UNDERWRITING A WHOLE DIFFERENT RISK:

When The Excess Insurer Has A Duty To Defend

William J. Mitchell Ahmuty, Demers & McManus

Your underlying general liability insurance policy will defend you in a suit, but your excess policy will not, right? Contrary to common understanding, there are instances where an excess policy will be required to provide a defense to the insured. Understanding how courts may interpret certain language in your excess policy (or in your opponent's policy) can be critical information for your risk transfer database.

Oftentimes, a party will purchase several layers of insurance coverage, in order to protect itself from both foreseeable and unforeseeable liability. This coverage is then stacked into layers of primary and excess coverage. Once the insured is aware of a claim and makes the proper notifications, its primary, or underlying, layer of coverage responds to the claim. From the underlying insurer's standpoint, control over the defense makes sense, because it is that insurer's policy limits that are at risk in the first place. Thus, the underlying policy typically provides that the underlying insurer has both the right and duty to defend the insured.

Excess policies usually make no promise to pay defense costs. These policies are reached less often and are relatively less expensive to purchase in comparison to underlying policies. Further, excess policies require the insured to maintain at least one layer of primary coverage that will pay before the excess policy, and normally contain a schedule of all the underlying policies that must pay first. Likewise, excess policies may tell you that they are excess; their "other insurance" clauses provide that when the insured has "other" insurance, that the excess policy is, naturally, excess over the other policies.

Accordingly, the general principle observed by the courts is that the underlying policies have the duty to defend the insured, while the excess policies do not. This is true even where the underlying carrier is insolvent or has denied coverage – the excess carrier will not be forced to "drop down" and provide the initial defense to the insured. Indeed, the excess carrier did not bargain for such an obligation. Distinguished from a duty to defend, it is also generally accepted that once the in-

sured's potential liability reaches the excess carrier's coverage, the excess carrier has the *right* to protect its interest by participating in the defense.

However, as you can tell by the title of this article, there are circumstances when the underlying carrier refuses to defend or becomes insolvent, and a duty to defend may be imposed on the excess carrier. At times, certain excess policy language can mix with the law of particular jurisdictions, with the result that an excess carrier will find itself faced with a duty to defend an insured, where that carrier probably never expected to do so. Several of those scenarios are presented here, and they often fall into two general categories: first, where the court finds the excess policy language is ambiguous or overly broad, and second, where the excess policy incorporates just enough of the language of the underlying policy for the court to find a duty to defend.

USE OF AMBIGUOUS TERMS VIS-À-VIS OTHER INSURANCE

First and foremost, the drafter of an excess policy must use clear language that states the excess carrier will not drop down and defend the insured. Otherwise, that old ambiguity problem rears its ugly head: ambiguous terms are interpreted in favor of coverage. Some excess policies state that liability would attach only after the primary carriers "have paid or *have been held liable to pay*." Being "held liable to pay" can certainly be viewed differently than "have paid." The latter means having actually paid, while the former imposes only the legal requirement to pay. There are several instances where the primary carrier had the legal obligation to pay but subsequently became insolvent, and the excess carrier was required to drop down.

In several other cases, the word "recoverable" caused similar problems. Where an excess policy stated that it would pay "in excess of…*the amount recoverable* under underlying insurance," insureds have sought judgment, maintaining that this language was ambiguous when nothing is recoverable from the underlying policy, and thus the excess insurer was obligated to cover the loss because the "amount recoverable" from the insolvent underlying insurer was zero. The courts have agreed, even in situations where the insured breached its duty to maintain underlying insurance, because, as one court wrote, "the term 'amount recoverable' can be interpreted as a variable amount which depends on the actual amount recoverable from the primary insurer, not the fixed policy limits." For similar reasons, the word "collectible" also has been problematic for excess carriers, and at least one court has written that when an excess insurer uses the term "collectible" or "recoverable" it is automatically agreeing to drop down in the event the primary coverage becomes uncollectible or unrecoverable.

Thus, it makes a good deal of sense, from an underwriting perspective, to avoid stating that your policy is excess over other available, recoverable, collectible, or liable policies, assuming you want the policy to be a true excess policy. Conversely, from the perspective of the insured without a paying underlying policy, or an additional excess carrier on the same risk, the exposition of such terms can be the basis for a drop-down argument, and thus a windfall.

NOTICE WHICH TERMS ARE INCORPORATED BY REFERENCE INTO THE EXCESS POLICY

It is common for an excess policy to adopt the terms and conditions of the underlying policy. In this manner, the excess coverage provided follows the form of the underlying coverage, and the exclusions may be incorporated as well. When a commercial insured transitions from job to job, and additional insureds are added and removed from the underlying policy, there is no need to modify the excess policy – additional insureds are simply identified as those additional insureds on the underlying policy. This streamlines the coverage and presumably removes any conflicts between primary and excess policies.

That said, such incorporation by reference can also become a trap for the excess carrier. Some courts reason that once an excess policy adopts the "warranties and terms" from the underlying policy, that the excess policy is also adopting the duty to defend from the underlying policy.

In more than one jurisdiction, because the language of the excess policies read that "This contract is subject to the same warranties, terms, conditions, exclusions and definitions…as are contained in…the policy/ies of the primary insurers," the courts will impose a defense duty onto the excess carrier. Interpreting the policies very strictly against the insurer, the courts note that this policy language "does not expressly declare with certainty and clarity that there is no obligation to defend." Thus, an excess policy that is silent as to a duty to defend – as many are – may have a duty to defend read into it, even where the policy clearly states that it is an excess policy. Note that this interpretation is not the controlling law in the majority of states, but can be an issue in several states. Of course, irrespective of the current precedent in your jurisdiction, depending on your posture in the case you may be in a position where it is in your best interest to advance this argument.

WHAT WORDS SHOULD PLACE THE EXCESS POLICY WHERE IT IS SUPPOSED TO BE?

Obviously, from an underwriting perspective, underwriters, risk managers, and anyone involved in the purchase or monitoring of insurance should remove references in their excess policies that would render coverage excess over coverage that is "available," "collectible," "valid and collectible," "recoverable," or "held liable to pay." So what words could be used to put the excess policy where it is supposed to be?

Rather than try to find just the right adjective for "underlying insurance," focus on triggering excess coverage *only* after the exhaustion of a *specified amount* of underlying coverage, such as "this policy applies only in excess of the $1 million underlying insurance and only after that $1 million in underlying coverage is exhausted." Courts have also found that an excess policy that requires exhaustion of the underlying policy, "by reason of losses paid thereunder," clearly demonstrates that the insured is liable for lower levels of damage if no underlying coverage was in force.

By the same token, even though the excess policy may state it is "excess" over all other insurance (and only applies after such insurance is fully exhausted), the excess policy should also state that it contains no defense duty.

CONCLUSION

In sum, there is a general understanding, by insurers, the public and judicial interpretation, that an excess policy has the right, but not the duty, to defend the insured. Nevertheless, there is certain wording that can make the excess policy susceptible to a claim for defense costs. Avoiding those words, avoiding broad incorporation of the underlying policy's coverage, and by specifically stating that the excess policy does not contain a duty to defend, you can help avoid the unintended consequence of a duty to defend in an excess policy.

William J. Mitchell is an attorney with Ahmuty, Demers & McManus in New York. His practice focuses on insurance coverage litigation, for both policy holders and insurers, and he may be reached at william.mitchell@admlaw.com.