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"Managing Difficult Excess Insurance Claims"

I. Key Differences Between Primary and Excess Insurers

Why is Excess Insurance Challenging?

Keenly managing and handling excess insurance is vital to any excess insurer's prosperity, but it can be challenging for a variety reasons. When the primary and excess insurers are presented with one or more claims, each insurer may take a different view of those claims relative to their potential economic exposure. Magnifying the potential for a disproportionate impact to all of the insurers is the relatively common scenario where differing policies and policy years are implicated by the claims. Understanding how and when to best handle these issues requires an understanding of the legal principles governing the relationship between excess and primary insurers.

Topics Covered Today

Today's presentation will cover examples of issues that arise when the interests of the excess and primary insurers diverge. This divergence includes basic issues at the forefront of the claim, such as when the excess insurer disagrees with the primary insurer's interpretation of the policy language. If the excess insurer follows form to the primary insurer, must it also follow the interpretations of the primary insurer? Today's presentation also covers more complex down-stream issues, such as covering what duties, if any, the primary insurer owes directly to the excess insurer. Today's speakers will also discuss the issue of when the excess insurer becomes obligated to contribute to a judgment or settlement: would it ever be wise to contribute to a settlement when the primary insurance policy has not been exhausted? These problems can remain hidden until appearing as powerfully divisive problems between excess and primary insurers. Today's presentation will help manage and avoid these issues.

II. What Makes Excess Insurance Claims Difficult to Manage?

High Dollar Exposures, Multiple Towers, Multiple Years

One reason excess insurance claims are difficult to manage is because of their sheer size. Excess insurance claims can reach multiple millions of dollars and frequently involve mass tort or other large scale disasters. In addition to the potential size of the

damages, some claims persist over several years which can implicate multiple policies, or perhaps only a few "long-tail" policies. The presence of multiple insurers over the course of several years and the size of the claims can lead to protracted and confusing litigation.

A Lack of Information Provided to Claims Handlers

Because excess insurers may not immediately be needed, they are often ignored at the outset of the claim and are frequently left wondering about the status of the claims. That issue is magnified by the fact that the primary insurer is typically the entity paying defenses costs, and as a result, the defense counsel tends to feed litigation information only to the primary insurer. It behooves excess insurers to get involved in the claim early to ensure information access, but as a practical matter, it should balance that persistence with its own evaluation of whether excess exposure truly exists.

III. Duties of the Primary Insurer to Excess Insurers

Because of the lack of contractual privity between the primary and excess insurers, these duties are not as clear as the duties owed from the primary insurer to the insured. Though a minority of jurisdictions do not recognize these duties at all—Tennessee, Alabama, Kentucky, & Idaho—most jurisdictions have recognized that a primary insurer owes an excess insurer duties of good faith and fair dealing through either a direct or equitable subrogation theory. Today, these duties are recognized under the following two categories: (1) the duty to keep excess insurers advised of claim developments and excess exposure, and (2) the duty to settle within policy limits.

Duty to Keep Excess Insurer Advised of Claim Developments and Potential Excess Exposure

Florida and California are two examples that have recognized this duty, whereby the primary insurer must keep the excess insurer apprised of all "significant developments" in the claim. In Florida, this duty is rationalized by the "subrogation theory." Under that theory, Florida recognizes that the excess insurer is actually sitting in the same position as an insured had there not been any excess insurance coverage. Therefore, because the primary insurer owes the insured a duty of good faith to avoid excess exposure, the excess insurer should necessarily receive the same treatment. Likewise, the primary insurer is obligated to provide notice to excess insurers whenever there is a potential for an excess judgment. For an example of the duty to keep the excess insurer advised of claim developments, see *United States Fire Ins. Co. v. Morrison Assurance Co.*, 600 So. 2d 1147, 1151 (Fla. Dist. Ct. App. 1st Dist. 1992). For an example of the primary insurer's duty to notify the excess insurer of the potential for excess exposure, see *United States Fire. Ins. Co. v. Am. Nat'l Fire Ins. Co.*, 53 Pa. D. & C. 4th 474 (Pa. County Ct. 2001).

Duty to Settle Within Policy Limits

Similar to the rationale for the duty to keep the excess insurer advised of claim developments, this duty exists because the primary insurer a large degree of control over the litigation. To that extent, the primary insurer is in the best position to accomplish a settlement within policy limits. In addition to recognition of this general duty, Florida also recognizes that excess insurers may have a cognizable bad-faith claim against a primary insurers when it is exposed to amount greater than it would have been had the primary insurer acted without bad faith. For recent examples of the primary's duty to settle within policy limits, see *St. Paul Fire & Marine Ins. Co. v. Liberty Mut. Ins. Co.*, 353 P.3d 991 (Haw. 2015); *Perera v. United States Fid. & Guar. Co.*, 35 So. 3d 893, 900 (Fla. 2010).

IV. Evaluating Follow Form Insurance

Is the Excess Insurer Bound by the Policy Interpretations of the Underlying Insurer?

No, the excess insurer is not bound to the interpretations of the underlying insurer, despite following form to the same exact terms. This issue has been litigated in a variety of scenarios and courts and commentators alike agree that following-form to underlying insurance does not mean that the excess insurer must follow the *interpretations* of the underlying insurer. This means, of course, that the excess insurer is free to take a different coverage position than the underlying insurer—either to exclude coverage or find coverage exists. As opportunistic as this legal principle appears, it has the potential to back-fire. If the primary and excess insurers disagree on the interpretation of the same policy, the insured is likely to argue that the policy is ambiguous. For further reading and examples of this principle, see *Keystone Shipping Co. v. Home Ins. Co.*, 840 F.2d 181 (3d. Cir. 1988); *Allmerica Fin. Corp. v. Certain Underwriters at Lloyd's, London*, 966 N.E.2d 854 (Mass. App. Ct. 2012); *Edward E. Gillen Co. v. Ins. Co. of the State of Pa.*, 2011 U.S. Dist. LEXIS 48119 (E.D. Wis. 2011); *Pratter v. Reliance Ins. Co.*, 2010 Pa. Commw. LEXIS 733 (Pa. Commw. Ct. Dec. 2010); 4-24 APPLEMAN ON INSURANCE § 24.02.

V. Exhaustion of Primary Insurance

Filling the Gap or "Limit Shaving"

Because excess insurance is not triggered until underlying insurance limit is exhausted, an insured may attempt to "fill the gap" between the limits of the underlying insurance and the amounts paid by the underlying insurer with the goal of triggering excess insurance. However, there is relative agreement today that where policy language requires "actual payment by the primary policy," excess insurance is not triggered until actual payment by the underlying insurer and the insured cannot fill the gap. Conversely, where policy language only requires that primary insurance be "exhausted," the door remains open for the insured to fill the gap and trigger excess insurance coverage. The

underwriting response to this phenomenon has been to clarify the intent of the exhaustion clauses—which now frequently state that "actual payment by the underlying policy is required" to trigger excess indemnification. For an example of a Court requiring "actual payment by the primary policy," see *Martin Resource Mgmt. Corp. v. Axis Ins. Co.*, 2015 U.S. App. LEXIS 18279 (5th Cir. 2015).

VI. When There are Differences Between Primary and Excess Insurers

Practical Strategies for Handling Differences

To help manage some of these issues, excess insurers should first make an independent determination of the claim. To that end, excess insurers should stay in communication with the primary insurer regarding its position because it is very difficult to change coverage positions after they have been made to an insured. The ability to potentially influence the primary's coverage decision exists only at the early stages of the claim.

Perhaps most importantly, excess insurers should know and exercise their rights. Primary insurers are likely to be more receptive to requests for information if they are aware of their duty to keep excess insurers apprised of claim developments and settle within their own policy limits. While it is generally a good strategy to stay united with the primary insurer during coverage litigation, if an excess insurer needs to take a contrary position to protect itself, it should.

Settlements as the Excess Insurer

Similar to the strategies for handling claims and litigation, the excess insurer is in the best position if it works with the primary insurer on settlement issues. If that unity appears unlikely, a direct discussion with the insured or claimants may be advantageous. In either scenario, the excess insurer should try to remain transparent with both the insured and the primary insurer.

In some circumstances, it may be proper for the excess insurer to settle *without* exhaustion of the primary insurance policy. This strategy may make sense when there are disagreements about the potential exposure to the policies and bad faith exposure seems imminent. Settlement without the primary may also be necessary when the primary insurer is poorly managing the claim or litigation. In any event, if the excess insurer opts to settle without the primary it should pursue indemnification against non-settling parties.

VII. General Strategies and Wrap-Up