Accident* (1st Cir. 2003)
- If covered, defense costs are payable as part of excess insurer’s indemnity duty to pay “loss.”

Treatment of Defense Costs

- Unless umbrella carrier is defending pursuant to "direct coverage," its payment of defense costs is within limits and is treated as arising from insurer's indemnity duty to pay "loss."

- Duty to pay defense costs should be subject to indemnity standard (actual facts), not "duty to defend" standard (potential for coverage),

Excess Duty to Defend?

- Most courts have held that excess carrier's duty to defend doesn't arise until primary limits are exhausted.
- But if there is a likelihood of an excess verdict, doesn't the excess insurer have an equitable obligation to share in the cost of defense?
  - NO!: Majority view.
  - YES!—Colorado, Kansas, Michigan, Montana, Nevada, New York and Pennsylvania.

ABT Building v. National Union Fire Ins., 472 F.3d 99 (4th Cir. 2006)

- 4th Circuit ruled that umbrella carrier's duty arose upon payment of primary limit.
- Court criticized National Union's argument that its duty shouldn't arise until settlements had actually been paid out.
  - "National Union's view would mean that it never could be required to defend a case…until the lawsuit had been resolved and the need for a defense had passed."

The Problem Of Multiple Claims

- Insured collides with vehicle, killing driver and injuring passengers.
- Primary insurer seeks to settle all claims but is ultimately only able to resolve some.
- May primary insurer effect a partial settlement?
  - No *Smoral v. Hanover* (NY App. 1971)
  - Yes. *Pekin v. Home* (Ill. App. 1985)
- If so, may primary insurer tender defense to excess carrier upon payment of policy limit?

Excess Carrier Does Have Right To Take Over Defense

- Many umbrella policies do give the insurer the right to participate or take over the defense.
- Umbrella carrier may be dissatisfied with primary insurer's unenthusiastic defense.
- Gives excess carrier the ability to protect its own interests.

Duty to Settle

- Excess insurer's obligations don't arise until underlying limits are exhausted.
- But does excess insurer have a pro-active duty to protect insured if likely exposure exceeds primary limits?

Duty to Settle?

- No. Not until limits are triggered
  - *Highlands v. Continental Cas.* (9th Cir. 2005)
    - Excess insurer has no duty to participate in settlement discussions until underlying limits are exhausted.

- Yes. Insurer must be pro-active if the claim is serious enough to reach layer.
  - *Grace v. INA* (Alaska 1997)
  - *Associated Grocers v. Americold* (Kan. 1997)

Central Ill. v. Public Service Co., 378 Ill.App.3d 728 (Ill.App.5th 2008)

- Lower tier insurer owes duty to higher layers to engage in settlement negotiations
- Duty may exist even if case cannot be settled within the available policy limits
- Potentially significant expansion of duties among layers

What Defenses Do Excess Insurers Have?

Absence of Primary Exhaustion

Known Loss

Late Notice

Underlying Exhaustion

- 1. What Constitutes “Exhaustion”?
- 2. Horizontal Exhaustion
- 3. Determining The Underlying Limits
  - “Occurrences”
  - Applicable Aggregates

Exhaustion Must Be Actual

- It is not enough that the primary policies are “deemed” to be exhausted.
  - *Domtar v. Niagara Fire* (Minn. App. 2004)
- Mere commitment to pay limits in the future is not enough; the primary limits must actually have been paid out.
  - *County of Santa Clara v. USF&G* (9th Cir. 1995)

What Constitutes Exhaustion?

- *Teigen v. Telco* (Wis. 1985)
  - Primary limits deemed exhausted by insurer's purchase of structured settlement where ultimate pay-out exceeded limits even through cost of the structure was less than policy limit.

- *County of Santa Clara v. USF&G* (9th Cir. 1995)
  - Primary limits not exhausted where primary insurer had agreed to pay money into settlement fund but no funds had yet been transferred.

Service Corporation v. Great American (5th Cir. 2008)

- Chubb paid its $25 million primary limit towards a $100 million global settlement of claims against a funeral home for improperly disposing of “clients.”
- Defense counsel allocated $13.75 of the settlement to injuries during Chubb’s year.
- Court rejected subsequent tender to Great American, which wrote $50 million excess over Chubb.
- Result not affected by the fact that Chubb believed that it was paying for losses in its year or that insured has used entire limit towards settlement.

Wausau Underwriters v. United Plastics Group (7th Cir. 2008)

- Manufacturer sought excess coverage for $26.5 million judgment arising out of faulty plumbing fixtures.
- Of 600 fixtures that failed, only 65 took place during Ohio Casualty's policy.
- 7th Circuit held that insured had failed to show that undifferentiated verdict was for covered loss exceeding primary limits.

But see: Lexington Ins. v. Virginia Surety Co. (D. Mass. 2007)

- Lexington's umbrella policy issued excess of primary policy that treated defense costs as outside of policy limits.
- Lexington coverage excess of $250,000.
- Federal District Court ruled that carrier's duty to defend was triggered once insured's total defense and indemnity exceeded $250,000.
- Thereafter, umbrella and primary held to each pay 50% of defense until primary exhausted.

Must The Primary Insurer Have Paid Its Full Policy Limits?

Q. Are there circumstances in which an umbrella carrier's obligations may arise even if the primary insurer has not actually paid its full policy limit?

A. It depends on the policy wording.

Full Limits Not Required

- *Yaffe Co. v. Great American Ins. Co.*, 499 F.3d 382 (10th Cir. 2007)
  - Scrap yard operator paid $1.8 million to settle BI claims arising out of plant explosion.
  - Great American was excess over $1 million ACE primary policy.
  - Primary had a $10,000 “per claim” deductible.
  - As a result, ACE only paid $497,999.10.
  - Nonetheless, Yaffe sought $800,000 from GA

Yaffe v. Great American

- Tenth Circuit affirmed Oklahoma court's declaration that Great American's coverage was triggered even absent primary exhaustion.
- Coverage was for "those sums in excess of the retained limit that the insured becomes legally obligated to pay…"
- Insured's bargain with primary was irrelevant to scope of excess duties.

Waste Mgt. v. Transcontinental Ins., 502 F.3d 769 (8th Cir. 2007)

- Transcontinental's excess was written over $1 million Reliance primary.
- Insured, another auto carrier and Minnesota Guaranty Fund put together $1 million package.
- 8th Circuit held that the fact that it wasn't Reliance that paid the $1 million didn't excuse excess from paying what it owed.
- Coverage was keyed to amount of insured's liabilities, not who pays to satisfy them.

ABT Building v. National Union Fire Ins., 472 F.3d 99 (4th Cir. 2006)

- Wausau paid $1.5 million to insured for release of coverage for construction defect claims under three $1 million primary policies.
- National Union's excess coverage was triggered by underlying insurer's "payment of claims."
- Even though only $276,000 had actually been disbursed to claimants in settlements, Fourth Circuit ruled that Wausau's payment was, in effect, for "payment of claims."
- Court also awarded $11 million for AIG bad faith

All Sums x SIRS = Trouble

- *American Safety Ins. Co. v. Bordeaux, Inc.* (Wash. App. July 7, 2008)
  - Construction defect claims over two policy periods, each of which had $100,000 self-insured retention.
  - Court ruled that $105,000 in defense costs that the insured had incurred in order to trigger Zurich's policy obligations was likewise sufficient to trigger American Safety's duties under its policy.
  - American Safety had no right to apportion these defense costs to reflect the fact that some of the underlying construction defect claims did not occur during its policy.

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Watch Out For Wasting Limits

- Most commercial lines policies are now written with “wasting limits” so that defense costs will erode available coverage.
- Excess insurer may not be as “excess” as it thinks.

Horizontal Exhaustion

- Where a long-tail loss is presented, may excess insurer demand that all primary insurance during triggered period be exhausted or is it sufficient that just the underlying insurance be gone?

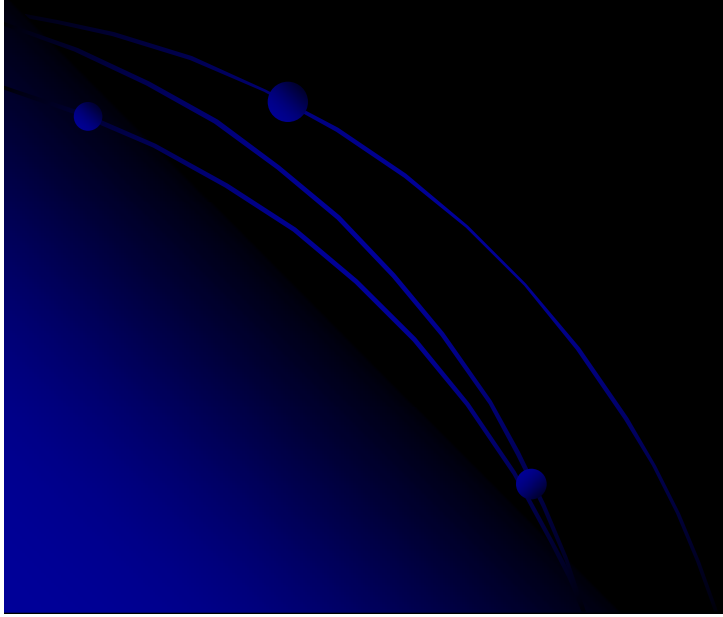
Allocation

- *Service Corp. v. Great American* (5th Cir. 2008)
- Insured only allocated 50% to Chubb period
- Does not trigger excess even though total loss sufficient to pierce layer

Wausau v. United Plastics

- Independent inquiry required
- Court must determine percentage of loss that occurred during policy period
- Jury verdict alone not sufficient to trigger

MULTIPLE OCCURRENCES AND AGGREGATES



"Occurrences": Toxic Torts

- Recent trend is towards treating each individual claimant as a separate "occurrence"
- *Plastics Engineering Co. v. Liberty Mut. Ins. Co.,* 759 N.W.2d 613 (Wis. 2009)(asbestos claimants)
  - occurrence could be "ongoing and span a substantial amount of time but still be one occurrence within Wisconsin law." Court emphasized that the focus of the "cause" analysis in a multiple injury situation is on the "uninterrupted nature and closeness in time and location between the event and its consequent injuries."
  - In this case, the asbestos exposures did not present a single uninterrupted and continuing cause and therefore no basis existed for "aggregating events widely separated in time, space and circumstances into one occurrence."

Appalachian Ins. Co. v. General Electric Co., 8 N.Y.3d 162 (2007)

- Asbestos PI claims at 22,000 sites
- 400,000 cases
- GE average share of settlement or judgment was $1500
- Excess Policies: 1966-1986
- Policies were above a $5M per occurrence limit

GE

- GE and captive (EMLICO) agreed to group injury claims by product type to reach the $5 million ceiling
- The Lemony Snickett “unfortunate event” test controls
- Liability arises from each individual’s “continuous or repeated exposure”

Clean Up Claims

- Still very little case law.
- Multi-Site Cases
  - Common plan of operation or ownership?
- Single Site Cases
  - Separate sources, causes or operating units
- Trend is one site/one limit per year.

State of California v. Continental Ins. Co. (Cal. App. January 5, 2009), *appeal pending* (Cal. 2009)

- Superior Court did not err in declaring that the State's liability arose out of a single "occurrence" at Stringfellow.
- Court of Appeal rejected State's contention that factors such as fractures in the granite subsurface, the barrier dam and an underground stream bed should be considered as the causes of pollution that escaped from the site.
- Actual cause was the deposit of waste at the site without which there could not have been any property damage from any source.
- "It was only at that point that the three other preexisting conditions, operating concurrently, caused the escape of contaminants."
- Case now pending before California Supreme Court.

KeySpan v. Hanover Ins. (Mass. Super. August 20, 2008)

- Insured operated manufactured gas plant.
- After settling with primary insurers, insured sought to obtain multiple limits from umbrella carrier by arguing that there were discrete pollution-causing operations on the site.
- Superior Court granted summary judgment to CNA, declaring that cause of insured's liability was overall operation of the site.

Aggregates

- *Continental Cas. Co. v. Employers Ins. of Wausau,* 871 N.Y.S.2d 48 (1st Dept. 2008)(*Keasbey*)
  - Trial court erred in finding that CNA had failed to establish that all of the underlying claims against Keasbey fell within the "products/completed operations hazard" and were therefore subject to aggregate limits in the policies.
  - Suits were all originally pleaded as products claims based upon an alleged failure to warn of the hazards of asbestos.
  - Frontier Insulation distinguished as involving the duty to defend whereas these claims solely pertained to Continental Casualty's claimed indemnity duties.
  - Mere exposure to asbestos fibers is not itself an injury; given latency period, injuries plainly occurred after any installation operations occurred.

Known Loss

- Courts continue to cut back on scope of this defense.
- Defense especially problematic for excess. Insured may know it faces a loss but may not appreciate at the time that the amount of clean up will penetrate excess layers.

Breach of Policy Conditions

- Harder to show prejudice due to late notice where insurer didn't have a defense duty that was thwarted by delay.
- Excess wordings generally lack "immediate" or "as soon as practicable" language.
  - *Century Ind. Co. v. Brooklyn Union Gas Co.,* 2009 N.Y. App. LEXIS 436 (App. Div. January 29, 2009).
- Settlement or breach of cooperation may still succeed as a defense, however.
  - *Vigilant Ins. v. Bear Stearns Co.,* No. 25 (N.Y. March 13, 2008)

American Guaranty v. State National (N.Y. App. 11/12/2009)

- Primary insurer allegedly disclaimed late
- Excess insurer settled
- Excess cannot rely on primary's breach

Rights of Excess Insurers

Contribution
Recoupment

What Rights Do Excess Insurers Have?

- Right to associate in defense.
- Right to sue other insurers for equitable contribution or subrogation.

Contribution

- Equitable subrogation or contribution claims against other insurers:
  - Additional Insured issues.
  - Reallocation of “spiked” long tail claims in “all sums” jurisdictions (*e.g. Koppers).*
  - Claims by CGL insurers against other lines of coverage (*e.g.* D&O, liquor liability, etc.)
  - Bad faith “failure to settle” against lower layer.

Limitations to the Remedy

- Claims may not be allowed because excess insurers and primary insurers provide coverage for different risks.
- Rights subject to all defenses that the other insurer could have raised against direct claim by policyholder.
- Excess carrier only succeeds to rights insured would have had.
  - *National Surety Corp. v. Hartford Cas. Ins. Co., No. 06-6168 (6th Cir. July 30, 2007)*

Recoupment

- Where excess carrier pays to settle a claim that caps insured's exposure, may it recoup that payment if the claim is later declared not to be covered?
  - YES: *Blue Ridge v. Jacobsen* (Cal. 2001)
  - NO: *Frank's Casing* (Tex. 2008)