



## Recent Decision Addresses Whether Below-Limits Settlements May Exhaust Underlying Insurance and Trigger Excess Coverage

One ongoing issue for excess insurance carriers and policyholders is whether an insured party, who has settled with underlying carriers for less than the full underlying policy limits, should be permitted to trigger excess coverage by "filling the gap" left by below-limits settlements. Most excess policies contain an "exhaustion" provision, which typically indicates that excess coverage will not be implicated until all underlying insurance is exhausted. However, policies use varying language regarding the manner in which the underlying insurance must be exhausted. With this in mind, when an insured settles with an underlying insurer for less than the full limit and purports to trigger excess coverage by paying the remaining gap with its own self-insurance, these circumstances may lead to disputes between policyholders and their excess carriers as to whether the settlement constitutes exhaustion.

Historically, courts have tended to favor policyholders with regard to below-limits settlements and have not required actual payment of the full limits by the insurance carriers. See, e.g., *Zeig v. Mass. Bonding & Ins. Co.*, 23 F.2d 665 (2d Cir. 1928); *Pereira v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, No. 04 Civ. 1134, 2006 U.S. Dist. LEXIS 49263, at \*23-\*27 (S.D.N.Y. July 12, 2006). However, more recently, when some courts found the exhaustion provision to be sufficiently specific on this issue, they distinguished the seminal *Zeig* case and its progeny and allowed insurers to deny coverage on this basis. See *Qualcomm, Inc. v. Certain Underwriters at Lloyd's, London*, 161 Cal. App. 4th 184, 195-99, 204 (2008); *Comerica Inc. v. Zurich Am. Ins. Co.*, 498 F. Supp. 2d 1019, 1030-34 (E.D. Mich. 2007).

However, the recent decisions of *Qualcomm* and *Comerica* were countered by *HLTH Corporation v. Agricultural Excess and Surplus Insurance Co.*, No. 07C-09-102, 2008 Del. Super. LEXIS 280, at \*42-\*47 (July 31, 2008), thereby fueling further uncertainty of exhaustion issues regarding settlements with underlying carriers. *Qualcomm* and *Comerica* (and even *Zeig* as it appears) permit parties to contract around what those courts view as a default rule in *Zeig* (provided that the exhaustion language is unambiguous). However, the *HLTH* decision, in a notably brief discussion, follows the outcome of the *Zeig* line of cases and appears to view such decisions as establishing a public policy rule as a matter of law regardless of the particular policy language at issue.

Recently, on September 25, 2009, another court addressed the exhaustion requirement in connection with below-limits settlements, providing further support for the notion that the *Zeig* decision established only a default rule that can be overridden by contract. In *Trinity Homes LLC v. Ohio Casualty Insurance Co.*, No. 1:04-cv-1920, 2009 U.S. Dist. LEXIS 88697, at \*34-\*49 (S.D. Ind. Sept. 25, 2009), the court confronted an exhaustion provision in an excess CGL policy and held that, "based on the language of the contract at issue in th[at] case, settlements executed by [the insureds] at amounts less than full underlying coverage do not constitute 'exhaustion'" under the excess policy. *Id.* at \*41.

The court in *Trinity Homes* reasoned that "only full exhaustion, and not mere reduction, suffices to render the underlying insurance unavailable" and that, "[t]he language of the [excess] policy, like the language of the contract in *Comerica*, is clear, and the parties are bound by the agreement they made." *Id.* at \*40. The court further explained that the insureds "cannot circumvent that clear intention embodied in the contract simply by branding each settlement with an underlying insurer an 'exhaustion' of the policy, when, in fact, it patently is nothing more than a 'reduction' of the coverage under that policy." The *Trinity Homes* court also reiterated the reasoning in *Comerica*, noting that "to ignore language clearly drawing a distinction between reduction and exhaustion 'would essentially require a holding that parties simply cannot contract for an excess policy to be triggered only upon full, actual payment by the underlying insurer.'" *Id.* at \*40-\*41 (quoting *Comerica*, 498 F. Supp. 2d at 1034 and citing *Qualcomm*, 161 Cal. App. 4th 184). Accordingly, with regard to the policy at issue in *Trinity Homes*, the insurer's duties would arise only in the event that all of the insureds' relevant underlying insurance policies are fully exhausted. *Id.* at \*42. Therefore, given that none of the underlying policies were exhausted by the settlements, the court found that the insureds failed to satisfy the prerequisite of rendering their underlying insurance unavailable and therefore afforded no excess coverage. *Id.* at 47.

We note that the Trinity Homes court applied Indiana substantive law and the decision is currently on appeal in the Seventh Circuit. With this in mind, we also note that there remains a great deal of uncertainty as to whether a below-limits settlement along with a policyholder's own gap-filling payment is sufficient to implicate excess layers of coverage. Notwithstanding, Trinity Homes is a significant decision confronting the issue and potentially indicates that subsequent court decisions may be more willing to put aside the outcome in Zeig and place more emphasis on whether the policy language itself allows the policyholder's self-insurance to "fill the gap." Given that excess policy forms have different specific language regarding their exhaustion provisions, we may see more decisions arriving at the same outcome as Trinity Homes.

Kaufman Dolowich Voluck & Gonzo LLP will continue to monitor these developments. If you have any questions regarding this decision and the exhaustion issue or you would like a copy of the decision, please contact Ivan J. Dolowich, Esq. at [idolowich@kdvglaw.com](mailto:idolowich@kdvglaw.com), Daniel H. Brody, Esq. at [dbrody@kdvglaw.com](mailto:dbrody@kdvglaw.com) or call them at 516-681-1100 to discuss how KDVG may assist you.

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