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Five Tips For Building A Better Insurance Coverage Tower

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Christopher L. Lynch
Partner

Insurance coverage cases from 2014 have illustrated a disturbing trend: excess insurers are continuing to take aggressive coverage positions and are increasingly unwilling to let the scope of their coverage be dictated by the terms of the primary policy or the coverage decisions of the primary insurer. Thus, if there was ever a time when policyholders could afford to simply assume their primary and excess policies would operate together to provide an uninterrupted tower of coverage, that time has passed. Today more than ever, policyholders would be well advised to work with their brokers or experienced coverage counsel to carefully review the coverage forms of their excess policies to try to identify and eliminate potential gaps between layers and shortcomings in the excess coverage. To help start that conversation, below are five tips to keep in mind when considering excess coverage and structuring an insurance tower.

1. Don’t assume a “follow form” excess policy will actually “follow form”

While many excess policies still contain the words “Follow Form” in their title, true follow form policies are increasingly rare. Today, even nominally follow form excess policies frequently put conditions on the extent to which they follow the terms of the primary policy, purporting to follow form “subject to” the terms of the excess policy or “unless” or “except to the extent” the primary

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policy terms are inconsistent with the terms of excess policy. As a general rule, where the terms of the excess policy conflict with or are inconsistent with the primary policy, it is the terms of the excess policy that will determine the scope of that policy's coverage. The thickness of the excess policy may provide a clue as to whether, and to what extent, it follows the terms of the primary policy. Any excess policy longer than a page is unlikely to provide unqualified follow form coverage. And the thicker the excess policy is, the more excess-specific terms, exclusions, conditions and definitions it may contain.

2. Match policy dates and the events that must occur relative to those dates

It should come as no surprise that if the dates applicable to determining coverage under the primary policy don't align with the dates for determining coverage under the excess policies, then the coverage provided by those policies may differ. To the extent possible, policyholders should try to align all relevant dates and time periods across each layer of coverage or at least identify any differences to determine whether and how they may impact coverage. And this goes beyond making sure the policy periods line up. Differences in retroactive dates, notice or reporting periods, prior or pending litigation dates, and similar dates may also create differences in the scope of coverage provided among the policies.

Equally important, but often overlooked, is to determine whether the policies are consistent with respect to the events that must occur relative to the key coverage dates. For example, even if the primary and excess policies have the same policy period, their scope of coverage could differ if the primary policy requires "injury" or "damage" to occur during that policy period but the excess policy requires an "occurrence" to occur during that period, depending on whether and how those terms are defined in the policies. Differences in a triggering event are a particular concern where underlying claims are likely to involve latent injury or damage that doesn't manifest or isn't discovered until some time after the event that causes it.

3. Avoid restrictions on who must pay the underlying limits

Compare the following policy provisions:

- "Liability under this [excess policy] does not apply to a given claim unless and until … The insured or insured's 'controlling underlying insurer' has become obligated to pay the 'retained limit' …"
- "It is expressly agreed that liability for any covered Loss shall attach to the [excess] Insurer only after the insurers of the underlying insurance have paid, in the applicable legal currency, the full amount of the Underlying Limit."

Under the first provision, the policyholder would seemingly be entitled to excess coverage as soon as it becomes obligated to pay sums above the specified limit. Under the second provision, the excess insurer would likely argue that its coverage would attach only if and after the underlying insurer – and not the policyholder – first paid the full amount of its policy limits via actual payments of money. Any restrictions on who must pay the underlying limits could significantly impact a policyholder's ability to settle a coverage dispute with an underlying insurer or to access excess coverage in the event an underlying insurer is unwilling or unable to pay its limits. Therefore, in choosing excess policies, policyholders would be wise to look for, and avoid if possible, provisions purporting to restrict exhaustion of the underlying limits to monetary payments made by the underlying insurer.

4. Avoid provisions limiting which payments count toward exhaustion

Excess policies may also contain provisions purporting to limit which payments made by an underlying insurer will count toward exhaustion of the underlying limits. For example, some excess policies have provisions stating that the underlying limits must exhaust in payment of claims that would also be covered by the excess policy. Other excess policies contain provisions that may allow an excess insurer to challenge whether a payment made by the primary insurer was actually within the coverage provided by the primary policy such that it counts against the limits of that primary policy.

Again, policyholders should generally try to avoid excess policies with these types of exhaustion restrictions. But keep in mind that they can be difficult to spot. Provisions that may allow an excess carrier to challenge whether the underlying limits were “properly” exhausted are not always obvious and can appear in a variety of places in excess policy forms, including, the insuring agreement, limits of liability provisions, definitions, conditions, and other provisions.

5. Don’t assume a duty to defend

Not all excess policies contain a duty to defend provision. And while most excess policies do include defense expenses as a component of the loss or damage the excess insurer will pay if the underlying claim is covered, a court may not view a duty to pay or reimburse defense expenses as being the same as a duty to defend. In most jurisdictions, the duty to defend is recognized as being broader than the duty to indemnify and requires the insurer to defend the policyholder against any claims that are even arguably or potentially within the scope of coverage. In some jurisdictions the duty to defend may also carry accompanying fiduciary obligations or heightened obligations of good faith on the part of the insurer. But, depending on the jurisdiction and the particular language of the policy at issue, the broad coverage and/or the additional protections that are associated with a contractual duty to defend may not apply to an excess insurer’s agreement to pay or reimburse defense costs.

Policyholders who want their excess insurers to continue to defend them against potentially covered claims – which is of particular a concern where defense expenses count against the primary policy’s limits – would be wise to confirm that their excess policy forms specifically impose a duty to defend on the excess insurer. The fundamental purpose of excess insurance is to provide a solid and seamless tower of coverage to protect the policyholder in the event of a catastrophic loss or liability. When faced with bet-the-company claims, policyholders want a coverage tower that is the insurance equivalent of the Tower of London, not a coverage tower that resembles the aftermath of a Jenga game.

To that end, and especially given the proclivity of modern excess insurers to include restrictive provisions in their policies, policyholders and their advisors would be wise to look beyond the declaration pages of their excess policies and examine the excess coverage forms for potential coverage differences and gaps. Even if the ideal of unqualified, follow form excess coverage may now be the exception rather than the rule, with care and diligence, policyholders can still construct a solid coverage tower to provide a safe-haven against catastrophic loss or liability.