PROPER POLICY: EXCESS INSURER LIABILITY FOLLOWING SETTLEMENTS FOR LESS

By: Louis A. Russo[1]

An excess insurer typically becomes liable when the underlying primary policy is exhausted. In this context, settlements between insureds and primary insurers for less than policy limits create an interesting legal issue to be deciphered by the courts. Namely, should these settlements for less than the full value of the primary policy be deemed exhausted thereby triggering excess coverage? Many courts faced with this issue have answered affirmatively; however, the California Court of Appeal recently broke rank.

In *Qualcomm, Inc. v. Underwriters at Lloyd's*,[2] Qualcomm, Incorporated ("Qualcomm") was previously sued by several of its employees relating to the right to unvested stock options. These various suits ultimately cost Qualcomm $29 million to defend or settle.

Qualcomm had a $20 million director and officer insurance policy with National Union Fire Insurance Company of Pittsburg, P.A. ("National Union"). Qualcomm also had a $20 million first layer excess policy (the "Policy") with certain underwriters at Lloyd's, London ("Lloyd's"). The Policy contained a maintenance clause requiring Qualcomm to maintain the full underlying National Union policy limit and also a "Limit of Liability" provision stating that:

> This Policy provides excess coverage only. . . . This Policy does not provide coverage for any loss not covered by the [National Union policy] except and to the extent that such loss is not paid under the [National Union policy] solely by reason of the reduction or exhaustion of the Underlying Limit of Liability through payments of loss thereunder. . . . Lloyd's 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. ["Exhaustion Provision"][3]

National Union's total payout under the primary policy after settling with Qualcomm was $16 million ($4 million less than the full value of the policy). Qualcomm asked Lloyd's to cover its remaining $9 million unreimbursed loss that exceeded the $20 million National Union policy limit. Lloyd's refused.

Qualcomm filed suit for breach of contract and sought a judicial declaration that the Policy had been triggered. Lloyd's demurred, arguing that Qualcomm had failed to maintain and exhaust Qualcomm's primary coverage, and therefore Lloyd's excess policy had not been triggered. The trial court granted the demurrer finding that Qualcomm failed to maintain the National Union policy limit by settling for less than the full $20 million policy amount.

At issue on appeal before the California Court of Appeal was whether primary insurance should be deemed exhausted and an excess carrier liable for losses exceeding the actual limits of underlying primary insurance, even where the primary insurer settled for less than the actual policy limits. On this point, the court addressed two distinct arguments which both focused on policy.

Lloyd's argued that the clear and unambiguous language of the **Policy** should control the court's analysis. Coverage under the Policy had not been triggered, according to Lloyd's, because National Union, by settling for $16 million, or 75% of the full value of its policy, had not truly "paid" or been "held liable" to pay the $20 million policy limit as was required by the Exhaustion Provision.

Qualcomm, on the other hand, argued that such an interpretation was not required in light of the parties' awareness of contrary authority existing at the time the Policy was issued (*Zeig v. Massachusetts Bonding & Ins. Co.*[4] ("*Zieg*") and its progeny in particular). Qualcomm argued that the parties' awareness of such authority which broadly interpreted similar exhaustion clauses to include settlements for less was enough to create an ambiguity as to the parties' understanding of the Exhaustion Provision, thus, making dismissal premature. The court disagreed.

The court reasoned that there was no good reason why Lloyd's should be imputed with knowledge of only the *Zeig* line of cases because there also was authority to it before the parties entered into the Policy in 1999. In addition, the court was not persuaded by Qualcomm's reliance on *Zeig*. It disagreed with the

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[2] 73 Cal. Rptr. 3d 770 (Cal. Ct. App. 2008)

[3] Emphasis supplied.

[4] 23 F.2d 665 (2d Cir. 1928).

Zeig court's refusal to require absolute and actual collection of the primary insurance in interpreting the word "payment" in the exhaustion clause. Furthermore, the *Zeig* court admitted there may be circumstances where settlements for less might not trigger excess liability—where the excess policy explicitly required actual payment as a condition precedent to coverage. The court in *Qualcomm* believed the Exhaustion Provision, which required that National Union "*have paid* or *have been held liable to pay the full amount*," fell squarely within this exception.

Most troubling to the *Qualcomm* court, however, was the *Zeig* court's focus on **public** policy. The *Zeig* court rejected an "unnecessarily stringent" standard of requiring actual collection of funds by the insured from the primary insurer because to do so "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 interest to the insurer." Qualcomm argued that the court should consider giving these public policy concerns equal weight. In the end, the court refused citing its disapproval of the *Zeig* court's placement of public policy concerns over the explicit language of the Exhaustion Provision.

As a result, the California Court of Appeal ultimately affirmed the judgment of the trial court.

UM AND PIP...

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interest on reserve funds, the possibility of administering the plan at a lower cost than a commercial insurer, and the ability to keep all monies saved where the loss experienced is less than the loss expected.[7] In addition, a company can always cap its exposure by purchasing excess insurance or reinsurance to cover claims over a certain amount.

PIP AND UM OBLIGATIONS FOR SELF-INSURERS

An issue can arise for a self-insurer where a self-insured vehicle is involved in an accident with an uninsured or underinsured vehicle. Is the self-insurer obligated to provide PIP and/or UM coverage?

Generally, every motor vehicle liability insurance policy must include PIP and UM coverage unless the named insured rejects the coverage in writing.[8] For example, Washington law requires the following levels of PIP coverage: medical and hospital benefits of $10,000; funeral expense benefit of $2,000; income continuation benefits of $10,000, subject to a limit of $200 per week, and loss of services benefits of $5,000, subject to a limit of $200 per week.[9] Typical coverage under a UM statute includes $25,000 for bodily injury or death of a person, $50,000 for bodily injury or death of two or more persons, and $10,000 for property damage.[10]

Courts in the majority of states have held that self-insurance is not a "motor vehicle liability insurance policy."[11] As a result, additional insureds and third parties cannot make a claim against a self-insurer on the basis that, by virtue of the self-insured retention, it issued insurance in the amount of the retention.[12] The majority of decisions hold that UM requirements apply only to insurance policies that have been "issued" as such.[13] Because a certificate of self-insurance is not a liability policy and has not been issued, a self-insurer is not required to furnish UM coverage.[14]

For example, in *Cann v. King County*, a passenger injured on a King County, Washington, bus brought an action against the self-insured county to recover UM benefits.[15] In response to the plaintiff's argument that as a self-insurer, King County had a liability policy and was therefore required to provide UM coverage for its passengers, the court observed that the Washington State Supreme Court has held that self-insurance is not a liability policy under the UM statute.[16] Self-insurance

7 1A Steven Plitt et. al., *Couch on Insurance* § 10:1 (3d ed. 2007). A variety of income and tax implications arise when a business decides to self-insure. Those considerations are not dealt with in this article.

8 *See* Wash. Rev. Code §§ 48.22.030, .085; Cal. Ins. Code §§ 11580, 11580.2. Oregon law allows the insured to elect, in writing, lower limits, so long as the election does not go below the prescribed amount to meet the requirements of Or. Rev. Stat. § 806.070 for bodily injury or death. *See* Or. Rev. Stat. § 742.502(2)(a).

9 Wash. Rev. Code § 48.22.095

10 *See, e.g.,* Or. Rev. Stat. § 806.070.

11 *See* Cann v. King County, 86 Wash. App. 162, 937 P.2d 610 (1997); Thompson v. Estate of Pannell, 176 Or. App. 90, 29 P.3d 1184 (2001); O'Sullivan v. Salvation Army, 85 Cal. App. 3d 58, 147 Cal. Rptr. 729 (1978).

12 Alan D. Windt, *Insurance Claims and Disputes* § 11:31 (5th ed. 2007).

13 *Automobile Liability Insurance* § 19:26 (4th ed. 2008).

14 *Id.*

15 Cann v. King County, 86 Wash. App. 162, 937 P.2d 610 (1997).

16 *Id.* (citing Kyrkos v. State Farm Mut. Auto Ins. Co., 121 Wash. 2d 669, 674, 852 P.2d 1078 (1993)); Wash. Rev. Code § 48.22.030(1).