Wretched Excess – Working with Umbrella and Excess Coverage to Manage the Large Claim

Untangling the web of issues that can bedevil primary-excess carrier rights, duties and obligations requires understanding both the fundamentals of the relationship and the differences and often nuances in approaches adopted, not always consistently, by various jurisdictions.

I. Primary v. Excess Defense Obligations.

Typically, the primary carrier owes the initial duty to defend. Depending on policy language, an excess carrier may owe a duty to defend if the primary layer becomes exhausted or insolvent. An excess policy may also have language affording it the right but not the duty to defend. Excess policies often disavow a duty to defend, at least absent exhaustion. They are "following form," that is, they adopt the same coverage, exceptions, exclusions, etc. as the listed underlying policy or policies. *See* 2 Barry R. Ostranger & Thomas R. Newman, Handbook on Insurance Coverage Disputes §13.01[a] (17th ed. 2015) ("Ostranger & Newman"). At least one court has found the following form to encompass a duty to defend absent and express disavowal. *Johnson Controls, Inc. v. London Market*, 2010 WI 52, 325 Wis. 2d 176, 192-193, 784 N.W.2d 579, 587 (finding excess policy duty to defend before exhaustion of underlying primary limits because following form). Whether an umbrella policy imposes a duty to defend depends on the particular coverage triggered. *Compare Legacy Vulcan Corp. v. Superior Court*, 110 Cal. Rptr. 3d 795 (Ct. App. 2010) (umbrella carrier owed duty to defend as primary carrier under its umbrella as opposed to excess coverage), *with Padilla Constr. Co. v. Transp. Ins. Co*., 58 Cal. Rptr. 3d 807, 813 (Ct. App. 2007) (treating umbrella coverage as excess policy).

The complication most typically arises where the ultimate indemnity amount by judgment or settlement exceeds the primary policy's limit. That scenario has spawned a plethora of solutions. Some courts hold the primary carrier or carriers to bear all defense costs so long as they remain solvent and their policies not exhausted. *E.g.*, *Signal Cos. v. Harbor Ins. Co*., 612 P.2d 889 (Cal. 1980) (primary policy limits were not exhausted until the settlement, and the excess carrier had never assumed or been called upon to take over the defense; the burden of defense expenses remained solely on the primary carrier); *Liberty Surplus Ins. Corp. v. Segal Co.*, 420 F.3d 65 (2d Cir. 2005) (applying New York law); *U.S. Fid. and Guar. Co. v. Federated Rural Elec. Ins. Corp.*, 2001 OK 81, 37 P.3d 828; *Boston Old Colony Ins. Co. v. Gutierrez*, 386 So. 2d 783 (Fla. 1980); *Keck, Mahin & Cate v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 20 S.W.3d 692 (Tex. 2000); *SRM, Inc. v. Great Am. Ins. Co.*, 798 F.3d 1322 (10th Cir. 2015) (predicting Oklahoma law); *but compare Gen. Star Indem. Co. v. Superior Court*, 55 Cal. Rptr. 2d 322, 323 (Ct. App. 1996) (policy excess of self-insured retention disclaimed duty to defend

but promised to share pro rata in defense costs if settlement or judgment exceeded self-insured retention), *with City of Oxnard v. Twin City Fire Ins. Co.*, 44 Cal. Rptr. 2d 177 (Ct. App. 1995) (excess carrier owed no defense costs where insured's contribution to settlement within self-insured retention limit). Cases following this approach generally reason that the excess carrier has no obligation to participate in the defense until after the primary carrier's limits have been exhausted by settlement or judgment.[1]

Other courts equitably allocate defense expenses between primary and excess carriers when a claim or indemnity exceeds the primary policy limits. *E.g.*, *Gen. Accident Ins. Co. of Am. v. Safety Nat'l Cas. Co.*, 825 F. Supp 705 (E.D. Pa. 1993) (applying Pennsylvania law); *Coastal Iron Works, Inc. v. Petty Ray Geophysical,* 783 F.2d 577 (5th Cir. 1986) (primary and excess carriers must share litigation costs where insured was only required to pay amount of primary policy); *Columbia Cas. Co. v. U.S. Fid. & Guar. Co.,* 870 P.2d 1200, 1202 (Ariz. Ct. App. 1994) (equitable factors required sharing defense expenses where from the start of the litigation, it was apparent to both insurers that the primary limits would be inadequate, and one would "expect the insurers to work together to minimize the amount of the settlement and the amount of fees and costs incurred before settlement"); *Gen. Accident Ins. Co. of Am. v. Safety Nat'l Cas. Corp.,* 825 F. Supp. 705 (E.D. Pa. 1993); *Pallotta v. Aetna Ins. Co.*, 322 N.Y.S.2d 92 (N.Y. Sup. Ct. 1971) (excess carrier may be required to share costs of defense); *Am. Fid. Ins. Co. v. Emp'rs Mut. Cas. Co.*, 593 P.2d 14, 22 (Kan. Ct. App. 1979) ("Under general principles of equitable subrogation" where the same risk is covered by both primary and secondary insurance, both are liable for a pro rata share of the costs of defense); *Celina Mut. Ins. Co. v. Citizens Ins. Co. of Am.,* 349 N.W.2d 547 (Mich. Ct. App. 1984) (where excess insurer knew that the primary coverage would be exhausted, it was obligated to pay pro rata share of defense costs based on the amount of settlement it was required to pay); *Am. Motorists Ins. Co. v. Trane Co.,* 544 F. Supp. 669, 692 (W.D. Wis. 1982), judgment aff'd, 718 F.2d 842 (7th Cir. 1983) ("Whether the damage was covered by an underlying policy depends on the interplay of two factors: first, whether the monetary limits of the underlying policy are exceeded; and second, whether actual substantive coverage is denied by the underlying insurer. If the claim against the insured exceeds the monetary limits set by the underlying insurer, the excess insurer's duty to defend is usually activated, even if the underlying insurer undertakes the defense as well"); *Celina Mut. Ins. Co. v. Citizens Ins. Co. of Am.,* 349 N.W.2d 547, 550-51 (Mich. Ct. App. 1984) (holding that although the excess carrier's policy obligated it to defend the insured if the primary coverage was exhausted, "an insurer's obligation to defend does not depend on

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[1] *See also Cont'l Ins. Co. v. Bayless & Roberts, Inc.,* 608 P.2d 281 (Alaska 1980); *Md. Cas. Co. v. Marquette Cas. Co.*, 143 So. 2d 249 (La. Ct. App. 1962); *Emp'rs' Liab. Assurance Corp. v. Indem. Ins. Co. of N. Am.,* 228 F. Supp. 896 (D. Md. 1964); *Fid. Gen. Ins. Co. v. Aetna Ins. Co.*, 278 N.Y.S.2d 787 (N.Y. App. Div. 1967); *Emp'rs' Liab. Assurance. Corp. v. Liberty Mut. Ins. Co.*, 167 N.E.2d 142 (Ohio C.P. 1959).

its eventual liability to pay; it must defend when the pleadings show that the action is within the policy coverage"); *Royal Ins. Co. v. Reliance Ins. Co.* (D.S.C. 2001) 140 F. Supp. 2d 609 [excess carrier owed duty to defend upon filing complaint seeking damages exceeding primary policy limits].[2]

The result often may depend on the precise language of the excess and primary policies as well as equitable considerations. Following form language and pro-ration provisions in an "other insurance" clause make sharing of defense expenses between primary and excess policies more likely. *See Nautilus Ins. Co. v. Lexington Ins. Co.*, 321 P.3d 634, 652 (Haw. 2014) ("an otherwise primary insurer who becomes an excess insurer by operation of an "other insurance" clause owes the duty to defend from the time the defense is tendered"); *Johnson Controls, Inc. v. London Market*, 2010 WI 52, 325 Wis. 2d 176, 192-93, 784 N.W.2d 579, 587 (finding excess policy duty to defend before exhaustion of underlying primary limits because following form).

When the primary limits have to be exhausted before the excess carrier has any obligation to contribute to defense expenses, the question arises whether the primary carrier may terminate its ongoing defense obligation by simply tendering its policy limits to the excess carrier. The majority rule is no. *E.g.*, *Diamond Heights Homeowners Ass'n v. Nat'l Am. Ins. Co.*, 227 Cal. Rptr. 906, 914 (Ct. App. 1991) ("even if the insured's potential liability exceeds primary policy limits and invades excess coverage, and the primary insurer is willing to pay to the excess insurer the primary policy limits, the primary insurer may not as a matter of right tender the defense of the action to the excess insurer or otherwise relieve itself of the duty to defend"); *Chubb/Pac. Indem. Grp. v. Ins. Co. of N. Am*., 233 Cal. Rptr. 539 (Ct. App. 1987) (tendering limits to excess carrier does not relieve primary carrier of defense obligation); *Hartford Accident & Indem. Co. v. Cont'l Nat'l Am. Ins. Co.,* 861 F.2d 1184 (9th Cir. 1988) (the insurer whose coverage is primary cannot shift its duty to defend to the excess carrier by tendering its limits. The duty to defend can only be extinguished by actual settlement or payment of judgment); *Conway v. Country Cas. Ins. Co.*, 442 N.E.2d 245 (Ill. 1982); *Barber v. RLI Ins. Co.*, No. 1:06CV630(FJS/RFT), 2008 WL 5423106, at *3 (N.D.N.Y. Dec. 24, 2008) ("The tender of a policy limit does not relieve a primary insurer of the duty to defend where the contract unambiguously establishes that defense costs are in addition to the policy limit, the tender of the policy limit does not extinguish the duty to defend, and the insurer is obligated to defend until the exhaustion of the policy limits through payment of either a judgment or settlement"). The tender to the excess carrier of the primary carrier's policy limits may, however, trigger an excess carrier's duty to participate in the costs of defense or in a good faith settlement.

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[2] *See also Rocky Mountain Fire & Cas. Co. v. Allstate Ins. Co.,* 485 P.2d 552 (Ariz. 1971)**;** *Auto. Underwriters, Inc. v. Hardware Mut. Cas. Co.*, 273 N.E.2d 360 (Ill. 1971); *MFA Mut. Ins. Co. v. Emp'rs Mut. Cas. Co.*,278 F. Supp. 326 (D. Kan. 1967); *Hartford Accident & Indem. Co. v. S.C. Ins. Co.*, 166 S.E.2d 762 (S.C. 1969)**.**

II. Primary v. Excess Settlement Obligations.

Both primary and excess carriers owe the insured a duty of good faith and fair dealing in evaluating and effecting settlement. *E.g.*, *N. Am. Van Lines, Inc. v. Lexington Ins. Co.,* 678 So. 2d 1325, 1333–34 (Fla. Dist. Ct. App. 1996) (holding that excess insurer may be liable for insured's out-of-pocket payment to settle case when excess insurer refused reasonable within-limits settlement offers). But the excess carrier's obligation to do so may not be triggered until the primary carrier's policy limits are exhausted or tendered. *E.g.*, *SRM, Inc. v. Great Am. Ins. Co.*, 798 F.3d 1322, 1324, 1327, 1329 (10th Cir. 2015) (predicting Oklahoma law; excess carrier has no duty to investigate or initiate settlement until primary limit exhausted; accordingly, excess carrier not liable for additional $500,000 the insured had to contribute to settle above excess policy limits where no prior settlement demand within excess policy limits); *Keck, Mahin & Cate v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 20 S.W.3d 692, 701 (Tex. 2000) (the excess insurer owed no duty to evaluate the settlement demand or supervise the defense before the primary insurer tendered its limits).

Many courts also hold that an excess carrier either is equitably subrogated to the insured's contract right to have the primary carrier settle within its policy limits or, in a minority of jurisdictions, has a direct bad faith action against the primary carrier. *See Twin City Fire Ins. Co. v. Country Mut. Ins. Co.*, 23 F.3d 1175, 1178-80 (7th Cir. 1994); *Gen. Star. Indem. Co. v. Vesta Fire Ins. Corp.*, 173 F.3d 946, 950 (5th Cir. 1999); minority rule: *St. Paul-Mercury Indem. Co. v. Martin,* 190 F.2d 455, 457-58 (10th Cir. 1951); *Schwartz v. Twin City Fire Ins. Co.*, 492 F. Supp. 2d 308, 329-30 (S.D.N.Y. 2007); *Nat'l Union Fire Ins. of Pittsburgh, Pa. v. Liberty Mut. Ins. Co.*, 696 F. Supp. 1099, 1101 (E.D. La. 1988); *Schal Bovis, Inc. v. Cas. Ins. Co.*, 732 N.E.2d 1082 (Ill. App. Ct. 1999); *Hartford Accident & Indem. Co. v. Mich. Mut. Ins. Co.*, 462 N.Y.S.2d 175 (App. Div. 1983); *W. World Ins. Co. v. Allstate Ins. Co.*, 376 A.2d 177 (N.J. Super. Ct. App. Div. 1977); majority rule, *e.g.*: *Travelers Indem. Co. of Ill. v. W. Am. Specialized Transp. Servs., Inc.*, 409 F.3d 256, 260 (5th Cir. 2005); *AMHS Ins. Co. v. Mut. Ins. Co. of Ariz.*, 258 F.3d 1090, 1100 (9th Cir. 2001); *Evanston Ins. Co. v. Stonewall Surplus Lines Ins. Co.*, 111 F.3d 852, 858-59 (11th Cir. 1997); *Greater N.Y. Mut. Ins. Co. v. N. River Ins. Co.*, 85 F.3d 1088, 1096 (3d Cir. 1996); *Commercial Union Ins. Co. v. Med. Protective Co.*, 393 N.W.2d 479, 483 (Mich. 1986) ("an excess insurer may maintain a cause of action against a primary insurer for the latter's bad-faith failure to defend or settle within policy limits. The excess insurer is equitably subrogated to the position of the insured and acquires no lesser or greater rights than those held by the insured"); *Kranzush v. Badger State Mut. Cas. Co.*, 307 N.W.2d 256 (Wis. 1981). In some cases, the claim by the excess carrier extends to a claim for legal malpractice against the insured's defense attorney. *Am. Centennial Ins. Co. v. Canal Ins. Co.*, 843 S.W.2d 480 (Tex. 1992); *contra Cont'l Cas. Co. v. Pullman,*

Comley, Bradley & Reeves, 929 F.2d 103 (2nd Cir. 1991); *Am. Emp'rs Ins. Co. v. Med. Protective Co.*, 419 N.W.2d 447 (Mich. 1988), *appeal denied*, 431 Mich. 856 (1988).

A rarer instance is when a primary carrier claims that it is harmed by an excess carrier's failure to accept a reasonable settlement offer within its policy limits which causes the case to continue to be litigated, incurring further defense expenses for the primary carrier. *Am. Alt. Ins. Corp. v. Hudson Specialty Ins. Co.*, 938 F. Supp. 2d 908, 916 (C.D. Cal. 2013) ("fairness and equity require that . . . a primary insurer[] be permitted to assert a counterclaim for equitable subrogation against . . . an excess insurer, for its alleged failure to reasonably settle the [defended] Action [against the insured], thereby exposing [the primary carrier] to 'unwarranted liability' for defense costs and costs and interest on the Judgment"). Alternatively, sometimes "a primary insurer may negotiate a good faith settlement of a claim in an amount which invades excess coverage, and . . . may enter into such settlement binding upon the excess insurer without the excess insurer's consent, notwithstanding [a] 'no action' clause . . . . [¶] Consistent with its good faith duty, the excess insurer does not have the absolute right to veto arbitrarily a reasonable settlement and force the primary insurer to proceed to trial, bearing the full costs of defense. . . . [¶] In a case where probable liability far exceeds primary policy limits and invades excess limits, the excess insurer, if given the authority, might object to reasonable settlements simply because all costs of litigation would be borne by the primary insurer, and the amount of potential liability if the case proceeded to trial might not be substantially greater than the amount to be paid in settlement. The excess insurer would get a 'free ride' at the expense of the primary insurer to the detriment of all other parties involved." *Diamond Heights Homeowners Ass'n v. Nat'l Am. Ins. Co.*, 227 Cal. Rptr. 906, 915-17 (Ct. App. 1991). The excess carrier may avoid an unwelcome such settlement by assuming the defense. (*Ibid.*)

An insured, however, owes no duty to agree to settle within primary limits. *Commercial Union Assurance Co. v. Safeway, Inc.*, 610 P.2d 1038 (Cal. 1980). For similar reasons, an insured should not owe a duty to a carrier above a self-insured retention limit to settle within that limit in order to protect the carrier. *Compare* 2 H. Walter Croskey et al., California Practice Guide, Insurance Litigation ¶¶ 7:388-7:389 (Rutter Group 2016), *with* 2 Ostranger & Newman § 13.13[c] at 1220-22; *see Harbor Ins. Co. v. City of Ontario*, 282 Cal. Rptr. 701 (Ct. App. 1991) (insured obligated to pay its self-insured retention where it gave excess carrier permission to settle, but did not agree to settlement).

III. Attachment Points, Vertical and Horizontal Exhaustion.

Excess carriers often view attachment points as sacrosanct. Unless and until the full amount of underlying coverage is paid, they often believe that they have no obligations. Courts do not always agree.

One circumstance that crops up is where the underlying primary (or lower level excess layer, or in the case of a self-insured retention, the insured) is insolvent. Does an excess carrier have to drop down to cover a gap created by insolvent underlying insurance? The decisional authority is divided, but the majority rule appears to weigh against requiring an excess carrier to drop down. *E.g.*, majority rule: *Shapiro v. Associated Int'l Ins. Co.*, 899 F.2d 1116, 1123 (11th Cir. 1990) (predicting Florida law); *Fed. Ins. Co. v. Srivastava*, 2 F.3d 98 (5th Cir. 1993) (Texas law; insolvent intervening excess layer); *Denny's, Inc. v. Chicago Ins. Co.*, 286 Cal. Rptr. 507 (Ct. App. 1991) (expressly states rule); *Donegal Mut. Ins. Co. v. Long*, 597 A.2d 1124, 1129 (Pa. 1991); *Canal Ins. Co. v. Montello, Inc.*, No. 10-CV-411-JHP-TLW, 2013 WL 6732658, at *6 (N.D. Okla. Dec. 19, 2013) (no drop down to cover insolvent primary layer); minority rule: *Nasello v. Transit Cas. Co.*, 530 So. 2d 1114 (La. 1988); *Reserve Ins. Co. v. Pisciotta*, 30 Cal. 3d 800, 814 (1982); *see* 2 Ostranger & Newman §§ 13.03[a] & [b], 13.12 at 1197-1213 (chart regarding various jurisdictions). Often, however, the outcome depends on the wording of the excess policy (e.g., is it excess of "collectible" insurance or regardless of insolvency).

Another issue is what happens if coverage is contested and the insured settles with the primary carrier to accept less than its full limits under the primary policy? Again, the decisional law is mixed. *See* 2 Ostranger & Newman § 13.04 at 1170-74 (citing opposing decisions).

In multi-year, multi-policy claims (e.g., asbestos, environmental, progressive property damage) the critical issue is often *which* underlying policies have to be exhausted before excess coverage is triggered. *See State v. Cont'l Ins. Co.*, 281 P.3d 1000 (Cal. 2012) (each carrier on risk when pollution occurred liable for all ensuing damages, whether in policy period or not). As with other issues, particular policy language, especially in the excess policies, is often critical. Nonetheless, two general approaches have developed. One—horizontal exhaustion—requires that *all* primary policies, from all policy periods, be exhausted before an excess carrier has a duty to contribute to indemnity/settlement or indemnity. *E.g.*, *Cmty. Redevelopment Agency v. Aetna Cas. & Sur. Co.*, 57 Cal. Rptr. 2d 755, 761 (Ct. App. 1996) (defense expenses); *Fed.-Mogul U.S. Asbestos Pers. Injury Trust v. Cont'l Cas. Co.*, 666 F.3d 384, 389 (6th Cir. 2011) (Michigan law); *U.S. Gypsum Co. v. Admiral Ins. Co.*, 643 N.E.2d 1226, 1261-62 (Ill. App. Ct. 1994); *Ill. Emcasco Ins. Co. v. Cont'l Cas. Co.,* 487 N.E.2d 110 (Ill. App. Ct. 1985). Under the other approach—vertical exhaustion—the excess policy's obligations are triggered when either the specific underlying policies it describes or all primary or underlying policies for the particular policy period are exhausted. *E.g.*, *Carter-Wallace, Inc. v. Admiral Ins. Co.*, 712 A.2d 1116, 1123 (1998) (rejecting horizontal exhaustion); *see generally* 2 Ostranger & Newman § 13.14.

References:

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2 Barry R. Ostranger & Thomas R. Newman, Handbook on Insurance Coverage Disputes ch. 13 (17th ed. 2015)

1 Allan D. Windt, Insurance Claims & Disputes §§ 5:26 & 5:27 (6th ed. 2013)