2019 Construction Conference
September 25 – 27, 2019
San Diego, California

Big Claim, Big Issues: What Happens When Exposure Reaches the Excess

I. Understanding the Unique Issues Presented in Large Loss / High Exposure Claims

Aside from the obvious, which is that large loss and high exposure claims are typically complex in nature, they become even more complex when the primary and excess or umbrella carriers are different and/or have different insuring agreements. This situation is occurring with greater frequency in the construction defect arena. While it arises more often in the project specific context of Owner Controlled Insurance Programs and Contractor Controlled Insurance Programs, it also presents itself on a more limited basis in the standard general liability arena.

By way of example, a project owner "Owner," is interested in developing a mixed-use project that consists of commercial and retail on the lower levels and residential condominiums above. The Owner contracts for the construction with a licensed and professional general contractor ("General Contractor') who subcontracts out the work to various professional trade contractors ("Trade Contractors'). Due to

market conditions, the Owner decides to purchase an Owner Controlled Insurance Program for the project through its independent insurance agent ("Insurance Broker"). The parties agree that the appropriate amount of general liability coverage for the project is One Hundred Five Million Dollars and Zero Cents ($105,000,000.00). The Insurance Broker is unable to find a carrier who is willing to underwrite this risk. As such, he procured $5,000,000 of primary coverage through Insurer A[1]. He procures $25,000,000 of excess coverage ("Tier 1") through Insurer B; $25,000,000 of excess coverage through Insurer A ("Tier 2") (who is willing to write the second tier excess); and $50,000,000 of umbrella coverage from Insurer C ("Tier 3").

The policies are similar in many respects but have some key differences. The primary policy has endorsements which provides defense outside of limits; sets the tail of the products completed operations coverage at 10 years from the date the construction is completed; and allows the carrier to settle without consent of the insureds.

Tier 1 excess is generally the same except it contains a cross suit exclusion; and sets the tail of the products completed operations coverage at 10 years from the date that the Prime Contract is signed. It also does not have any defense obligation.

Tier 2 excess is shorter and has a follow form provision (not clear as to whether it flows form to both the Primary and Tier 1 excess). It also contains a residential condominium exclusion and a requirement to obtain the consent of the first name

[1] This is a $2,000,000 per occurrence and $5,000,000 in the aggregate.

insured (the Owner) for settlement. Further, it contains a defense obligation within limits.

Tier 3 umbrella coverage follows form to the primary policy.

During construction, Insurer A pays out one claim totaling $1,000,000 which reduces the available aggregate to $4,000,000. After construction (within 10 years from the completion of construction but over 10 years from the date of the Prime Contract) two separate claims come in. One relates to the commercial space and the other relates to the residential condominiums. A rough preliminary evaluation by the Owner's general counsel sets the claim relating to the commercial space at $20,000,000 and claim relating to the residential space at $22,000,000. The primary carrier retains Defense Firm A to defend both matters, with a reservation of rights. Insurer B distrusts Defense Firm A, and would rather use Defense Firm B. The umbrella carrier does not believe that it will be exposed and therefore is only loosely monitoring. There is a strong argument that the alleged property damage as to commercial space occurred within 10 years from the date that the Prime Contract was signed.

II. The Issues Created by Differing Insuring Agreements

The fact scenario above is meant to illustrate some of the common issues that could arise when different carriers write different insuring agreements for the same loss. As a preliminary matter, the Insurance Broker and the Owner's general counsel should have reviewed these polices and advised the insured(s) of the potential coverage traps and issues that were likely to advise. Additionally, the carriers should (most likely through their respective coverage counsel) meet and discuss the various coverage

concerns and positions of the carriers. They should endeavor to advise the insured of their coverage positions as soon as practicable.

A. The Impact and Effect of Differing Reservations of Rights

As highlighted above, Insurer A, Insured B, and Insurer C, have differing coverage exclusions available to them which may impact some of all of the claims. For instance, Insurer A under the primary policy would not typically have the benefit of a statute of limitations defense whereas, Insurer B under the Tier 1 excess policy may (at least for the residential claim). This reservation by Insurer B, could have the effect of barring any coverage under the Tier 1 excess and leave Insurer A exposed under the Tier 2 excess policy. Insurer A under the Tier 2 excess policy (and to some extent Insurer C under the umbrella policy) may reserve and take the position that they are not implicated until Insurer B exhausts its Tier 1 excess coverage.

Similarly, to the extent that that Owner, General Contractor or Trade Contractors decided to file claims against each other (for non-covered claims or as a result of coverage reservations), this may impact Insurer's B coverage determination as to those claims.

In other words, aside from the standard reservations that are asserted by any given carrier in the typical claim setting, in a situation like the one above, insurers will find themselves not only viewing the facts presented under their own policies, but also viewing the facts as they relate to other carriers in their insurance tower. Conversely,

the positions taken by other carriers based on the facts presented may cause a carrier to reserve or view its policy slightly differently.

B. The Impact and Effect of Differing Case Assessments

Separate and apart from differing reservations, the underlying coverages could have an impact on how the downstream carriers evaluate the claims. Based on the facts above, the first issue that is different is defense costs. The primary carrier is obligated to pay defense costs which do not reduce the aggregate limit of insurance -namely they are limitless. As to Insurer B under the Tier 1 excess, it does not have a defense obligation and does have a cross suit exclusion. As such, to the extent that Insurer A under the primary policy is assessing the cases which is inclusive of defense costs and cross claims, Insurer B would not be. This could have a significant impact on cause valuation. Even more to this point, given the facts above, Insurer B may have a complete defense to both claims as its completed operations coverage may be expired. As such, Insurer B may value these cases at zero.

The same is true as to Insurer A under the Tier 2 excess. It has a residential condominium exclusion which may serve to bar all of the residential condominium claim. It also follows form (to the extent consistent with the subsequent policies) which may (or may not) include the cross suit exclusion.

As to the umbrella carrier, it follows form with the primary policy which does not contain the cross suit exclusion or the residential condominium exclusion. To that end, while the underwriters for the umbrella carrier believed there was $55,000,000 of

coverage before it was implicated, given the products completed operations limitations under Tier 1 excess and the residential condominium exclusion under Tier 2 excess, it may have only one layer of excess above it on the commercial claim and no excess above it on the residential claim. This will obviously impact the case evaluation and assessment throughout the tower.

C. The Impact and Effect of Differing Litigation Strategies

While defense counsel is retained as counsel for the insured and has the professional responsibility and obligation to the insured, (as opposed to the insurer), the coverage issues identified above would have an impact on litigation strategies. In other words, the carrier's willingness to litigate or resolve a claim is framed, at least in part, by its evaluation of exposure and responsibility under the insuring agreements. For instance, Insurer A, who is responsible for paying defense fees and costs on a claim well in excess of its limits, it going to be extremely motivated to resolve the matters. With that said however, any resolution would most likely require the participation of the excess and/or umbrella carriers who may be less motivated due to coverage exclusions or a belief the case value could be improved through further litigation and discovery (on someone else's' dime). Additionally, among and between the excess and umbrella carries, the case assessment and litigation strategies will differ. For instance, the insurers with residential condominium exclusion may be more motivated to push and settle the commercial claim within the limits of the lower tier carriers as opposed to resolving them as a package.

III. Rights of Primary and Excess Carriers and Tips for Resolution

While we hope that all carriers within a tower will have the utmost trust and faith in their co-carriers and appointed defense counsel, sometimes they do not. This reveals itself most often in selection of defense counsel. Whether it be that a particular carrier has greater trust or familiarity in a given defense counsel, or that a given carrier believes that they are not being reported to correctly or timely, an excess or umbrella carrier may see fit to retain its own defense counsel for the insured. Under a typical commercial general liability policy, as well as, the standard terms of most WRAP programs, excess and umbrella carriers typically have the right, but not the obligation, to participate in the defense of its insured prior to exhaustion. This right is often exercised when the excess or umbrella carriers desire to have different counsel in the litigation. This counsel, as with any insurer appointed counsel, is obligated to represent the insured with full faith and loyalty to the insured.

As with retention of defense counsel, the excess and umbrella carriers may also choose to exercise this right in the retention of experts.

With regard to the rights of the insured, it is the same rights that they are owed regardless of the position of the carrier within the tower of coverage. The insured can and should insist on the utmost good faith and fair dealings with all of its carriers, appointed counsel and retained experts.