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Recommended Citation

John F. O'Connor, *Insurance Coverage Settlements and the Rights of Excess Insurers*, 62 Md. L. Rev. 30 (2003)

Available at: <http://digitalcommons.law.umaryland.edu/mlr/vol62/iss1/5>

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INSURANCE COVERAGE SETTLEMENTS AND THE RIGHTS OF EXCESS INSURERS

JOHN F. O'CONNOR*

INTRODUCTION

Several years ago, professional football coach Bill Parcells famously complained about his job situation in the following way: "A friend told me if you're going to cook the meal, they ought to let you shop for the groceries."¹ Parcells meant that he was burdened with high expectations to make his football team successful, and it was unfair to place his fate as a coach largely in the hands of some general manager who had the authority to shop for the players that Parcells would be required to coach.

In the slightly less violent world of complex insurance coverage litigation, we often see policyholders attempting to do exactly the same thing to their excess liability insurers.² Policyholders frequently argue that an excess insurer's coverage obligations actually can *increase* as a result of the policyholder's voluntary decision to settle its coverage disputes with primary or lower-level excess insurers, even though the excess insurer has no role in these settlements.³ The policyholder in effect argues that the nonsettling excess insurer's fate is in the hands of third parties, who have absolutely no incentive to represent the excess insurer's interests in settlement negotiations.⁴ In response, excess insurers frequently argue that the risk of a bad settle-

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1. Ara Najarian, *Parcells Would Rather Coach No One in '97: He Chooses Not To Renew Contract with Patriots*, L.A. TIMES, Feb. 1, 1997, at C1, available at 1997 WL 2178387.

2. See, e.g., *Chem. Leaman Tank Lines, Inc. v. Aetna Cas. & Sur. Co.*, 177 F.3d 210, 228 (3d Cir. 1999) (describing the public policy argument against allowing a policyholder to recover more from all its insurers than its actual loss).

3. See, e.g., *Koppers Co. v. Aetna Cas. & Sur. Co.*, 98 F.3d 1440, 1443 (3d Cir. 1996) (describing the trial court's ruling that excess insurers are liable for the full amount of a claim without accounting for the plaintiff's pre-trial settlements with other liability insurers).

4. See Michael M. Marick, *Excess Insurance: An Overview of General Principles and Current Issues*, 24 TORT & INS. L.J. 715, 749 (1989) (noting that "the primary carrier may not in its claims handling adequately protect the excess insurer's interests").

ment between a policyholder and its underlying insurers should stay with the parties to the settlement agreement and not be foisted upon the excess insurer.⁵ An understanding of this issue requires a brief primer on the nature of general liability insurance.

General liability insurance typically is issued to a policyholder in a series of layers, by a series of different insurers.⁶ A Fortune 500 company might have twenty or more general liability policies in effect for a given year, providing hundreds of millions of dollars of coverage.⁷ For a given policy period, the policyholder's policies will apply in a serial order to claims triggering coverage for that policy period.⁸ The first policy to respond is the policyholder's primary policy.⁹ After the primary policy has paid its limit(s), the excess policies apply to covered claims in a predetermined order.¹⁰ Usually, excess policies are written to apply "excess" to the coverage provided by the primary policy and any underlying excess policies.¹¹ Disputes often arise, how-

5. See *id.* at 735-36 (discussing settlements for less than the primary or underlying policy limits and selected court decisions supporting the position of excess insurers); Scott M. Seaman & Charlene Kittredge, *Excess Liability Insurance: Law and Litigation*, 32 TORT & INS. L.J. 653, 703 (1997) (asserting that "the excess insurer may seek to hold the primary insurer liable for the excess verdict").

6. BARRY R. OSTRAGER & THOMAS R. NEWMAN, HANDBOOK ON INSURANCE COVERAGE DISPUTES § 6.03[a], at 293 (10th ed. 2000); see also Kenneth S. Abraham, *The Maze of Mega-Coverage Litigation*, 97 COLUM. L. REV. 2102, 2106 (1997) (explaining that "[Commercial General Liability] policyholders typically were (and are today) covered by both primary and multiple 'layers' of excess liability insurance each year"). See generally Marick, *supra* note 4, at 716-19 (describing the practice of purchasing multiple layers of liability insurance and addressing the difference between "primary insurance," "self-insurance," and "excess insurance").

7. KENNETH S. ABRAHAM, ENVIRONMENTAL LIABILITY INSURANCE LAW 223 (1991) (explaining that many of America's largest companies have excess insurance policies that provide liability insurance worth several hundred million dollars).

8. Marick, *supra* note 4, at 731 (stating that an excess insurer's duty to indemnify typically attaches only when an insured generates liability in excess of any underlying policies).

9. See OSTRAGER & NEWMAN, *supra* note 6, § 6.03[a], at 292 (explaining that "[p]rimary insurance is coverage that attached immediately upon the happening of an occurrence that is covered under the terms of the policy"); Marick, *supra* note 4, at 716 (describing coverage under a primary insurance policy "as coverage 'whereby, under the terms of the policy, liability attaches immediately upon the happening of the occurrence that gives rise to liability'" (quoting *Whitehead v. Fleet Towing Co.*, 442 N.E.2d 1362, 1366 (Ill. App. Ct. 1982))).

10. Marick, *supra* note 4, at 717.

11. OSTRAGER & NEWMAN, *supra* note 6, § 13.01[a], at 767 (stating that "excess insurers frequently agree to provide coverage to an insured in excess of agreed types and amounts of underlying insurance, without having seen . . . the underlying policies or, in many cases, without even knowing the name of the underlying insur[er], leaving such matters 'to be advised'").

ever, as to when one insurer's coverage obligation ends and another insurer's coverage obligation begins.¹²

In some cases, determining when an excess insurance policy applies is simple. If a court finds, or the parties all agree, that the underlying policies must pay the policyholder's first \$5 million of liability, and that they are then exhausted, a policy applying excess of the underlying policies has a duty to pay once the policyholder's covered liability exceeds \$5 million. In complex insurance coverage litigation, however, the facts and the law are almost never so clear. General liability policies typically are written with an "aggregate limit," which states the total amount the insurer will pay for certain types of claims, no matter how many claims are asserted against the policyholder.¹³ However, such policies often are written so that the aggregate limits apply only to certain hazards, with the aggregate limit not applying to other types of claims covered by the policy.¹⁴ As a result, the parties frequently dispute whether the policies' aggregate limits apply to the particular types of claims for which the policyholder seeks coverage.¹⁵ A primary insurer or lower-level excess insurer might argue that its available limits of liability have exhausted, meaning that responsibility for the claims at issue rests with either a higher-level insurer or (if there is no higher-level insurer) with the policyholder itself.¹⁶ Conversely, excess insurers often argue that they have no coverage obligation because the underlying coverage is not exhausted, meaning that

12. Thomas M. Bower, *Partial Settlements By Primary Insurers: The Law*, 29 TORT & INS. L.J. 536, 536 (1994).

13. See Ronald E. Mallen & David W. Evans, *Surviving the Directors' and Officers' Liability Crisis: Insurance and the Alternatives*, 12 DEL. J. CORP. L. 439, 449 (1987) (explaining that "the aggregate limit is usually defined as the total limits available for all claims [out of the same type of occurrence] made within the policy year").

14. For example, one commonly used provision in post-1973 general liability policies provides as follows: "[T]he total liability of the company for all damages because of (1) all bodily injury included within the completed operations hazard and (2) all bodily injury liability included within the products hazard shall not exceed the limit of bodily injury liability insurance stated in the [declarations] as 'aggregate.'" ABRAHAM, *supra* note 7, at 292 (reproducing a 1973 comprehensive general liability insurance policy form originally produced by Insurance Services Offices, Inc.) (footnote omitted).

15. See, e.g., *Brazas Sporting Arms, Inc. v. Am. Empire Surplus Lines Ins. Co.*, 220 F.3d 1, 6 (1st Cir. 2000) (resolving a dispute about the applicability of policy aggregate limits by holding that such limits applied to gun liability suits against the policyholder).

16. See, e.g., *Fibreboard Corp. v. Hartford Accident & Indem. Co.*, 20 Cal. Rptr. 2d 376, 380 (Cal. Ct. App. 1993) (affirming the trial court's ruling that the insurer had no further coverage obligations for the policyholder's asbestos liabilities because the insurer had exhausted the limits of all coverage available under the policies at issue).

responsibility for the claims rests with the lower-level insurer whose coverage has not yet exhausted.¹⁷

The analysis of which an insurer within a given policy period, if any, has a responsibility to respond to claims against the policyholder often is further complicated by the policyholder's settlement with, and release of, some of its insurers.¹⁸ For example, imagine the situation where a primary insurer and its policyholder dispute whether an exclusion bars coverage for a series of claims tendered by the policyholder. If the exclusion applies, the primary insurer pays nothing. If the exclusion does not apply, the primary insurer is liable for its full \$5 million policy limit. In such a situation, the parties might settle for \$3 million in recognition that the dispute over the exclusion might go either way in court. One thing is certain: the settling insurer's actual policy obligation does not equal the \$3 million settlement payment; it is either zero or it is \$5 million. What effect does such a settlement have on the obligations of an insurer that provided coverage "excess" to the settled primary policy?¹⁹ Must the excess insurer pay the amount of the policyholder's liability exceeding \$3 million?²⁰ Does the court determine the excess insurer's obligation by determining whether the primary insurer's settlement was reasonable?²¹ Or is the excess insurer entitled to a judicial determination of what the primary insurer's liability would have been in the absence of a settlement, with the excess insurer liable only to the extent that the policyholder's covered liability exceeds that judicially-determined amount?

Although these issues arise in practically every complex insurance coverage dispute,²² there are remarkably few decisions addressing the manner in which the settlement of underlying policies affects the obli-

17. See, e.g., *Allstate Ins. Co. v. Dana Corp.*, 759 N.E.2d 1049, 1063 (Ind. 2001) (recognizing that the excess insurer has no obligation if the coverage available under an underlying policy is not exhausted); see also *Seaman & Kittredge*, *supra* note 5, at 672 (stating that "excess insurance contracts do not respond to losses unless and until there has been full and proper exhaustion of primary insurance, SIRs, and underlying excess insurance").

18. See *Bower*, *supra* note 12, at 537 (stating that issues occur "when a primary insurer settles part of a claim by paying less than its full policy").

19. See *id.* (asking whether a "partial settlement constitute[s] 'exhaustion' of the primary limit sufficient to trigger the excess carrier's policy").

20. *Id.*

21. *Id.* at 538 (noting that many cases deal with "whether a partial settlement of a claim for less than the primary carrier's limit may constitute 'exhaustion' of that limit, at least for the purpose of triggering an excess insurer's indemnity obligation").

22. See *Seaman & Kittredge*, *supra* note 5, at 673-74 (discussing the multitude of issues that arise in determining how to allocate the insured's liability among the triggered policies).

gations of excess insurers.²³ In addition, there is little scholarly treatment of this subject.²⁴ This Article will analyze the manner in which courts have dealt, and should deal, with the thorny issues that arise when a policyholder settles with some of its liability insurers and then seeks additional coverage from insurers whose policies apply excess of the settled coverage. In particular, this Article will focus on situations where one or more excess insurers contends that an underlying insurer settled for less than its actual policy limits, and how courts have determined who must cover the gap in coverage between what an underlying insurer actually owed under its policy and the amount it paid in settlement.²⁵ Finally, this Article will explain why most courts correctly have held that a policyholder must fill any gap in coverage caused by its below-limits settlements, thereby precluding a policyholder and its lower-level insurers from adversely affecting a nonsettling excess insurer's coverage obligations through their own settlement.²⁶

23. Cf. Marick, *supra* note 4, at 750 (noting that “[a]lthough there once was a relative dearth of case law addressing the role of the excess insurer in litigation against the insured, principles of law have begun to develop”).

24. See Abraham, *supra* note 6, at 2102 (explaining that litigation between policyholders and insurers receives less scholarly attention than the claim against the policyholder that generated the initial liability).

25. A similar situation arises where a settling insurer arguably paid more than its actual policy limits in settling a coverage dispute with its policyholder. In that situation, the issue is whether the excess insurers are required to pay amounts over the settled carrier's actual policy limits, or only amounts in excess of the settled carrier's settlement payment. The issue of an above-limits settlement has its own set of unique public policy concerns, not the least of which is whether a policyholder can be permitted, in essence, to make a profit through its commission of torts by successfully negotiating above-limits settlements with some of its liability insurers. See *Chem. Leaman Tank Lines v. Aetna Cas. & Sur. Co.*, 177 F.3d 210, 228-29 (3d Cir. 1999); *Koppers Co. v. Aetna Cas. & Sur. Co.*, 98 F.3d 1440, 1452 (3d Cir. 1996); *United Techs. Corp. v. Am. Home Assurance Co.*, 118 F. Supp. 2d 190, 200 (D. Conn. 2000); *Gerrish Corp. v. Aetna Cas. & Sur. Co.*, 949 F. Supp. 236, 242 (D. Vt. 1996) (recognizing that public policy concerns are appropriately met when a policyholder is not permitted to reap a double recovery whereby it recovers more from its insurers than the amount of the loss it has suffered). Because below-limits settlements are more often the issue in complex insurance coverage litigation, and because above-limits settlements implicate a separate set of public policy concerns, the proper treatment of above-limits settlements is beyond the scope of this Article.

26. A similar issue can arise in those jurisdictions where consecutive insurers are held jointly and severally liable for indivisible bodily injury or property damage claims taking place over multiple policy periods. For example, if indivisible environmental contamination takes place continuously from 1960 to 1980, some jurisdictions have held that such a loss renders each triggered insurer jointly and severally liable for the entire loss. The policyholder selects an insurer to pay the entire loss, subject to the selected insurer's policy limits, with the selected insurer permitted to seek contribution from the other triggered insurers. See, e.g., *Keene Corp. v. Ins. Co. of N. Am.*, 667 F.2d 1034, 1047-50 (D.C. Cir. 1981) (holding that each insurer of a policyholder that caused an indivisible loss is jointly and severally responsible for covering that loss). In such a situation, the policyholder

Part I of this Article will explore the factual backdrop against which a policyholder's below-limits settlement with one or more of its insurers takes place. Essentially, it is a function of the structure of the general liability insurance program typical of any large manufacturer, contractor, or other business, with multiple policies issued by multiple insurers in every policy period.²⁷ When coverage defenses and disputes about the applicability of policy limits are added to the mix, a policyholder may reasonably determine that it makes good business sense to settle its coverage claims against some of its insurers, while continuing to pursue coverage from its remaining insurers. As in any compromise, such settlements frequently require the policyholder to accept less in settlement than it might have obtained had it prevailed at trial.²⁸ When the policyholder decides to settle with some, but not all, of its insurers, the proper treatment of such settlements as it relates to the nonsettling insurers is a necessary issue that must be resolved by the court.

Part II of this Article will address the relatively commonplace situation where a policyholder settles with an insurer for an amount that is less than the insurer's actual policy obligations. For the most part, courts correctly have held that a policyholder settling a policy for less than its actual limits is liable for any gap in coverage between the settled policy limits and the amount received from the settled carrier.²⁹ Policyholders sometimes argue, however, that such a rule should not apply in so-called "modern" coverage litigation, where a policyholder settling its disputes with some of its insurers might have difficulty de-

might settle with the carriers on the risk from 1960 to 1970, while continuing to seek coverage from the carriers on the risk from 1971 to 1980. Courts generally have held that where the policyholder has settled with and released insurers that were jointly and severally liable with the nonsettling insurers, the amount that the policyholder may recover from the nonsettling insurers must be offset by the settling insurers' equitable share of the loss. *See, e.g., Gould, Inc. v. Cont'l Cas. Co.*, 585 A.2d 16, 19 (Pa. Super. Ct. 1991). While this Article is concerned with the effect, if any, that settlements by underlying insurers have on the obligations of excess insurers issuing policies for the same policy period, and the apportioned share set-off rule discussed in *Gould* and other cases concerns settlements by jointly and severally liable insurers, the rationales underlying the majority rule in both situations are the same. In either situation, courts generally have held that one insurer's settlement cannot increase the ultimate coverage obligations of a nonsettling insurer, and that the policyholder must pay any gaps in coverage caused by its below-limits settlement of triggered policies. *Id.* By placing the risk of a below-limits settlement on the policyholder, courts allow settling insurers to obtain the finality for which they bargained, while preventing the policyholder's decision to settle with certain of its insurers from negatively affecting the coverage obligations of nonsettling insurers.

27. Marick, *supra* note 4, at 715.

28. *See id.* at 735 (discussing the practice of entering into settlements for less than primary policy limits).

29. *See, e.g., Koppers*, 98 F.3d at 1454.

termining at the time of settlement whether it is settling for less than the actual limits of the settling insurers' policies.³⁰ This argument notwithstanding, courts have more or less uniformly applied the same rule in "modern" coverage cases that they have applied for decades, ruling that a policyholder's settlement with an underlying insurer cannot negatively affect the obligations of a nonsettling excess insurer.³¹

While Part II demonstrates that courts have not required nonsettling excess insurers to fill gaps in coverage caused by the policyholder's below-limits settlements, Part III analyzes the factual underpinnings of this rule and explains why this rule makes sense. As Part III demonstrates, a rule requiring an excess insurer to fill gaps in coverage caused by underlying insurers' below-limits settlements in effect transfers obligations from the policyholder and the settling insurers to the nonsettling excess insurer.³² By requiring a policyholder to fill any gaps in coverage caused by its below-limits settlements with underlying insurers, courts sensibly have allocated the risk of the policyholder's settlement to the policyholder instead of to an excess insurer that is a stranger to the underlying settlement agreements.

I. THE FACTUAL UNDERPINNINGS OF A BELOW-LIMITS SETTLEMENT

A. *The Structure of the Typical General Liability Insurance Program*

The business of general liability insurance is predicated on the notion of spreading risks.³³ One of the reasons why businesses purchase general liability insurance is to exchange the unknown risk of future legal liabilities for the fixed, known cost of an annual insurance premium.³⁴ For example, a company that knows there is a one percent chance of having a catastrophic, business-threatening loss during a year has an economic incentive to pay an annual liability insurance premium instead of rolling the dice that it will not have such a loss, knowing that a catastrophic uninsured loss might threaten its ability to remain in business.³⁵

30. See Seaman & Kittredge, *supra* note 5, at 707 (stating that it is "increasingly difficult to evaluate claims promptly" and that there is "difficulty in evaluating the value of the underlying claims").

31. *E.g.*, *Gould*, 585 A.2d at 19.

32. *Zeig v. Mass. Bonding & Ins. Co.*, 23 F.2d 665, 666 (2d Cir. 1928).

33. ABRAHAM, *supra* note 7, at 15.

34. See *id.* (noting that businesses "prefer to pay an insurance premium in order to transfer to a third-party the risk of suffering a large loss, even when the actuarial value of that loss (the probability that the loss will occur multiplied by its expected magnitude if it occurs) is smaller than the premium").

35. See *id.*

Insurance companies similarly are in the business of spreading the risks they insure. While an insurance company might issue billions of dollars in coverage each year, that coverage will be spread among many different policyholders. The economic rationale for such a practice is that by spreading its exposure among many different policyholders, the insurance company avoids the risk that a single catastrophic loss by one of its policyholders will render the insurer insolvent.³⁶ Thus, an insurance company will spread its risk by issuing coverage in relatively small amounts to a large number of policyholders.³⁷ Such a business model also benefits policyholders for the simple reason that it helps avoid a situation in which an insurer becomes insolvent and is unable to pay claims submitted by its other policyholders.³⁸

While insurance companies avoid the risk of a catastrophic loss by issuing policies with moderate limits of liability, large businesses still have a need for large amounts of insurance coverage each year.³⁹ For example, a large manufacturer might purchase liability insurance extending into the hundreds of millions of dollars in policy limits each year.⁴⁰ In order to obtain such high limits of annual liability insurance, businesses typically purchase general liability insurance in layers. For each year, the policyholder will purchase a primary policy, which usually has a reasonably low limit of liability (usually no more than a few million dollars in policy limits).⁴¹ The primary policy pays covered claims until its limits of liability are exhausted, with the policy-

36. See JOHN F. DOBBYN, *INSURANCE LAW IN A NUTSHELL* 4 (1981) (stating that the law of averages helps to minimize the risk to the insurer when a large number of policies are involved).

37. See ABRAHAM, *supra* note 7, at 15 (explaining that “[t]he insurer makes a profit by pooling a large number of such risks and suffering an average loss per insured of only \$100”).

38. Insurers further spread the risk by reinsuring the policies they issue to many different insurers, thereby spreading the financial consequences of a covered loss among many insurers. See *id.* at 223. Reinsurance occurs when a primary or excess insurer transfers some or all of the risk in a policy to another insurer. *Id.*

39. See ABRAHAM, *supra* note 7, at 15 (noting that many large corporations, or their creditors, are risk-averse, and thus purchase insurance “against catastrophically large losses resulting from utterly unexpected events or radical legal change that could bankrupt or severely impede the functioning of the corporation”).

40. *Id.* at 223 (noting that large companies often purchase hundreds of millions of dollars in general liability insurance each year).

41. See *id.* (explaining that the first “layer” of large business insurance coverage is a primary insurance policy); Seaman & Kittredge, *supra* note 5, at 655 (describing the obligations of the primary or underlying insurer with respect to liability coverage and defense obligation).

holder possibly being liable for a deductible or self-insured retention.⁴²

In addition to purchasing primary insurance, businesses that desire more coverage than the limits typically available under primary policies must purchase excess insurance.⁴³ Excess insurance is issued in layers corresponding to the policy's attachment point.⁴⁴ In the usual coverage profile, the lowest-level excess insurer agrees to pay the first dollar of claims for which the primary policy is exhausted,⁴⁵ and to keep paying claims until its own limits of liability are exhausted.⁴⁶ Like primary policies, however, an excess insurer's obligations might be subject to a deductible or self-insured retention, by which the policyholder remains liable to pay a portion of each claim or occurrence, or to pay a fixed dollar amount, before the excess insurer's obligations begin.⁴⁷ At that point, the next lowest-layer excess policy begins paying claims for which the primary policy and lowest-layer excess policy are exhausted, and pays until *its* policy limits are exhausted.⁴⁸ This sequential march up the coverage chart continues until either the policyholder runs out of covered claims or the policyholder runs out of insurance coverage for its claims.⁴⁹

42. Marick, *supra* note 4, at 716.

43. *Id.* at 717 (stating, "excess insurance is the next 'layer' or 'level' of coverage above the primary policy or the insured's self-insured retention").

44. See Seaman & Kittredge, *supra* note 5, at 656 (describing the role of the excess insurer and stating that excess insurers generally indemnify the policyholder for sums in excess of underlying coverage and the excess insurer's liability is most often, by contract, to be fixed by a judgment or settlement agreement).

45. Marick, *supra* note 4, at 717.

46. ABRAHAM, *supra* note 7, at 225.

47. See *id.* at 16 (stating that many large corporations purchase policies with high deductibles); Marick, *supra* note 4, at 717 (explaining that self-insurance essentially performs the same function as a deductible).

48. See, e.g., *Koppers Co. v. Aetna Cas. & Sur. Co.*, 98 F.3d 1440, 1454 (3d Cir. 1996) (observing that "a true excess or secondary policy is not 'triggered' or required to pay until the underlying primary coverage has been exhausted"). See also Marick, *supra* note 4, at 731 (explaining that "[b]y definition, excess insurers generally are liable only for the amount of loss or damage in excess of underlying coverage"). Of course, liability insurance is a matter of private contract, and the parties are free to structure excess coverage so that it is triggered when the policyholder's liability exceeds an agreed-upon dollar level, without tying coverage to the exhaustion of the underlying coverage. See *id.* at 717 (noting the contractual nature of insurance policies). The disadvantage to such an approach is that it can leave gaps in coverage if the excess insurance is triggered at an attachment point greater than the limits of the underlying coverage. See, e.g., *Soc'y of the Roman Catholic Church of the Diocese of Lafayette, Inc. v. Interstate Fire & Cas. Co.*, 126 F.3d 727, 732 (5th Cir. 1997) (explaining that a gap in coverage existed because the excess coverage was not written to apply upon exhaustion of the policyholder's underlying coverage).

49. Seaman & Kittredge, *supra* note 5, at 656.

Thus, the insurance coverage profile of even a moderately-sized business looks something like a grid or a stack of blocks. In any given year, the policyholder will have a primary insurance policy or self-insured retention, with excess insurance policies providing coverage once the primary policy or self-insured retention is exhausted.⁵⁰ To the left and the right, the policyholder will have a similar succession of primary and excess insurance policies covering other policy years.⁵¹ Indeed, in order to avoid gaps in coverage caused by differences in policy language, many excess insurance policies are “following form” policies,⁵² whereby the insurer, subject to certain limitations, agrees to provide the same coverage as an underlying policy issued for the same policy period.⁵³ Following form policies can be exceedingly short (sometimes just a page or two) because the actual terms, conditions, and exclusions governing coverage under the policy are previously set out in the underlying policy.⁵⁴

One important aspect of excess insurance is the *attachment point*. The attachment point is the amount in covered claims that must be paid by underlying primary and excess insurers before the insurer’s obligation to pay arises.⁵⁵ For example, a policy that is excess of a \$2 million primary policy and a \$5 million lower-level excess policy has an attachment point of \$7 million for claims to which the policy limits of the underlying policies apply. The attachment point not only establishes which insurer has a duty to pay a covered claim, but also

50. See ABRAHAM, *supra* note 7, at 223-24 (discussing the multi-layered nature of business insurance).

51. *Id.*

52. Frequently, excess insurers agree to provide an insured with an excess policy that “follows form” or mirrors the language of the underlying policy. ABRAHAM, *supra* note 7, at 225; OSTRAGER & NEWMAN, *supra* note 6, § 13.01; Marick, *supra* note 4, at 718. Sometimes excess insurance happens “by coincidence” when several primary policies apply to the same liability. Seaman & Kittredge, *supra* note 5, at 657 (citing Rhone-Poulenc, Inc. v. Int’l Ins. Co., 71 F.3d 1299 (7th Cir. 1995)).

53. A typical “following form” excess insurance clause may read:

The provisions of the immediate underlying policy are incorporated as part of this policy except for any obligation to investigate and defend and pay for costs and expenses incident to any of the same, the amounts of the limits of liability, any “other insurance” provision and any other provisions therein which are inconsistent with this policy.

Marick, *supra* note 4, at 718.

54. See ABRAHAM, *supra* note 7, at 225 (explaining that “[m]any excess policies . . . simply state that their terms are identical to those in the underlying primary policy, with the exception of their limits of liability”).

55. See Household Int’l, Inc. v. Liberty Mut. Ins. Co., 749 N.E.2d 1, 12 (Ill. App. Ct. 2001) (illustrating that “an excess policy with an ‘attachment point’ of \$51 million in excess of underlying coverage will not be implicated until the insured has exhausted \$51 million in lower-level coverage”).

greatly affects policy premiums.⁵⁶ A \$1 million policy that is excess to \$25 million in limits will be significantly cheaper than a \$1 million policy, covering the same perils, that is excess of only \$5 million.⁵⁷ One of the reasons why the higher-layer policy is less expensive per dollar of coverage provided, than the lower-layer policy is that there is a reasonable possibility that the policy excess of \$5 million will be triggered to pay claims while the higher-level policy pays nothing.⁵⁸ For example, if a policyholder suffers \$10 million in covered liabilities, and all of the liabilities are subject to the policy limits, the policy excess of \$5 million must pay its entire \$1 million policy limit, but the policy excess of \$25 million is never touched.

As stated above, the multiple insurance policies in effect for a given year respond to covered claims in an explicit, sequential order. Once the primary policy exhausts its applicable policy limit(s) for a covered claim or type of covered claim, the first-layer excess policy, or “umbrella” policy,⁵⁹ must respond.⁶⁰ Once the umbrella policy has exhausted *its* applicable policy limits, the next lowest excess policy responds, and so on. The difficulty in complex insurance coverage litigation often is determining *which* limit(s) apply to the claims.⁶¹ The typical general liability policy has two types of policy limits, a *per occurrence limit*⁶² and an *aggregate limit*.⁶³ The per occurrence limit establishes how much the insurer will pay for all claims arising out of a

56. See Thomas M. Bower, *Some Unforeseen Issues Arising from the Mid-Term Cancellation of an Excess Policy*, MEALEY'S LITIG. REP.: INS., Sept. 6, 2000, at 21 (noting that higher “layer” excess policies result in lower premium rates per dollar of coverage).

57. See *id.* Bower notes:

Barring some legal catastrophe . . . an upper excess layer insurer may never even have to open a claim file, even if the primary and lower excess layers defend and pay numerous claims. This difference in the risk confronted by successive layers of insurance is normally reflected in the relative cost of each policy: the higher one goes in the layering, the lower the premium rate per dollar of coverage.

Id.

58. Marick, *supra* note 4, at 715.

59. Umbrella policies usually provide two types of coverage: following form excess coverage and coverage that complements the primary policy by providing broader protection than the primary policy. *Id.* at 718.

60. See Seaman & Kittredge, *supra* note 5, at 672 (explaining that “excess insurance contracts do not respond to losses unless and until there has been full and proper exhaustion of primary insurance, SIRs, and underlying excess insurance”).

61. Abraham, *supra* note 6, at 2106.

62. See OSTRAGER & NEWMAN, *supra* note 6, § 9.02, at 485 (providing that “there is one set of per-occurrence policy limits available for damages during a policy year arising out of each occurrence”); Seaman & Kittredge, *supra* note 5, at 673 (stating that “[m]ost occurrence-based contracts provide coverage for personal injury, bodily injury, and/or property damage that takes place during the policy period”).

63. See *supra* note 13 (defining “aggregate limit”).

single occurrence. "Occurrence" typically is a defined term in general liability policies, and often is defined in terms similar to the following: "[A]n accident, including injurious exposure to conditions, which results, during the policy period, in bodily injury or property damage neither expected nor intended from the standpoint of the policyholder."⁶⁴

While this concept seems simple enough in theory, the case reporters contain innumerable decisions in which courts were required to resolve disputes as to the number of occurrences involved in a series of claims against a policyholder. Take, for example, the case of an asbestos manufacturer sued for causing thousands of claimants to suffer asbestos-related diseases as a result of exposure to the manufacturer's products. Some courts have held that all of the underlying asbestos claims arise out of a single occurrence—the policyholder's decision to become involved with asbestos-containing products⁶⁵—while other courts have held that the relevant occurrence is each claimant's exposure to the policyholder's asbestos-containing products.⁶⁶ Thus, the number of occurrences involved in asbestos-related claims against a single policyholder might range from a finding of one occurrence to a finding that the claims arise out of tens of thousands of occurrences.⁶⁷

64. Rebecca M. Bratspies, *Splitting the Baby: Apportioning Environmental Liability Among Triggered Insurance Policies*, 1999 BYU L. REV. 1215, 1222 (quoting John J. Tarpey, *The New Comprehensive Policy: Some of the Changes*, 33 L. COUNS. J. 223, 234 (1966)).

65. *Int'l Surplus Lines Ins. Co. v. Certain Underwriters & Underwriting Syndicates*, 868 F. Supp. 917, 922 (S.D. Ohio 1994); *Unigard Sec. Ins. Co. v. N. River Ins. Co.*, 762 F. Supp. 566, 595 (S.D.N.Y. 1991), *rev'd on other grounds*, 4 F.3d 1049 (2d Cir. 1993); *Colt Indus., Inc. v. Aetna Cas. & Sur. Co.*, No. 87-4107, 1989 WL 147615, at *6 (E.D. Pa. Dec. 6, 1989); *Air Prods. & Chems., Inc. v. Hartford Accident & Indem. Co.*, 707 F. Supp. 762, 773 (E.D. Pa. 1989), *vacated in part on other grounds*, 25 F.3d 177 (3d Cir. 1994); *Owens-Illinois, Inc. v. Aetna Cas. & Sur. Co.*, 597 F. Supp. 1515, 1527 (D.D.C. 1984); *Owens-Illinois, Inc. v. United Ins. Co.*, 625 A.2d 1, 23 (N.J. Super. Ct. App. Div. 1993), *rev'd in part on other grounds*, 650 A.2d 974 (N.J. 1994); *Morton Thiokol, Inc. v. Aetna Cas. & Sur. Co.*, No. A-8603799, slip op. at 1 (Ohio Ct. Comm. Pleas Dec. 28, 1988) (copy on file with author), *rev'd on other grounds per curiam*, No. C-900283, 1991 WL 201651 (Ohio Ct. App. Oct. 2, 1991).

66. *Dicola v. Am. S.S. Owners Mut. Prot. & Indem. Ass'n (In re Prudential Lines, Inc.)*, 158 F.3d 65, 81 (2d Cir. 1998); *Babcock & Wilcox Co. v. Arkwright-Boston Mfg. Mut. Ins. Co.*, 53 F.3d 762, 767-68 (6th Cir. 1995); *Pittsburgh Corning Corp. v. Travelers Indem. Co.*, No. 84-3985, 1988 WL 5302, at *2 (E.D. Pa. Jan. 21, 1988); *Metro. Life Ins. Co. v. Aetna Cas. & Sur. Co.*, 765 A.2d 891, 896 (Conn. 2001); *Commercial Union Ins. Co. v. Porter Hayden Co.*, 698 A.2d 1167, 1211 (Md. Ct. Spec. App. 1997).

67. See *Seaman & Kittredge*, *supra* note 5, at 694 (discussing courts' divergent views as to whether claims arise out of a single or multiple occurrence in the context of asbestos-related claims).

In addition to a per occurrence policy limit, most general liability policies also have an aggregate limit of coverage.⁶⁸ Aggregate limits typically apply to cap the insurer's obligations for certain types of claims no matter how many occurrences are involved.⁶⁹ Thus, a policyholder could face ten thousand claims, arising out of ten thousand separate occurrences, and the insurer's exposure still will be limited to the policy aggregate so long as that aggregate limit applies to the category of claims involved. Disputes over the interplay, and applicability, of per occurrence limits and aggregate limits can lead a policyholder and its insurer to have widely divergent views as to the amount of coverage available under the policy.⁷⁰ When a policyholder and its insurer have such divergent views as to the total amount of coverage available, any subsequent settlement of the parties' coverage disputes likely will involve a settlement payment somewhere between the parties' litigation positions and can be significantly less than or significantly more than the policy obligations that would be adjudged if the dispute were resolved by a court.

B. *How Below-Limits Settlements Occur*

Why would a policyholder ever settle a claim against one of its insurers for less than the insurer's actual policy obligations? While such a course of action seems foolish at first blush, there are many reasons why a policyholder might rationally settle with and release an insurer for less than the amount the policyholder would have recovered had the dispute proceeded to a litigated result.

1. *Disputes Over the Existence of Coverage.*—Fundamentally, a policyholder and its insurer might dispute whether a particular claim is

68. See *Unigard Sec. Ins. Co.*, 762 F. Supp. at 595 (asserting that "[t]he purpose of having an aggregate limit in addition to an occurrence limit is to cap the indemnity payments made in a given policy period regardless of the number of occurrences").

69. *Id.*

70. For example, in *Fibreboard Corp. v. Hartford Accident & Indemnity Co.*, the policyholder contended that the \$1 million aggregate limits contained in primary policies issued by Hartford in 1978 and 1979 did not apply to asbestos-related claims against Fibreboard, and that Fibreboard was therefore entitled to perpetual coverage subject only to the policies' per occurrence limits. 20 Cal. Rptr. 2d 376, 380 (Cal. Ct. App. 1993). By contrast, Hartford contended that the aggregate limits of its policies applied to all asbestos-related claims, thereby limiting Hartford's duty to indemnify Fibreboard to a total of \$2 million for asbestos-related bodily injury and property damage claims. *Id.* at 379. The California Court of Appeals ultimately agreed with Hartford's interpretation, holding that the asbestos-related claims against Fibreboard were "products hazard" claims and therefore subject to the policies' aggregate limits for products hazard claims. *Id.* at 380.

even covered under the insurer's policy.⁷¹ In such a case, policyholders and their insurers frequently settle for an amount somewhere between the possible litigated results.⁷² For example, a policyholder might seek coverage for a series of claims arising out of alleged bodily injuries or property damage caused by the policyholder's use of lead paint in its contracting work a half-century ago, with the policyholder's overall liabilities for these claims exceeding the \$1 million limits of the primary policy. The primary insurer, however, might argue that lead is a pollutant or irritant, and that the claims are therefore excluded from coverage by the policy's pollution exclusion.⁷³ In such a case, the two possible litigated insurance coverage results are that the insurer is liable for either zero or \$1 million, but the parties might assess their likelihood of prevailing at trial and settle for \$500,000. When such a settlement takes place, the settlement is *necessarily* for more or less than the primary insurer's actual liability, creating an issue as to how the primary policy settlement should affect the policy obligations of any excess insurers during that same policy period.

2. *Disputes Over the Application of Policy Limits.*—A second reason why a policyholder might end up settling its coverage claim for less than the settling insurer's actual policy obligations arises out of the interplay between the per occurrence limits and the aggregate limits of the insurer's policy.⁷⁴ While some policies are written such that the policy's aggregate limit applies to all covered claims, many general liability policies are written such that the aggregate limit applies only

71. See Seaman & Kittredge, *supra* note 5, at 708, 711-12 (examining different coverage issues that may arise in insurance litigation).

72. Rob S. Register, Comment, *Apportioning Coverage Responsibility of Consecutive Insurers When the Actual Occurrence of Injury Cannot Be Ascertained: Who Has to Contribute in a Settlement?*, 49 MERCER L. REV. 1151, 1151-52 (1998) (noting that when questions arise regarding liability coverage, the parties frequently enter into a settlement).

73. Courts have come to differing conclusions as to whether bodily injuries and property damage occurring as a result of lead paint contamination fall within the terms of the standard pollution exclusion. Compare *Sullins v. Allstate Ins. Co.*, 667 A.2d 617, 624 (Md. 1995) (holding that the standard absolute pollution exclusion does not unambiguously exclude coverage for lead paint-related bodily injury claims), with *United States Liab. Ins. Co. v. Bourbeau*, 49 F.3d 786, 786-87 (1st Cir. 1995) (holding that the absolute pollution exclusion unambiguously excludes coverage for lead paint-related property damage claims).

74. See ABRAHAM, *supra* note 7, at 106 (explaining that CGL insurance "policies typically provide coverage on a *per occurrence* basis, sometimes subject to an aggregate dollar limit per policy. For example, a policy may provide limits of liability of \$1 million per occurrence, subject to a \$2 million annual aggregate limit of liability.") (internal quotation marks omitted).

to certain enumerated types of claims.⁷⁵ Indeed, for many years, an aggregate limit clause used in many policies provided that the policy's aggregate limit applied only to two types of claims: (1) products hazard claims; and (2) completed operations hazard claims.⁷⁶ Under such a clause, all other types of claims are not subject to an aggregate limit, with the insurer's total exposure for these other types limited only by the per occurrence limit of liability.⁷⁷ Thus, for claims falling outside of the aggregate limit, a determination of the number of occurrences involved is crucial in determining the insurer's ultimate liability.⁷⁸

Assume that a policyholder has a primary general liability policy with a \$1 million per occurrence limit and a \$1 million aggregate limit, with the aggregate limit being applicable only to products hazard and completed operations hazard claims. The policyholder is sued by one thousand claimants who allege that they were injured by the policyholder and those one thousand claims are settled for \$100,000 each, for a total liability of \$100 million. Assume further that there is no question that the policy covers the types of claims asserted by the one thousand claimants against the policyholder and that the claims do not involve bodily injury occurring in other policy periods. The policyholder and its insurer might dispute whether all one thousand claims arise out of a single occurrence, or whether the claims arise out of one thousand separate occurrences.⁷⁹ Similarly, the parties might dispute whether or not the claims arise out of one of

75. See *id.* at 292 (reproducing a commonly used 1973 policy form providing that aggregate limits applied to products hazard claims and completed operations hazard claims); *id.* at 308 (reproducing a commonly used 1966 policy form providing that aggregate limits applied to products hazard claims and completed operations hazard claims). Some policies provide that their aggregate limits apply to other types of claims as well. For example, one such policy stated that the aggregate limit applies to "all property damage arising out of premises or operations rated on a remuneration basis." *Allstate Ins. Co. v. Dana Corp.*, 759 N.E.2d 1049, 1058 (Ind. 2001).

76. See ABRAHAM, *supra* note 7, at 292, 308 (providing language used in some commercial general liability policies from 1966 until 1986).

77. See OSTRAGER & NEWMAN, *supra* note 6, at 485 (stating that "[i]f all applicable policy terms and conditions are satisfied, there is one set of per[-]occurrence policy limits available for damages during a policy year arising out of each occurrence").

78. See *id.* (explaining that "[t]he determination of the number of occurrences giving rise to the bodily injury or property damage for which the insured is liable can have a significant impact on the amount of coverage available to respond to the claim or claims") (internal quotation marks omitted).

79. See *supra* notes 64-67 and accompanying text (describing circumstances in which an insurer and policyholder disagree on whether claims arise out of one or multiple occurrences).

the hazards to which the policy's aggregate limit applies.⁸⁰ The following grid demonstrates how a determination of the number of occurrences and the applicability of the policy's aggregate limit greatly affect the amount that the primary insurer must pay in order to exhaust its policy obligations.

THE PRIMARY INSURER'S POLICY OBLIGATIONS UNDER DIFFERENT
NUMBER OF OCCURRENCES AND AGGREGATE LIMIT RULINGS

	All 1000 Claims Arise Out of a Single Occurrence	The 1000 Claims Arise Out of 1000 Separate Occurrences
The Policy's Aggregate Limit Applies	\$1 Million	\$1 Million
The Policy's Aggregate Limit Does Not Apply	\$1 Million	\$100 Million

Given that the primary insurer in the illustration above might owe \$1 million under the policy, or perhaps is liable for the entire \$100 million, it is easy to see that the policyholder and insurer might settle this dispute for some amount between \$1 million and \$100 million, a figure that will depend on each party's assessment of the likelihood that the number of occurrences and aggregate limit issues would be decided in its favor at trial. If the parties settle the dispute for \$10 million, the policyholder still has \$90 million in uncompensated losses. In such a case, the policyholder likely will turn to its excess insurer in that same policy period in an effort to obtain excess coverage for the uncompensated losses.⁸¹

In litigation between the policyholder and the excess insurer, the excess insurer might argue that the aggregate limits of the primary policy did not apply to the claim and that each claim arises out of a separate occurrence.⁸² Under this view, the primary policy was liable for the entire \$100 million in claims against the policyholder, meaning that the excess insurer would not have had any liability for the

80. See *supra* note 70 and accompanying text (noting an asbestos case in which the policyholder asserted that the aggregate limit did not apply to the asbestos-related claim while the insurer argued that the aggregate limit did apply to the claim).

81. Of course, if there is no excess insurance available for that policy period, the policyholder will have no remaining coverage available in that period for claims for which coverage under the primary policy is exhausted.

82. See *Metro. Life Ins. Co. v. Aetna Cas. & Sur. Co.*, 765 A.2d 891, 894 (Conn. 2001) (presenting the excess insurer's argument that each underlying claim for which the plaintiff sought relief should be treated as a separate occurrence).

claims had the policyholder's dispute with the primary insurer proceeded to a litigated resolution.⁸³ Ironically, the policyholder, which argued to the primary insurer that the aggregate limit *did not apply* and that each claim arose out of a *separate occurrence*, can obtain coverage from the excess insurer only by adopting the *primary insurer's position* that the primary insurer's liability was capped at \$1 million by either the per occurrence limit or the aggregate limit of the primary policy. An alternative argument frequently offered by policyholders is that it need not prove that the primary insurer's obligations actually were capped at \$1 million, but only that the issues were sufficiently unclear such that the \$10 million settlement was fair and reasonable.⁸⁴

When the coverage dispute concerns the number of per occurrence limits of coverage available, the policyholder generally has an incentive to argue that each claim arises out of a separate occurrence. In some instances, however, a policyholder has a distinct incentive to argue that all of the claims against it arise out of a single occurrence. For example, many policies contain per occurrence deductibles or self-insured retentions, which could limit or even eliminate, coverage for a series of toxic tort claims if the claims generally are resolved for amounts near or below the amount of the deductible or retention and each claim arose out of its own occurrence.⁸⁵ In addition to deductibles and self-insured retentions, policyholders employ a variety of other devices that allow them to retain much or all of the risk associated with coverage under a primary policy, giving the policyholder a litigation incentive to downplay the coverage provided by its primary policies in order to access coverage under its excess policies. For example, policyholders sometimes purchase "fronting policies," which generally are policies that have a deductible equal to the coverage

83. See *id.* at 896 (holding that the excess insurer has no liability because the policyholder's liability did not exceed the per occurrence limits of the primary policy).

84. See *Zeig v. Mass. Bonding & Ins. Co.*, 23 F.2d 665, 666 (2d Cir. 1928) (accepting the argument that requiring a policyholder to completely exhaust its primary policy would do more harm than good in terms of increasing delay, promoting litigation, and preventing amenable settlement).

85. See *Appalachian Ins. Co. v. Liberty Mut. Ins. Co.*, 676 F.2d 56, 60 (3d Cir. 1982) (noting that a multiple occurrences ruling would leave the policyholder with no coverage for a sex discrimination class action settlement because no member of the class received a settlement payment in excess of the policyholder's \$25,000 per occurrence retention); *Champion Int'l Corp. v. Cont'l Cas. Co.*, 546 F.2d 502, 505 (2d Cir. 1976) (observing that finding multiple occurrences would leave the policyholder with no coverage for 1400 property damage claims arising out of the policyholder's manufacture of defective paneling because none of the individual claims would exceed the \$5,000 per occurrence deductible in the policyholder's primary policy).

available under the policy or require the policyholder to reimburse the insurer issuing the fronting policy for any amounts paid by the insurer under the policy.⁸⁶ Similarly, policyholders sometimes create their own insurance company—called a captive insurer—to provide lower-level coverage solely to the policyholder and affiliated companies, with excess policies issued by noncaptive insurers applying over the limits of the captive insurer's coverage.⁸⁷ In any of these situations, the policyholder's incentive may be to characterize a series of claims against it as arising out of a single occurrence in order to exhaust the "coverage" provided by the primary policy so the policyholder can access more favorable coverage available under its excess policies.⁸⁸ As a result, policyholders and their insurers often have differing views as to the number of occurrences involved in a series of claims against the policyholder, which sometimes causes the parties to compromise for an amount that ultimately is greater than or less than the actual amount of coverage available under the policy.

86. *Ins. Co. of N. Am. v. Pyramid Ins. Co. of Bermuda, Ltd.*, No. 92 Civ. 1816, 1994 WL 88701, at *4 (S.D.N.Y. Mar. 16, 1994). Fronting occurs when "an insurer, for a fee, issues a policy with the intent of passing most or all of the risk back to the policyholder, or to an unlicensed reinsurer or captive insurer." *Id.* (quoting *INSURLAW Thesaurus*, 1994 WL 200 (IPI)). By entering into fronting arrangements, policyholders can retain the risk associated with lower-level coverage while complying with financial responsibility laws and transferring claims handling responsibility to the insurer issuing the fronting policy. *Id.* For example, in *Pacific Employers Insurance Co. v. Domino's Pizza Inc.*, Domino's Pizza's primary general liability and automobile liability policies were fronting policies which required the policyholder "to pay all indemnity and defense obligations for losses covered by the policy." 144 F.3d 1270, 1272 (9th Cir. 1998). The policyholder also had excess policies, which were not fronting policies, applying excess of the primary fronting policies. *Id.* at 1272-73.

87. One court defined a captive insurer as "a corporation organized for the purpose of insuring the liability of its owner. Although there may be other permutations, generally the insured is both the sole shareholder and the only customer of the captive insurer." *Owens-Illinois, Inc. v. United Ins. Co.*, 625 A.2d 1, 5 (N.J. Super. Ct. App. Div. 1993) (citations omitted), *rev'd in part on other grounds*, 650 A.2d 974 (N.J. 1994).

88. *See Appalachian Ins. Co.*, 676 F.2d at 60 (noting a policyholder's assertions that injuries suffered by sex discrimination class action plaintiffs all arose out of a single occurrence, a result which would require the policyholder to pay just one \$25,000 per occurrence retention to settle the class action); *Champion Int'l Corp.*, 546 F.2d at 505 (noting a policyholder that asserted 1400 product liability claims arose out of a single occurrence where the policyholder had a \$5000 per occurrence deductible); *Colonial Gas Co. v. Aetna Cas. & Sur. Co.*, 823 F. Supp. 975, 984 (D. Mass. 1993) (holding that a policyholder's installation of hazardous insulation in 400 homes arose out of a single occurrence, where the policyholder's policy required it to pay \$100,000 in deductibles and retrospective premiums for each claimed occurrence); *Owens-Illinois, Inc. v. Aetna Cas. & Sur. Co.*, 597 F. Supp. 1515, 1528 (D.D.C. 1984) (holding that all of the asbestos-related claims against a policyholder arose out of a single occurrence, where the policyholder had per occurrence retentions in several of its policies).

3. *Policy Releases in Settlement of Prior Claims.*—One other way that a policyholder often settles a policy for an amount less than the actual policy obligations is uniquely a function of occurrence-based liability insurance. As discussed above, the standard occurrence-based general liability policy covers losses arising from bodily injury or property damage occurring during the policy period, no matter when the injury is discovered or suit is filed against the policyholder.⁸⁹ Often, a policyholder in settling a series of claims will accept a payment from the insurer in return for a release of the entire policy.⁹⁰ Thus, an insurer with significant lead paint liabilities very well might have entered into a settlement with its primary insurer in the early 1980s in which the insurer released all claims to coverage under the primary policy. Indeed, sometimes policyholders and insurers settle discrete coverage claims by way of a policy buy-back, whereby the insurer pays the policyholder an agreed-upon sum in return for the policyholder's complete release of all claims, known or unknown, for coverage under the policy.⁹¹

But what happens when the same policyholder receives a spate of claims in the late 1990s in which claimants allege to have been injured during the time the released policy was in effect by exposure to asbestos on the policyholder's premises? Assume further that the asbestos claims would not have been subject to any exclusions under the released primary policy. Because such claims allege injury occurring on the policyholder's premises, the policyholder likely will argue that the claims are not subject to the aggregate limit for products hazard or completed operations hazard coverage.⁹² As a result, in the absence of the policy release from the lead paint claims, the primary insurer normally would be required to provide coverage for the asbestos claims, but is relieved of that obligation by virtue of its prior settlement and policy release. In such a case, the policyholder's excess insurers will likely argue that the policyholder cannot transfer liability

89. See Abraham, *supra* note 6, at 2103 (stating that “[t]he trigger of coverage under a CGL policy has always been and continues to be the occurrence of bodily injury or property damage ‘during the policy period’”).

90. See, e.g., *Aerojet Gen. Corp. v. Transcon. Ins. Co.*, No. C036514, 2002 WL 1265692, at *3 (Cal. Ct. App. June 7, 2002) (describing a settlement between Aerojet and one of its insurers in which the insurer agreed to pay \$62.3 million to Aerojet in return for a release of all claims under the insurer's policies).

91. See *id.* (noting that a policyholder's final settlement with their primary insurer was a “Policy Buy-Back”).

92. ABRAHAM, *supra* note 7, at 287-88 (reprinting a common 1973 policy form defining the products hazard and completed operations hazard as applying only to bodily injury or property damage occurring “away from premises owned by or rented to the named insured”).

for the asbestos claims from the primary insurer to the excess insurers through its prior release of the primary insurer for less than its total policy obligations.⁹³ Instead, the excess insurers will argue that the policyholder, by virtue of its release of the primary insurer, must stand in the primary insurer's shoes and fund itself any claims that ordinarily would have been recoverable under the released primary policy.⁹⁴

II. THE EFFECT OF AN UNDERLYING SETTLEMENT ON AN EXCESS INSURER'S OBLIGATIONS

When a policyholder seeks coverage from an excess insurer, but has settled with and released an underlying insurer, there are three possible results: (1) the policyholder settled with the underlying insurer for *exactly* the amount that the underlying insurer owed under its policy; (2) the policyholder settled with the underlying insurer for *less than* the underlying insurer would have owed had its coverage obligations been fully litigated;⁹⁵ or (3) the policyholder settled with the underlying insurer for *more than* the insurer would have owed had its coverage obligations been fully litigated. The focus of this Article is upon the common situation where a policyholder has settled with and released an insurer in return for a payment that arguably is less than the settled insurer's policy obligations.

A. *The Development of a General Rule for Below-Limits Settlements*

Many of the early cases dealing with below-limits settlements by underlying insurers involved instances where the settling insurer's applicable policy limits were not in dispute, nor was there a dispute that the settling insurer paid less than those policy limits in return for its

93. See *Aeroflot Gen. Corp.*, 2002 WL 1265692, at *14 (explaining that a policy buy-back settlement did not constitute "admission of liability" in the primary policy and, therefore, the policy had not been exhausted). Actually, more than one of these situations can occur in the same case. A policyholder and its insurer might, for example, dispute whether the aggregate limit of a policy applies to a particular set of claims and also dispute whether a policy exclusion precludes any coverage at all for the claim. In such a case, the policyholder and insurer might settle their differences by taking each of these disputes into account in deciding on a settlement amount.

94. See, e.g., *Allstate Ins. Co. v. Dana Corp.*, 759 N.E.2d 1049, 1063 (Ind. 2001) (noting that the excess insurer had no obligation to indemnify the policyholder for environmental liabilities that would have been covered by the primary insurer in the absence of the policyholder's release of the primary insurer).

95. See *Zeig v. Mass. Bonding & Ins. Co.*, 23 F.2d 665, 665-66 (2d Cir. 1928) (describing a case where a policyholder settled for \$6000 when its combined policy limits were \$15,000); *Stargatt v. Fid. & Cas. Co.*, 67 F.R.D. 689, 690 (D. Del. 1975) (noting that the policyholder settled for \$135,000 when its primary policy was for \$250,000), *aff'd mem.*, 578 F.2d 1375 (3d Cir. 1978).

release. From the standpoint of the policyholder and the settling insurer, such a below-limits settlement often makes sense in that the settling insurer receives a discount on its maximum possible liability in return for compromising its potential coverage defenses. However, excess insurers in these cases often argued that they had no duty to respond unless the policyholder *actually collected* the full policy limits from the underlying settled insurer.⁹⁶

Indeed, the case establishing what has become the predominant rule for treatment of below-limits settlements is *Zeig v. Massachusetts Bonding & Insurance Co.*⁹⁷ In *Zeig*, the policyholder sought coverage for a burglary loss from an insurer whose policy was in excess of three underlying policies.⁹⁸ While the three underlying policies had combined policy limits of \$15,000, the policyholder settled its claims under the three underlying policies for a total payment of \$6000.⁹⁹ The excess insurer declined coverage, arguing that its liability began only after the underlying insurers had paid a total of \$15,000 on the loss.¹⁰⁰

The Second Circuit rejected the excess insurer's argument, holding instead that the excess insurer was liable for that portion of the loss exceeding the actual limits of the underlying policies, even if the underlying insurers paid less than those limits in settlement. The Second Circuit arrived at this result for three reasons. First, the excess insurer's policy, while providing that it applied excess of the underlying coverage, did not explicitly state that the policyholder's actual collection of the underlying limits was a precondition to coverage under the excess policy.¹⁰¹ In the absence of explicit language in the policy, the court then had to consider what result was the most consistent with the purposes of excess insurance. In that regard, the court noted that the excess insurer "had no rational interest in whether the insured collected the full amount of the primary policies, so long as it was only called upon to pay such portion of the loss as was in excess of

96. As one commentator notes:

The traditional view of the duties of an excess insurer is that it owes no obligation to defend or indemnify its insured unless and until any retained limit and the limits of any primary or other underlying insurance have been "exhausted" . . . [and] drafters of excess policies almost certainly intended *exhaustion* to mean the actual payment of losses.

Bower, *supra* note 12, at 536.

97. 23 F.2d 665 (2d Cir. 1928).

98. *Id.* at 666.

99. *Id.*

100. *Id.*

101. *Id.*

the limits of those policies.”¹⁰² Finally, the court explained that requiring actual collection of the limits of underlying policies would “involve delay, promote litigation, and prevent an adjustment of disputes which is both convenient and commendable.”¹⁰³

Thus, the *Zeig* court adopted the rule that an insurer whose policy applies excess of underlying policies is not necessarily freed from liability where the policyholder has settled with the underlying carriers for less than their policy limits.¹⁰⁴ Instead, the excess insurer’s policy is triggered, but only to the extent that the policyholder’s loss exceeds the actual policy limits of the underlying policies, with the policyholder being liable for any gap in coverage caused by its below-limits settlement(s).¹⁰⁵ As a result, the excess insurer in *Zeig* was liable for that portion of the policyholder’s loss in excess of \$15,000, subject to the insurer’s own policy limits, with the policyholder remaining responsible for the \$9000 gap in coverage caused by its settlement of \$15,000 in underlying coverage for a total payment of \$6000.¹⁰⁶

The vast majority of courts considering below-limits settlements have adopted the Second Circuit’s analysis in *Zeig*. For example, in *Stargatt v. Fidelity & Casualty Co. of New York*,¹⁰⁷ the policyholder’s primary policy had a \$50,000 deductible with applicable limits of \$250,000, and the policyholder also had a \$750,000 excess policy issued through Lloyd’s of London.¹⁰⁸ Although the policyholder’s liabilities exceeded its \$50,000 deductible and the \$250,000 limits of the primary policy, Lloyd’s sought summary judgment, arguing that the primary coverage was not exhausted because the policyholder settled with its primary carrier for \$135,000.¹⁰⁹ The court, relying on *Zeig*, rejected the Lloyd’s argument that a below-limits settlement of underlying coverage affects the attachment point of an excess insurer.¹¹⁰

102. *Id.*

103. *Id.*

104. *See id.*

105. *Id.* (noting that “[o]nly such portion of the loss as exceeded . . . the limits of these policies, is covered by the excess policy”).

106. *Id.*

107. 67 F.R.D. 689 (D. Del. 1975), *aff’d mem.*, 578 F.2d 1375 (3d Cir. 1978).

108. *Id.* at 690.

109. *Id.*

110. *Id.* at 691. The court explained:

If summary judgment is denied here, it will still be plaintiff’s burden to prove the amounts of McDonnell’s losses and their covered nature. The excess insurers will be liable only for covered losses in excess of \$300,000. I believe the reasoning of the *Zeig* case is correct, and I am confident that the Delaware courts would reach the same result in this case. Accordingly, summary judgment will be denied.

Several other courts have come to the same conclusion.¹¹¹ These courts have held that, so long as the policyholder's actual covered liabilities exceed its underlying policy limits, the policyholder can obtain coverage for the excess amount from its excess insurer, subject of course to the terms, conditions, and limits of the excess policy. For example, the New Mexico Supreme Court held in *Rummel v. Lexington Insurance Co.* that the policyholder could collect from Lexington once its covered liabilities exceeded the \$6 million attachment point of the Lexington policy.¹¹² The court so concluded, even though insurers

111. See *E.R. Squibb & Sons, Inc. v. Lloyd's & Cos.*, 241 F.3d 154, 172-73 (2d Cir. 2001) (per curiam) (affirming trial judge's ruling that excess insurers were liable once the policyholder's liability exceeded the limits of underlying coverage in a given policy period); *Chem. Leaman Tank Lines, Inc. v. Aetna Cas. & Sur. Co.*, 177 F.3d 210, 228-29 (3d Cir. 1999) (holding that nonsettling excess insurers were entitled to a set-off for the actual policy limits of settling underlying insurers even though such a set-off left the policyholder liable for a gap in coverage greater than \$11 million); *UNR Indus., Inc. v. Cont'l Cas. Co.*, 942 F.2d 1101, 1108 (7th Cir. 1991) (providing that "[w]hether or not the underlying insurer performed the obligations within its coverage, [the excess insurer] remains liable for claims beyond that underlying coverage"); *Kelley Co. v. Cent. Nat'l Ins. Co.*, 662 F. Supp. 1284, 1289 (E.D. Wis. 1987) (holding that an excess insurer was liable only for liability exceeding the settling primary insurer's applicable policy limits plus the policyholder's deductible); *Union Indem. Ins. Co. v. Certain Underwriters at Lloyd's*, 614 F. Supp. 1015, 1017 (S.D. Tex. 1985) (explaining that excess insurers' obligations do not begin until policyholder's loss exceeds applicable limits of primary policy); *Siligato v. Welch*, 607 F. Supp. 743, 747 (D. Conn. 1985) (stating that "Allstate's liability cannot be increased by the fact, if true, that the present value of [the primary insurer's] settlement agreement did not equal its \$300,000 coverage"); *Benroth v. Cont'l Cas. Co.*, 132 F. Supp. 270, 276 (W.D. La. 1955); *Gould, Inc. v. Arkwright Mut. Ins. Co.*, No. 3 CV-92-403, 1995 WL 807071, at *3 (M.D. Pa. Nov. 8, 1995) (observing that "an excess insurer has no rational interest in whether the insured collected the full amount of the primary policies, so long as it was only called upon to pay such portion of the loss . . . in excess of the limits of those policies"); *Drake v. Ryan*, 514 N.W.2d 785, 789 (Minn. 1994) (holding that insurer excess of a \$30,000 primary policy was liable for judgment in excess of \$30,000, even though primary insurer paid only \$20,000 in settlement); *Gould, Inc. v. Cont'l Cas. Co.*, 585 A.2d 16, 19 (Pa. Super. Ct. 1991) (holding that the policyholder's below-limits settlement with underlying insurers would not affect the attachment point of a nonsettled excess insurer); *Teigen v. Jelco of Wis., Inc.*, 367 N.W.2d 806, 810 (Wis. 1985) (holding that below-limits settlement of primary policyholder triggered excess insurer's policy, but only to the extent the policyholder's liability exceeded the \$500,000 policy limits of the settling insurer). Other courts, while not directly considering the effect of underlying settlements on an excess insurer's obligations, have recognized that an excess insurer's obligations only begin above the applicable limits of underlying insurance. See *Valentine v. Aetna Ins. Co.*, 564 F.2d 292, 298 (9th Cir. 1977) (stating that "if during settlement negotiations the primary insurer is allowed to force the excess insurer to cover part of the primary's insurance exposure, the coverages and rate structures of the two different types of insurance—primary and excess—would be distorted, and excess insurance premiums would have to be adjusted"); *Cont'l Cas. Co. v. United States Fid. & Guar. Co.*, 516 F. Supp. 384, 393 (N.D. Cal. 1981) (observing that an excess insurer cannot be required to contribute to a settlement within the limits of underlying coverage).

112. 945 P.2d 970, 979 (N.M. 1997).

whose policies were underlying the Lexington policy had settled for less than their policy limits or were in the process of litigating coverage with the policyholder.¹¹³ Indeed, a New Jersey state court has held that an excess carrier had no need for discovery of the policyholder's settlement agreements with underlying carriers because the attachment point of the excess carrier is based on the *limits* of the underlying policies, as opposed to the amount paid by the underlying carriers in settlement:

Thus, an excess carrier is entitled to a credit, not from the primary carrier's settlement, but from the amount allocable to the primary under its policies. In other words, the excess carrier is entitled to a credit for the full amount of the primary carrier's coverage before it is required to pay any cleanup expense. This credit has nothing to do with the details of the settlements between UMC and the other insurers.¹¹⁴

Accordingly, courts confronted with a policyholder that has entered into a below-limits settlement with its lower-level insurers typically have held that an excess insurer is liable only for those amounts exceeding the actual limits of the underlying, settled policies, with the policyholder being responsible for any gap in coverage caused by its release of the underlying insurers. This factual scenario, however, must be distinguished from that of the "partial settlement," where judicial treatment is far less uniform.¹¹⁵

In a "partial settlement," the policyholder and its primary insurer (or several of its lower-level insurers), settle with a tort claimant in such a way that eliminates their liability but leaves the nonsettling excess insurers exposed to an adverse tort judgment.¹¹⁶ In essence, the policyholder makes a payment to the tort claimant (funded in whole or in part by the lower-level insurers), in return for the tort claimant's

113. *Id.* (stating "Lexington is still liable for those damages that exceed \$6,000,000, even if the underlying \$6,000,000 is not fully paid").

114. *UMC/Stamford, Inc. v. Allianz Underwriters Ins. Co.*, 647 A.2d 182, 190-91 (N.J. Super. Ct. Law Div. 1994).

115. *See generally* Bower, *supra* note 12; David Greenwald, *Partial Settlements By Primary Insurers: A Critique*, 29 *TORT & INS. L.J.* 555 (1994) (discussing judicial treatment of partial settlements).

116. *See* Greenwald, *supra* note 115, at 556. The author explains:

The partial release form of settlement is a three-way agreement among a plaintiff, a defendant, and the defendant's primary insurer. The plaintiff reserves its right to sue on its claims, but agrees to seek satisfaction of any resulting judgment solely from the excess insurer and only to the extent that the judgment exceeds the primary's policy limit.

Id. (footnotes omitted).

agreement not to execute on the portion of any tort judgment that ordinarily would be covered by the settling insurers.¹¹⁷ For example, if a policyholder had a \$100,000 primary policy and a \$5 million excess policy, the policyholder and primary insurer might settle with the tort plaintiff for \$50,000. In return, the tort plaintiff agrees not to execute on the first \$100,000 of any judgment she might receive at trial. Such agreements also frequently include an agreement by the tort plaintiff not to execute any judgment against the policyholder's personal assets.¹¹⁸ Partial settlements are used most often where the excess insurer refuses to contribute to a settlement or disputes its coverage obligations.¹¹⁹

Some courts, particularly those in Minnesota and Wisconsin, have found partial settlements to be virtually indistinguishable from below-limits settlements, and have applied the Second Circuit's reasoning in *Zeig* to hold excess insurers liable for judgment amounts exceeding their respective attachment points.¹²⁰ The rationale of these decisions is that the nonsettling excess insurers are not prejudiced in any meaningful way because they are not required to pay that portion of a tort judgment that is below their attachment points.¹²¹

On the other hand, other courts have found the *Zeig* rule to be inapplicable to partial releases because the essence of the partial release is that the settlement agreement does not represent the policyholder's true liability. For example in *Federal Insurance Co. v. Srivastava*, the United States Court of Appeals for the Fifth Circuit held that the policyholder's "liability" was not the amount of a \$31.6 million tort judgment where the tort plaintiff agreed to release the first \$22 million of the judgment in return for a payment by the poli-

117. *Id.*

118. See *Allstate Ins. Co. v. Riverside Ins. Co.*, 509 F. Supp. 43, 49-50 (E.D. Mich. 1981) (reproducing the text of a partial release).

119. See *Bower*, *supra* note 12, at 548-49 (discussing partial settlements in light of an excess insurer's good-faith non-participation in an unsatisfactory settlement).

120. *Kelley Co. v. Cent. Nat'l Ins. Co.*, 662 F. Supp. 1284, 1289 (E.D. Wis. 1987); *Drake v. Ryan*, 514 N.W.2d 785, 788-89 (Minn. 1994); *Teigen v. Jelco of Wis., Inc.*, 367 N.W.2d 806, 810 (Wis. 1985); *Loy v. Bunderson*, 320 N.W.2d 175, 185 (Wis. 1982).

121. In *Drake v. Ryan*, the court wrote:

Furthermore, State Farm should not be concerned with the amount the plaintiffs received from Dairyland [the primary insurer]. The agreement provides that "in the event of any judgment which may be obtained by plaintiffs against defendants, \$30,000 [the policy limits] shall be credited against any such judgment * * * ." Thus, State Farm is not prejudiced because it is only being asked to fulfill its contractual obligations to its insured—to provide coverage in excess of that provided by the primary Dairyland policy.

514 N.W.2d at 789 (second alteration in original).

cyholder and its lower-level insurers of \$8.5 million.¹²² Under the terms of the partial settlement, the most that the tort plaintiff actually could collect was \$18.1 million of the \$31.6 million tort judgment,¹²³ an amount less than the attachment point of the nonsettling excess insurer's policy. Because the policyholder's actual loss did not exceed the excess insurer's attachment point, the court held that the *Zeig* rule did not render the excess insurer liable for any portion of the tort judgment.¹²⁴

None of the cases involving partial releases, however, is inconsistent with the Second Circuit's decision in *Zeig*.¹²⁵ The cases finding *Zeig* inapplicable to partial settlements do not quarrel with the *Zeig* court's analysis; instead, they find *Zeig* inapplicable only because the policyholder's true liability is not reflected in the tort judgment entered against the policyholder.¹²⁶ Thus, both lines of cases considering the effectiveness of partial releases begin with the concept that *Zeig* is the law of the land, but differ only as to whether a tort judgment subject to a partial settlement reflects the policyholder's actual liability for insurance coverage purposes.¹²⁷

122. 2 F.3d 98, 99-101 (5th Cir. 1993).

123. The \$18.1 million figure is composed of the \$8.5 million the tort plaintiff received in the partial settlement plus the portion of the tort judgment in excess of \$22 million. *Id.*

124. *Id.* at 103 (citing the court's expression in *Zeig*, the court stated, "Judge Hand assumed that the insured's loss was fixed before any settlement with the primary insurers. With the loss set, there was little danger that primary insurers could, contrary to the contracted-for risk, shift any part of their burden to excess carriers."). Applying Indiana law, the United States Court of Appeals for the Seventh Circuit came to the same conclusion in a case involving similar facts. See *United States Fire Ins. Co. v. Lay*, 577 F.2d 421, 423 (7th Cir. 1978) (holding that an excess insurer is not liable where the policyholder, through settlement, has been fully released from any personal liability for the tort plaintiff's loss).

125. See, e.g., sources cited *supra* note 120 and *infra* note 126 (illustrating that while Minnesota and Wisconsin courts differ from *Srivastava* and *Lay* in defining the applicability of *Zeig* to partial settlements, both lines of cases begin with the premise that *Zeig* provides the appropriate analytical framework).

126. *Srivastava*, 2 F.3d at 103; *Lay*, 577 F.2d at 423.

127. See *Srivastava*, 2 F.3d. at 103 (acknowledging *Zeig*'s analysis, but finding that "since the insured's loss does not reach the layer of [the excess insurer's] coverage, [the excess insurer] has no liability"); *Lay*, 577 F.2d at 423 (acknowledging the viability of *Zeig* but distinguishing it on the grounds that the insured never became liable for an amount exceeding the excess insurer's attachment point); *Kelley Co. v. Cent. Nat'l Ins. Co.*, 662 F. Supp. 1284, 1288 (E.D. Wis. 1987) (beginning with a reference to *Zeig* in its analysis of whether policyholder's deductible must actually be paid or whether a credit was sufficient); *Drake v. Ryan*, 514 N.W.2d 785, 786-87 (Minn. 1994) (referring to policy language by which the parties agreed to be bound by the "principles and rules established in the case of [*Teigen*] and [*Loy*]" both of which apply *Zeig*'s fundamental analysis); *Teigen v. Jelco of Wis., Inc.*, 367 N.W.2d 806, 812 (Wis. 1985) (declaring that, even in light of partial settlement, it was not "unreasonable in this case for [the excess insurer] to defend against the claims falling within the parameters of its coverage"); *Loy v. Bunderson*, 320 N.W.2d 175,

B. *Treatment of Below-Limits Settlements in "Modern" Coverage Litigation*

1. *The Uncertainties Inherent in "Modern" Coverage Litigation.*—One of the chief virtues of the *Zeig* rule is the ease by which it can be applied. Where the policyholder appears to have settled with underlying insurers for less than their policy obligations, the court simply reviews the underlying policies and holds the nonsettled excess carriers liable, subject to the terms of their own policies and any applicable coverage defenses, for the portion of the liability that exceeds the actual policy obligations of the settled insurers.¹²⁸ As a result, the policyholder is free to eliminate a portion of its downside risk by settling with one or more of its insurers, while nonsettling excess insurers remain free to litigate their coverage defenses, including exhaustion defenses,¹²⁹ without having underlying settlements to which they were not parties somehow affect the application of their policies.¹³⁰ In a sense, this rule makes the fact of underlying, below-limits settlements irrelevant to the rights and obligations of policyholders and their nonsettling excess insurers, and the litigation proceeds as if there had been no underlying settlements.¹³¹

One feature present in *Zeig*, and many of the early cases adopting the *Zeig* court's reasoning, was certainty as to the settled insurer's applicable policy limits. For example, in *Zeig*, there was no question but that the settling insurers had issued \$15,000 in coverage and that they had paid only \$6000 in settlement of the policyholder's coverage claim.¹³² Because the policyholder's loss happened on a single, easily identifiable day, there was also no dispute as to which policy period would be triggered by the claim if it were covered.¹³³ Thus, if a policyholder settled with some of its insurers for less than their actual policy limits, the reason for such a below-limits settlement almost always was in the form of a coverage discount to account for the possibility that

185 (Wis. 1982) (finding "no fundamental unfairness" in holding excess insurer liable for judgment amount exceeding its attachment point).

128. See *supra* notes 107-110 and accompanying text.

129. See, e.g., *Stargatt v. Fid. & Cas. Co.*, 67 F.R.D. 689, 690 (D. Del. 1975) (setting forth a typical exhaustion defense in which the excess insurer argues that "since the limits of the primary policy were not exhausted by the settlement, no liability could arise under the excess policy"), *aff'd mem.*, 578 F.2d 1375 (3d Cir. 1978).

130. See *id.* at 691 (explaining that "the [excess insurer] had no rational interest in whether the insured collected the full amount of the primary policies, so long as it was only called upon to pay such portion of the loss as was in excess of the limits of those policies").

131. See *id.* (reasoning that "[i]f summary judgment is denied here, it will still be [the] plaintiff's burden to prove the amounts of [the policyholder's] losses and their covered nature").

132. *Zeig v. Mass. Bonding & Ins. Co.*, 23 F.2d 665, 666 (2d Cir. 1928).

133. See *id.*

the claim might fall outside of the coverage of the settling insurer's policy.¹³⁴

In the past two decades, however, several developments in insurance coverage law have made it less obvious at the settlement stage as to which policy periods provide coverage for a claim or claims against the policyholder, and the limits available under each policy in the event that coverage exists.¹³⁵ These developments have had at least two effects as it relates to below-limits settlements. First, the likelihood of below-limits settlements has increased because of the addition of a second uncertainty in a policyholder's dispute with its insurers. Where cases such as *Zeig* involved only one level of uncertainty—whether the claim fell within the terms of coverage set forth in the policy—cases today often involve that threshold coverage dispute *and* a dispute as to which policy periods must respond to the claim.¹³⁶ Second, disputes as to whether aggregate limits apply to a claim or series of claims, and as to how many per occurrence limits of liability should apply in the event the claims are outside the aggregate limit, greatly affect the obligations of each insurer even in cases where there is no dispute that the claims against the policyholder are covered by the various insurers' policies.¹³⁷

In several cases decided in the early 1980s, typically with respect to insurance disputes over asbestos-related bodily injury claims, courts held that a single asbestos claim could trigger coverage under policies issued in more than one policy period—a multi-year trigger of coverage.¹³⁸ For example, in *Insurance Co. of North America v. Forty-Eight*

134. See *Stargatt*, 67 F.R.D. at 690 (noting that the policyholder settled his claim against his primary insurer for “a cash payment of not more than \$135,000 and a release of [the excess insurer's] counterclaim”). But see *Bower*, *supra* note 12, at 539 (discussing *Zeig* and stating that the reasons for the partial settlement are not provided in the opinion).

135. See *infra* notes 138-163 (discussing impact on insurance coverage of the multi-year trigger of coverage and aggregate limits disputes).

136. See *Ins. Co. of N. Am. v. Forty-Eight Insulations, Inc.*, 633 F.2d 1212, 1218-19 (6th Cir. 1980) (resolving the uncertainty involved in applying a multi-year trigger of coverage policy to an asbestos-related bodily injury claim by articulating that the plaintiff had a claim in every policy period in which he suffered injurious exposure to the policyholder's asbestos products), *clarified and aff'd on reh'g*, 657 F.2d 814 (6th Cir. 1981).

137. See *supra* notes 76-88 and accompanying text (discussing the significance of the interplay between per occurrence limits and aggregate limits in determining an insurer's coverage obligations).

138. See *Keene Corp. v. Ins. Co. of N. Am.*, 667 F.2d 1034, 1041 (D.C. Cir. 1981) (finding multi-year policy triggered in every policy period from the date of first exposure through manifestation of asbestos-related disease); *Porter v. Am. Optical Corp.*, 641 F.2d 1128, 1145 (5th Cir. 1981) (adopting *Forty-Eight Insulations's* “injurious exposure” theory and “logically consequent rule of proration of liability for insurance carriers who were on the coverage while the injured party was exposed to the asbestos hazards which resulted in illness and

Insulations, Inc.,¹³⁹ the United States Court of Appeals for the Sixth Circuit held that a claim against a policyholder for asbestos-related bodily injury triggered coverage in every policy period during which the policyholder suffered injurious exposure to the policyholder's asbestos products.¹⁴⁰ In allocating the loss among each of the triggered policy periods, the court held that liability should be prorated among all of the triggered policies by time on the risk during the claimant's period of exposure.¹⁴¹ Thus, if a claimant were exposed to the policyholder's asbestos products for ten years, an insurer issuing a one-year primary policy during that time would be liable for one-tenth of the policyholder's liability for that claim, subject to the insurer's other coverage defenses and limits of liability.¹⁴² In addition, under the *Forty-Eight Insulations* regime, the policyholder is liable for any portion of the liability allocated to periods for which it lacked responsive insurance.¹⁴³

One year later, the Court of Appeals for the District of Columbia went one step further and held in *Keene Corp. v. Insurance Co. of North America*¹⁴⁴ that an asbestos-related bodily injury claim against a policyholder triggered coverage in every policy period from the date of first exposure through the manifestation of asbestos-related disease.¹⁴⁵ Thus, the *Keene* court expanded on the Sixth Circuit's *Forty-Eight Insulations* "exposure trigger" by holding that asbestos-related bodily injury claims triggered policy periods during which injurious exposure occurred *as well as* policy periods between the time the claimant's active exposure ceased and the date that his or her asbestos-related disease manifested itself.¹⁴⁶ The *Keene* court, however, rejected the Sixth Circuit's proration rule, holding instead that the policyholder could select any triggered policy to pay the entire claim, subject to its limits of liability.¹⁴⁷ Once the policyholder selected a triggered insurer to pay the entire claim, that insurer could recoup a portion of the liability by seeking contribution from other triggered insurers, but the *Keene*

death"); *Forty-Eight Insulations*, 633 F.2d at 1218-19 (holding that several years of multi-year policy were triggered by asbestos exposure).

139. 633 F.2d 1212.

140. *Id.* at 1218-19, 1226.

141. *Id.* at 1225.

142. *See id.*

143. *Id.*

144. 667 F.2d 1034 (D.C. Cir. 1981).

145. *Id.* at 1047.

146. *Id.*

147. *Id.*

court prohibited contribution from the policyholder for any uninsured periods.¹⁴⁸

Since the *Forty-Eight Insulations* and *Keene* decisions, many courts have adopted multi-year triggers of coverage for bodily injury claims, both asbestos claims and nonasbestos claims, as well as for various types of progressive property damage claims, including claims based on the policyholder's liability for long-term environmental contamination.¹⁴⁹ The advent of the multi-year trigger has changed insurance coverage litigation in that it has injected an additional litigable issue in determining each insurer's policy obligations. When a policyholder seeks coverage from insurers on the risk in many different years for environmental contamination, the parties legitimately might dispute when the covered property damage first took place and when it ended. Thus, even if a court has held that every policy period from first contamination through manifestation is triggered for the policyholder's claim, such a ruling does not resolve the factual question of when the covered contamination began and when it became manifest. Indeed, given that general liability policies typically exclude coverage for property damage to the policyholder's own property, the factual dispute often turns not on when contamination began, but when the contamination first migrated off the policyholder's property and onto the property of another.¹⁵⁰

Given these developments in insurance coverage law, a policyholder might very well contend that covered property damage took place over a ten-year period, and thereby settle with one of its primary

148. *Id.* at 1050.

149. See *Spartan Petroleum Co. v. Federated Mut. Ins. Co.*, 162 F.3d 805, 810-11 (4th Cir. 1998) (finding that multiple policy periods may be triggered by progressive, indivisible property damage taking place over several years); *Stonewall Ins. Co. v. Asbestos Claims Mgmt. Corp.*, 73 F.3d 1178, 1198-99 (2d Cir. 1995) (finding multi-year trigger of coverage for asbestos-related bodily injury claims), *modified*, 85 F.3d 49 (2d Cir. 1996); *Commercial Union Ins. Co. v. Sepco Corp.*, 765 F.2d 1543, 1546 (11th Cir. 1985) (finding multi-year exposure trigger for asbestos-related bodily injury claims). For scholarly discussions on the advent of the multi-year trigger of coverage for progressive, indivisible bodily injury or property damage claims, see Abraham, *supra* note 6, at 2105-07; Bratspies, *supra* note 64, at 1229-31; Lee H. Ogburn, *The Progression of Trigger Litigation in Maryland—Determining the Appropriate Trigger of Coverage, Its Limitations, and Ramifications*, 53 MD. L. REV. 220, 221-24 (1994); Tung Yin, *Nailing Jello to a Wall: A Uniform Approach for Adjudicating Insurance Coverage Disputes in Products Liability Cases with Delayed Manifestation Injuries and Damages*, 83 CAL. L. REV. 1243, 1261-74 (1995); Chandra Lantz, Note, *Triggering Coverage of Progressive Property Loss: Preserving the Distinctions Between First- and Third-Party Insurance Policies*, 35 WM. & MARY L. REV. 1801, 1804-08 (1994); Register, *supra* note 72, at 1153-57.

150. *Spartan Petroleum Co.*, 162 F.3d at 808 (concluding "that the injury-in-fact must be to the third-party's property and thus that the gasoline contamination of the [third-party's] property must have occurred during the policy period in order for [the insurer] to be liable").

insurers for ten percent of its overall liability. For example, a policyholder with \$1 million in liability might settle with a primary insurer on the risk for one of the ten years for a payment of \$100,000. If, however, the nonsettling carriers prove at trial that the covered property damage began later than the date asserted by the policyholder, such that the covered property damage took place in only five years, a flat pro rata allocation would allocate \$200,000 to each of the five policy periods.¹⁵¹ In such a case, the policyholder's settlement with its one primary insurer for \$100,000 was too low (assuming that the primary insurer's policy limits were at least \$200,000), leaving a question as to who should be liable for the \$100,000 gap caused by the policyholder's below-limits settlement. If there is an excess insurer on the risk in the settled primary carrier's year, the policyholder likely will contend that the excess insurer should be liable for the \$100,000 gap, with the policyholder's argument being that its reasonable settlement with the primary insurer exhausts the primary policy and triggers the excess insurer's obligations. On the other hand, the excess insurer likely will argue that it is irrelevant whether the policyholder's settlement with its primary insurer was a reasonable, good-faith settlement; the primary insurer's *actual* obligation was for the full \$200,000 allocable to the policy period, and the excess insurer's obligations do not begin until the policyholder's liabilities exceed the actual policy limits of the primary policy.

There is no question that the fact-dependent nature of modern trigger of coverage analysis can create uncertainty as to the applicable trigger of coverage period, which in turn can result in a policyholder entering into a settlement that is less than the settled insurer's *actual* policy obligations.¹⁵² While that scenario is common, and can create significant gaps in coverage, a more intriguing and potentially higher stakes scenario arises when the policyholder and its insurers dispute whether the aggregate limits in the insurers' policies apply to the policyholder's claims.

151. This example assumes that the jurisdiction at issue requires proration of the policyholder's liability to each triggered policy period by time on the risk. However, even if a jurisdiction allows the policyholder to select one policy period to pay the entire claim the analysis is the same, assuming that there are no periods where the policyholder lacks responsive insurance, because subsequent contribution actions among the insurers would leave \$200,000 of the liability in each of the five triggered policy periods. See *Koppers Co. v. Aetna Cas. & Sur. Co.*, 98 F.3d 1440, 1449-50 n.9 (3d Cir. 1996) (noting that the ultimate results of a pro rata and a joint and several allocation are similar except where the policyholder has an uninsured period or where one or more triggered insurers is insolvent).

152. See, e.g., *Spartan Petroleum Co.*, 162 F.3d at 810 (demonstrating in the context of asbestos-related bodily injury claims and environmental pollution the difficulty in ascertaining the applicable trigger of coverage period).

When a policyholder faces an avalanche of toxic tort claims, it is not uncommon for the policyholder and its insurers to dispute whether the aggregate limits of the policyholder's policies apply to the losses at issue. The most prominent current example of this phenomenon is the trend by which companies facing asbestos-related bodily injury suits contend that the products hazard and completed operations hazard aggregate limits of their policies do not apply to asbestos claims arising out of the policyholder's installation (as opposed to mere manufacture or sale) of asbestos-containing products.¹⁵³ Another argument offered by policyholders, to only limited success, is that products hazard aggregate limits do not apply to underlying products liability suits that include allegations of a failure to warn of the dangerous nature of the policyholder's product. This argument holds that the liability for a failure to warn claim arises out of the policyholder's conduct and not out of the defective nature of its product.¹⁵⁴ Policyholders and insurers also sometimes dispute whether the

153. See *Commercial Union Ins. Co. v. Porter Hayden Co.*, 698 A.2d 1167, 1209 (Md. Ct. Spec. App. 1997) (holding that coverage potentially existed for claims alleging exposure to asbestos during the policyholder's installation of asbestos even though the policy did not provide coverage for products hazard or completed operations hazard claims); *Frontier Insulation Contractors, Inc. v. Merchs. Mut. Ins. Co.*, 690 N.E.2d 866, 870 (N.Y. 1997) (holding that insurers on the risk had a duty to defend, but not necessarily to indemnify, the policyholder for claims alleging exposure to asbestos, while installing asbestor-containing products, even where no products hazard coverage was available). *But see Aetna Cas. & Sur. Co. v. Wallace & Gale Co. (In re Wallace & Gale Co.)*, 275 B.R. 223, 241 (D. Md. 2002) (explaining that a claim stemming from alleged installation-related asbestos exposure would be subject to a products hazard or completed operations hazard aggregate limit for insurers issuing policies after the policyholder had completed the installation process), *vacated in part on other grounds*, 284 B.R. 557 (D. Md. 2002)); *Johnson v. Studyvin*, 828 F. Supp. 877, 884 (D. Kan. 1993) (holding that the allegation of asbestos-related property damage was a products hazard claim for insurers issuing policies after the policyholder had completed the installation process).

154. *Scarborough v. N. Assur. Co.*, 718 F.2d 130, 136 (5th Cir. 1983); *Farm Bureau Mut. Ins. Co. v. Lyon*, 528 S.W.2d 932, 934 (Ark. 1975); *Colony Ins. Co. v. H.R.K., Inc.*, 728 S.W.2d 848, 851 (Tex. App. 1987). Nevertheless, most courts have correctly rejected this argument, holding that claims involving injuries arising out of the policyholder's product are products hazard claims even if the policyholder is alleged to have failed to warn of the hazards associated with the product. These courts reason that the underlying claimant's injury arises out of the defective or unreasonably dangerous nature of the product, rendering the claim a products hazard claim, even if the claimant also alleges negligence, failure to warn, or some other conduct-based cause of action. *Brazas Sporting Arms, Inc. v. Am. Empire Surplus Lines Ins. Co.*, 220 F.3d 1, 5-6 (1st Cir. 2000); *Northland Ins. Co. v. Guardsman Prods., Inc.*, 141 F.3d 612, 618-19 (6th Cir. 1998); *Ott v. Crews*, 830 F.2d 773, 776-77 (7th Cir. 1987); *Beretta, U.S.A., Corp. v. Fed. Ins. Co.*, 117 F. Supp. 2d 489, 495 (D. Md. 2000); *Brewer v. Home Ins. Co.*, 710 P.2d 1082, 1084 (Ariz. Ct. App. 1985); *K-C Mfg. Co. v. Shelby Mut. Ins. Co.*, 434 So. 2d 1004, 1007 (Fla. Dist. Ct. App. 1983); *Cobbins v. Gen. Accident Fire & Life Assurance Corp.*, 290 N.E.2d 873, 877 (Ill. 1972); *Tiano v. Aetna Cas. & Sur. Co.*, 301 N.W.2d 476, 480 (Mich. Ct. App. 1980); *Pa. Gen. Ins. Co. v. Kielon*, 492 N.Y.S.2d 502, 503-04 (N.Y. App. Div. 1985); *Lindley Chem. v. Hartford Accident & Indem.*

policies' aggregate limits apply to environmental property damage claims.¹⁵⁵

In cases where a court accepts a policyholder's argument that the policies' aggregate limits do not apply to a particular class of claims, the policies' per occurrence limits become the only limitation on the insurer's duty to provide coverage to the policyholder.¹⁵⁶ As a result, if each claim were held to arise out of a separate occurrence, a primary insurer theoretically could face perpetual, first-dollar liability for mass tort claims implicating its policy period,¹⁵⁷ with liability shifting to the excess layer of coverage (or to the policyholder if there is no excess layer of coverage) only to the extent that the amount of a particular claim exceeds the primary policy's per occurrence limits.¹⁵⁸

Disputes over the applicability of policy aggregate limits can lead to high stakes coverage litigation between a policyholder and its primary-level insurers. Some policyholders, such as companies that previously manufactured or sold asbestos-containing products, can face hundreds of thousands of tort suits,¹⁵⁹ which in turn can create overall liability in the hundreds of millions or even billions of dollars.¹⁶⁰ Yet, if each claim arises out of a separate occurrence, these hundreds of

Co., 322 S.E.2d 185, 188 (N.C. Ct. App. 1984); *LaBatt Co. v. Hartford Lloyd's Ins. Co.*, 776 S.W.2d 795, 799 (Tex. App. 1989).

155. See, e.g., *Allstate Ins. Co. v. Dana Corp.*, 759 N.E.2d 1049, 1063 (Ind. 2001) (involving a dispute over whether primary policies had aggregate limits applicable to the policyholder's environmental claims). See generally Jeannine W. Chanes, *Endless Liability: Determining Aggregate Limits for Environmental Property Damage in Pre-1986 Liability Policies*, 13 ENVTL. CLAIMS J. 3 (2000) (discussing disputes over the applicability of liability policies' aggregate limits to environmental claims).

156. See *infra* note 163 and accompanying text (asserting that *Porter Hayden* represents a primary insurer's worst-case scenario by exposing it to the possibility that its policy might never exhaust with respect to certain claims).

157. Of course, if the policies are subject to a deductible or self-insured retention, the insurer's liability is not actually first-dollar liability because first-dollar liability remains with the policyholder. For ease of discussion, this Article assumes that there are no applicable deductibles or self-insured retentions for the policyholder's policies. In cases where a policyholder's coverage is subject to a deductible or self-insured retention, the analysis throughout this Article remains the same, with an insurer having first-dollar liability only after the policyholder has satisfied all applicable deductibles and retentions.

158. See *Commercial Union Ins. Co. v. Porter Hayden Co.*, 698 A.2d 1167, 1209-11 (Md. Ct. Spec. App. 1997) (finding asbestos-related claims at least arguably outside the products hazard, with a concomitant finding that each claim arises out of a separate occurrence).

159. See *In re Johns-Manville Corp.*, 52 B.R. 940, 941 (S.D.N.Y. 1985) (explaining that at the time Johns-Manville had filed for bankruptcy, approximately 17,000 claims had been filed against the company for asbestos related health problems).

160. For example, by the time Owens Corning filed for bankruptcy protection in October 2000, it had paid \$1.1 billion in judgments and settlements for asbestos-related bodily injury claims. DEBORAH HENSLER ET AL., *ASBESTOS LITIGATION IN THE U.S.: A NEW LOOK AT AN OLD ISSUE* 25 (RAND Institute for Civil Justice Aug. 2001) (copy on file with author); see also *Tarica v. McDermott Int'l, Inc.*, No. Civ. 99-3831, 2000 WL 1346895, at *1 (E.D. La.

thousands of claims can be settled or reduced to judgment without ever exhausting the per occurrence limits of the primary policies.¹⁶¹ On the other hand, a primary insurer with, for example, a \$1 million per occurrence and \$1 million aggregate limit will have its total liability for the asbestos claims against its policyholder capped at \$1 million if either the claims fall within the products hazard aggregate limit or all of the claims arise out of a single occurrence.¹⁶² Thus, in this example, the determination of the number of occurrences and the applicability of the policy's aggregate limits can mean the difference between \$1 million in total liability and endless, first-dollar liability on the part of the primary insurer.¹⁶³

Given the enormity of the stakes involved, it is hardly surprising that these disputes often settle. It is here that the policyholders' typical argument often becomes a game of high-stakes poker. Policyholders frequently argue that a reasonable settlement with underlying insurers exhausts those underlying policies and triggers the indemnity obligations of the lowest-level nonsettled carrier to pay amounts over and above the amount actually received from the settling underlying insurer.¹⁶⁴ If the policyholder's claims are not subject to the policies' aggregate limits, but all of the claims against the policyholder arise out of the single occurrence, the policyholder's argument is that the nonsettled excess insurers must immediately begin indemnifying the policyholder until they have exhausted the per occurrence limits of

Sept. 19, 2000) (explaining that in 1999 McDermott International estimated its asbestos liability to be \$1.562 billion).

161. See, e.g., *Metro. Life Ins. Co. v. Aetna Cas. & Sur. Co.*, 765 A.2d 891, 896 (Conn. 2001) (holding that more than 100,000 asbestos claims settled by the policyholder for about \$250 million would not exhaust the \$25 million per occurrence limits of the underlying primary policies because the claims arose out of multiple occurrences).

162. Cf. ABRAHAM, *supra* note 7, at 109-10 (explaining the dynamics of aggregate limits with different dollar amounts).

163. See *Porter Hayden Co.*, 698 A.2d at 1209-11 (holding that injuries incurred during the policyholder's installation of asbestos within the policy period potentially fall outside the products hazard and that each claim constitutes a separate occurrence). *Porter Hayden* potentially represents the primary insurer's worst-case scenario, where the primary insurer's policy might never exhaust with respect to claims involving the policyholder's installation of asbestos-containing products during the insurer's policy period. If the holding of *Porter Hayden* were applied beyond the duty to defend, and held to include the duty to indemnify, claims involving injuries arising out of the policyholder's installation of asbestos products during the policy period would implicate excess coverage only to the extent that a particular claim exceeds the per occurrence limit of the primary policy.

164. See *Koppers Co. v. Aetna Cas. & Sur. Co.*, 98 F.3d 1440, 1454 (3d Cir. 1996) (considering, and ultimately rejecting, the policyholder's argument that an excess insurer must pay amounts excess of payments received in reasonable settlements with underlying insurers).

their excess policies.¹⁶⁵ Thus, in the nonproducts, single occurrence scenario, the debate is over whether nonsettled excess insurers must fill the gap in coverage between the actual policy limits of the underlying settled insurers and the settlement amounts paid by those insurers, or whether that gap in coverage must be funded by the policyholder.¹⁶⁶

More pernicious is the argument involved where the policyholder contends that each mass tort claim is not subject to policy aggregates and arises out of a separate occurrence. Here, the excess insurer correctly argues that, in the absence of a settlement, the limits of the primary policy would *never* exhaust, and would be liable in perpetuity for each claim up to the primary policy's per occurrence limit.¹⁶⁷ From that fact, the excess insurers typically argue that they are liable only to the extent that an individual claim exceeds the released primary policy's per occurrence limit.¹⁶⁸

The policyholder, however, responds to this argument by contending that its reasonable settlement with the primary insurer exhausts that policy and triggers the next-lowest-level insurer's obligations.¹⁶⁹ The policyholder's argument, then, is that once it has released the primary insurer in a reasonable settlement, the lowest-level nonsettled excess insurer becomes liable for all succeeding claims, subject only to its own per occurrence limit.¹⁷⁰ If this argument were to succeed, it would mean that the lowest-level nonsettled insurer's policy *never* exhausts,¹⁷¹ and that the nonsettled excess insurer becomes primarily liable for all of the policyholder's future claims. This argument essentially is a game of "hot potato," with the policyholder claiming an ability to transfer perpetual, first-dollar lia-

165. See Marick, *supra* note 4, at 731-32, 735 (discussing the excess insurer's duty to indemnify generally, and identifying the point at which an excess insurer's obligation attaches as one of controversy, especially in a situation where the insured and primary policyholder have settled for an amount below the primary policy's limit).

166. *Id.* at 735 (citing *U.S. Fire Ins. Co. v. Lay*, 477 N.E.2d 1322 (7th Cir. 1978) as the "principal decision supporting the position of excess insurers that such [below-limits] settlements are improper").

167. In this situation, however, the primary insurer normally would be liable only for covered claims, or the portion of covered claims, allocable to the primary insurer's policy period. See *id.* at 716 (presenting an overview of a primary insurance carrier's obligations).

168. Seaman & Kittredge, *supra* note 5, at 676.

169. See *id.* at 685 (discussing a policyholder's argument that a below-limits settlement with a primary insurer functionally exhausted that policy).

170. See *id.* at 656 (describing excess insurance as "the next 'layer(s)' or 'level(s)' of coverage above the primary [insurance policy] contract").

171. Of course, even under this scenario, the excess insurer's policy would exhaust for a particular claim if the policyholder's liability for that claim exceeded the per occurrence limit of the excess insurer's policy.

bility to any excess insurer by settling with and releasing all of the underlying insurers. Of course, in the absence of a settlement between the policyholder and its primary insurer, the excess insurers could *never* face perpetual, first-dollar liability.

Fortunately, courts have rejected the argument that the uncertainties of “modern” coverage litigation, and the public policy in favor of settlement of disputes, should require nonsettled excess insurers to pay amounts that would have been the responsibility of an underlying insurer in the absence of that insurer’s settlement with the policyholder.¹⁷² Instead, courts have held that an excess insurer remains free to litigate the extent of coverage that would have been available to the policyholder under the underlying settled policies, with the excess insurers responsible only for amounts exceeding the amount that would have been allocated to the underlying settled carriers in the absence of a settlement.¹⁷³ In effect, then, these courts have reaffirmed the rule that the policyholder must fill any gap in coverage, including a perpetual, first-dollar obligation, caused by the policyholder’s settlement with one or more of its insurers.¹⁷⁴

2. *Treatment of Underlying Settlements in “Modern” Coverage Litigation.*—Perhaps the leading “modern” insurance coverage decision concerning the effect of underlying settlements on the obligations of excess insurers is the Third Circuit’s decision in *Koppers Co. v. Aetna Casualty & Surety Co.*¹⁷⁵ In *Koppers*, the policyholder sought coverage from its general liability insurers for environmental liabilities that the policyholder faced with respect to 150 different sites.¹⁷⁶ Although all of the insurers initially denied coverage, by the time of trial, all of *Koppers*’s insurers other than its London market insurers had settled.¹⁷⁷ Because the London market insurers had subscribed to excess policies only, the court was confronted with determining the effect of underlying insurers’ settlements on an excess insurer’s obligations.¹⁷⁸

172. *Stargatt v. Fid. & Cas. Co.*, 67 F.R.D. 689, 690 (D. Del. 1975), *aff’d mem.*, 578 F.2d 1375 (3d Cir. 1978); *Gasquet v. Comm. Union Ins. Co.*, 391 So. 2d 466 (La. Ct. App. 1980).

173. See *Bower*, *supra* note 12, at 538-43 (examining the court’s holding in *Zeig* as well as those that followed or reached similar results regarding nonsettling insurers).

174. *Id.*

175. 98 F.3d 1440 (3d Cir. 1996).

176. *Id.* at 1444.

177. *Id.* *Koppers* had initially brought suit against two of its primary insurers, then amended its complaint to include its excess insurers and additional primary insurers. *Id.*

178. *Id.* (noting that “[t]he district court limited the scope of trial to twelve specific policies, which provided multiple layers of occurrence-based, excess liability coverage for third-party property damage”).

Relying in part on the Pennsylvania Superior Court's decision in *Gould, Inc. v. Continental Casualty Co.*,¹⁷⁹ the Third Circuit recognized that the appropriate way to deal with underlying below-limit settlements was to hold the excess insurer liable only for the portion of the policyholder's liability that exceeds the applicable policy limits of the underlying settled policies.¹⁸⁰ Indeed, the *Koppers* decision provides perhaps the best statement of the appropriate treatment of settled underlying insurance and the rationale supporting such a treatment:

[S]ettlement with the primary insurer functionally "exhausts" primary coverage and therefore triggers the excess policy—*though by settling the policyholder loses any right to coverage of the difference between the settlement amount and the primary policy's limits. The excess insurer cannot be made liable for any part of this difference because the excess insurer never agreed to pay for losses below a specified floor (i.e., below the limits of the underlying primary policies).* Courts have adopted this rule because it encourages settlement and allows the insured to obtain the benefit of its bargain with the excess insurer, while at the same time preventing the insured from obtaining a double recovery.¹⁸¹

The Third Circuit's decision in *Koppers* is no anomaly when it comes to treatment of below-limits settlements in "modern" insurance coverage litigation, where uncertainty may exist as to the policy periods triggered by a loss as well as the application of policy limits to the policyholder's claims. In *Chemical Leaman Tank Lines, Inc. v. Aetna Casualty & Surety Co.*,¹⁸² the Third Circuit was once again confronted with determining the appropriate treatment of underlying below-limits settlements, this time under New Jersey law.¹⁸³ In *Chemical Leaman*, the policyholder sought coverage from its insurers for environmental liabilities at the policyholder's Bridgeport, Connecticut site.¹⁸⁴ Chemical Leaman eventually settled with its primary insurer, Aetna, and then sought coverage from its excess insurers for amounts in excess of Aetna's settlement payment.¹⁸⁵ The parties, however, disputed the appropriate attachment point of the excess policies.¹⁸⁶ Chemical Leaman argued that the excess insurers' obligations should begin

179. 585 A.2d 16 (Pa. Super. Ct. 1991).

180. *Koppers*, 98 F.3d at 1454.

181. *Id.* (emphasis added) (citations omitted).

182. 177 F.3d 210 (3d Cir. 1999).

183. *Id.* at 214-15.

184. *Id.* at 214.

185. *Id.* at 217-19.

186. *Id.* at 226-27.

once Chemical Leaman's liability at the Bridgeport site exceeded \$5,226,750, which was the portion of the Aetna settlement allocated by the settling parties to that site.¹⁸⁷ The excess insurers argued that their policies could not be required to respond until Chemical Leaman's liabilities exceeded the actual limits of coverage available under the underlying Aetna policies, even if Aetna had in fact paid a lesser amount in settlement.¹⁸⁸ Relying in part on a prior decision by New Jersey's intermediate appellate court, the Court of Appeals for the Third Circuit held that a policyholder must fill any gap in coverage caused by its settlement with an underlying insurer for less than the settled insurer's actual policy limits.¹⁸⁹

Similarly, in *Metropolitan Life Insurance Co. v. Aetna Casualty & Surety Co.*,¹⁹⁰ the policyholder (Met Life) had faced, and likely would continue to face, hundreds of thousands of asbestos lawsuits alleging that Met Life for many years had concealed the hazards of asbestos from the general public.¹⁹¹ By 1999, the policyholder had faced about 200,000 claims, with half of them settled at a nuisance value of about \$2500 per claim, for total payments of about \$250 million.¹⁹² From 1976 to 1986, Met Life had primary and lower-level excess insurance from Travelers with annual per occurrence limits of \$25 million.¹⁹³ In 1993, after litigating with Travelers over coverage for asbestos claims, Met Life settled with Travelers in return for a lump sum payment of \$300 million, at which point Met Life sought coverage from its excess insurers.¹⁹⁴

The trial court granted summary judgment to all of the nonsettled excess insurers, reasoning that the asbestos claims against Met Life arose out of a sufficiently large number of occurrences that Met Life would never exhaust the actual policy obligations of the settled Travelers policies.¹⁹⁵ On appeal, the Connecticut Supreme Court agreed.¹⁹⁶ First, the court adopted the rule that Met Life could not

187. *Id.* at 226.

188. *Id.*

189. *Id.* at 227 (quoting *Chem. Leaman Tank Lines, Inc. v. Aetna Cas. & Sur. Co.*, 978 F. Supp. 589, 602 (D.N.J. 1997), *rev'd*, 177 F.2d 210 (3d Cir. 1999)). For a discussion of the *UMC/Stamford* decision, see *supra* note 114 and accompanying text.

190. 765 A.2d 891 (Conn. 2001).

191. *Id.* at 893.

192. *See id.*

193. *Id.* at 893-94.

194. *Id.* at 893-94 n.2.

195. *Id.* at 895 (citing *Metro. Life Ins. Co. v. Aetna Cas. & Sur. Co.*, No. X04CV 950115305S, 1999 WL 244642, at *5 (Conn. Super. Ct. Apr. 16, 1999), *aff'd*, 765 A.2d 891 (Conn. 2001)).

196. *Id.* at 893.

obtain coverage from its excess insurers in a particular year until its liabilities exceeded the actual policy obligations of the underlying, but released, Travelers policies.¹⁹⁷

Having adopted this principle, the court affirmed the trial court's grant of summary judgment in favor of the nonsettled excess insurers. Accordingly, the court held that the number of occurrences involved in the claims against Met Life ensured that no single occurrence would exceed the \$25 million per occurrence limits of the settled Travelers policies.¹⁹⁸ Thus, the *Metropolitan Life* court expressly followed the widely-accepted rule that a policyholder is liable for any gap caused by its below-limits settlement with an underlying insurer, and that such obligations could not be foisted upon the nonsettled excess insurers.¹⁹⁹

In an even more recent decision, the Indiana Supreme Court rejected a policyholder's attempt to impose the terms of its primary settlement on its excess insurers.²⁰⁰ In *Allstate Insurance Co. v. Dana Corp.*, the policyholder sought coverage from its liability insurers for environmental contamination liabilities incurred at sixty-three different sites.²⁰¹ These environmental liabilities were of the "modern" variety in that they implicated multiple policy periods and involved disputes over whether the aggregate limits of the primary policies applied to the policyholder's liabilities.²⁰² By the time the case reached the Indiana Supreme Court, the policyholder had settled with all of its insurers except Allstate, which had issued first-layer excess policies that applied excess of primary policies issued by The Hartford Insurance Group.²⁰³ Allstate defended on the grounds that the aggregate limits in the underlying Hartford policies did not apply to the environmen-

197. The court stated: "The defendants' insurance policies all provide a stated dollar amount of insurance on a per occurrence basis, and are in excess of [the] Travelers coverage of \$25 million per occurrence. Thus, the defendants' policies are not implicated until *Metropolitan exhausts the underlying coverage of \$25 million per occurrence.*" *Id.* at 894 (citations omitted) (internal quotation marks omitted) (alteration in original) (emphasis added).

198. *Id.* at 893, 896 n.12. The court held that the "occurrence" for each claimant was the claimant's initial exposure to asbestos, but held that a "continuous exposure" clause in the Travelers policies had the effect of combining "claims arising from exposure to asbestos at the same place at roughly the same time into one occurrence." *Id.* at 896. Because Metropolitan did not present evidence to suggest that its liability to any set of claimants exposed at the same place and at roughly the same time exceeded \$25 million, the court granted summary judgment in the excess insurers' favor. *Id.* at 896 n.12.

199. See *supra* notes 183-189 (discussing those court rulings which are consistent with *Koppers*).

200. *Allstate Ins. Co. v. Dana Corp.*, 759 N.E.2d 1049, 1063 (Ind. 2001).

201. *Id.* at 1052.

202. *Id.* at 1057-60.

203. See *id.* at 1052.

tal claims at issue, meaning that an Allstate excess policy was not implicated unless the policyholder's liability for a particular site exceeded the per occurrence limit of the underlying settled Hartford primary policy.²⁰⁴

Dana Corporation, joined by Hartford as an intervenor, argued that the aggregate limit in the Hartford primary policies applied to Dana's environmental liabilities.²⁰⁵ Under the policyholder's argument, each of the Hartford primary policies would exhaust when Dana's total property damage liability allocated to the policy period exceeded the Hartford policy's aggregate limit, and Allstate would then provide first-dollar coverage on all subsequent claims until the Allstate policies exhausted.²⁰⁶ Hartford further argued that because the parties to the Hartford policies—Dana and Hartford—were in agreement regarding the proper construction of the policy, Allstate had no right to urge a policy construction other than that to which the contracting parties agreed.²⁰⁷

The Indiana Supreme Court rejected Hartford's argument, holding that "Allstate, as an excess carrier, is entitled to rely on the underlying policies in evaluating its risks."²⁰⁸ Having recognized an excess insurer's right to challenge the policyholder's (and primary insurer's) construction of the primary policy, the court then explicitly observed that a first-layer excess policy becomes implicated only when the policyholder's liability exceeds the applicable limits of the underlying primary policy.²⁰⁹ To the *Dana* court, it was irrelevant whether the underlying primary insurer settled for less than its policy limits because Dana—and not the excess insurer—would be liable for any amounts that would have been allocated to the released Hartford policies in the absence of a settlement. "Allstate's coverage attaches as soon as liabilities are incurred in the amount of the underlying Hartford limits for the applicable coverages. *Whether Dana's settlement with Hartford actually exhausted the underlying limits is also irrelevant; if it did not, then Dana is self-insured up to the applicable limits.*"²¹⁰

Thus, the *Dana* court adopted the rule—first announced in *Zeig* and widely-followed since—that an excess insurer is liable only when the policyholder's liabilities exceed the *actual limits* of the underlying

204. *Id.* at 1063.

205. *See id.*

206. *Id.* at 1058-59.

207. *Id.* at 1060.

208. *Id.*

209. *Id.*

210. *Id.* at 1063 n.10 (emphasis added).

policies, even if the policyholder received less than such limits in underlying settlements.²¹¹ To the extent that the policyholder's settlements cause a gap in coverage, the policyholder must pay that amount before seeking coverage from its excess insurers.²¹² Indeed, the *Dana* court explicitly held that if the primary policies were found on remand not to have applicable aggregate limits, *Dana's* release of Hartford would require *Dana* to step in Hartford's shoes and pay first-dollar amounts on all future environmental liabilities, with Allstate being liable only to the extent that *Dana's* liability at a particular site exceeded the per occurrence limits of the released Hartford policies.²¹³

3. *Policyholders' Faulty Reliance on the Supposed "Squibb Doctrine."*—As the foregoing discussion demonstrates, there is a considerable body of case law, including so-called "modern" coverage decisions, holding that a policyholder and its lower-level insurers may not through settlement unilaterally reduce the attachment point of nonsettling excess insurers. Nevertheless, policyholders continue to threaten excess insurers with the specter of gap-filling obligations, including the supposed threat of perpetual first-dollar coverage obligations. In making this argument, policyholders generally invoke as their main authority a series of trial court decisions from the United States District Court for the Southern District of New York in coverage litigation between E.R. Squibb & Sons and its insurers over coverage for Squibb's liabilities as makers of the drug diethylstilbestrol (DES).²¹⁴

However, such reliance on the trial court's rulings in *Squibb* is misplaced for two reasons. First, policyholders read too much into the *Squibb* decisions; by the time the trial court had finished with the issue, it had explicitly recognized that a policyholder, and not a nonsettling excess insurer, bears the risk of a below-limits settlement with underlying insurers.²¹⁵ Second, even if policyholders' reading of the *Squibb* trial court rulings were correct, the Second Circuit on appeal explicitly rejected the notion that a policyholder and its lower-level

211. *Id.* at 1063.

212. *See id.* at 1063 n.10.

213. *Id.* at 1063 (explaining that "[i]f there is a per occurrence limit [and no aggregate limit] on Hartford's property damage coverage, then *Dana* must have incurred \$1 million in liability at the Old Forge site alone . . . before Allstate's coverage attaches").

214. *See E.R. Squibb & Sons, Inc. v. Accident & Cas. Ins. Co.*, 853 F. Supp. 98 (S.D.N.Y.), *clarified and aff'd*, 860 F. Supp. 124 (S.D.N.Y. 1994).

215. *See E.R. Squibb & Sons, Inc. v. Lloyd's & Cos.*, 241 F.3d 154, 173 (2d Cir. 2001) (*per curiam*) (describing the trial court's reasoning).

insurers could increase an excess insurer's coverage obligations through settlement.²¹⁶

In the first pertinent *Squibb* trial court decision, United States District Judge Vincent L. Broderick considered a variety of issues ranging from trigger of coverage for DES claims to the policy obligations of *Squibb's* excess insurers.²¹⁷ In an opinion that confusingly treats settlement of underlying tort suits and settlement of insurance coverage disputes interchangeably, the court arguably endorsed requiring excess insurers to respond to DES claims once *Squibb's* liability exceeded the amounts actually received from underlying settled insurers: "Absent collusive arrangements to defraud an excess carrier, not present here, [an excess] carrier . . . must pay amounts due the insured which are unpaid for any reason, including a compromise reached by a first-tier carrier through an arm's length settlement."²¹⁸

Shortly thereafter, Judge Broderick issued a "clarifying" opinion that cast doubt on this conclusion.²¹⁹ In this clarification, Judge Broderick reaffirmed his view that an excess insurer's obligation commenced upon exhaustion of the underlying coverage, and that "such exhaustion may occur by payment or settlement, provided the settlement is noncollusive and at arm's length."²²⁰ Tellingly, however, Judge Broderick further noted that where an excess policy applies in excess of a given amount, an excess insurer cannot be required to pay amounts below that stated attachment point, commenting:

A question has been raised concerning the effect of a provision in an excess carrier's policy that a given amount must be satisfied by underlying insurers or *Squibb* before the excess carrier is liable. Such provisions create the equivalent of a deductible, which may be satisfied by payment or settlement by other carriers. Until such a deductible is satisfied by either or a combination of these methods or by unreimbursed payments by *Squibb* if the policy so provides the excess carrier is not liable to *Squibb*.²²¹

If anything, Judge Broderick's "clarification" only muddied the waters, as his second opinion suggests that amounts below an excess insurer's attachment point are properly viewed as akin to a deductible

216. *Id.* at 172-73.

217. *E.R. Squibb & Sons, Inc.*, 853 F. Supp. at 99.

218. *Id.* at 101.

219. *E.R. Squibb & Sons, Inc. v. Accident & Cas. Ins. Co.*, 860 F. Supp. 124 (S.D.N.Y. 1994).

220. *Id.* at 126.

221. *Id.* at 127.

that must be satisfied—either by the policyholder or the underlying insurers—before the excess insurer's obligation begins.²²² Such a determination is fully consistent with the many cases holding that a policyholder must fill any gap caused by its below-limits settlement with an underlying insurer.²²³

Indeed, the *third* trial court decision in *Squibb* on this issue clarified that any gaps in coverage caused by a below-limits settlement would be the responsibility of the policyholder.²²⁴ In this third iteration, certain excess insurers argued that their attachment points should *increase* because some of the underlying insurers paid settlement amounts that ended up exceeding their actual policy obligations.²²⁵ The excess insurers' basic argument was that if their attachment points were not increased to account for the alleged above-limits settlements, *Squibb* would reap a windfall by collecting from its insurers more than it would owe to the DES claimants.²²⁶

Judge John S. Martin, who had replaced Judge Broderick on the *Squibb* case, rejected this argument, holding instead that the excess insurers' obligations began once *Squibb's* liability exceeded the actual policy limits of the underlying settled policies, regardless of the amount received by *Squibb* in settlement.²²⁷ Central to Judge Martin's ruling was his recognition that *Squibb*, by settling with the underlying carriers, accepted the risk that it might have to fill gaps in coverage caused by settlements later determined to be less than the settling insurers' policy obligations, meaning that any windfall caused by an *above-limits* settlement should belong to *Squibb* as well.²²⁸

Thus, the *Squibb* trial court ultimately came to the same conclusion as practically every court considering the effect of underlying be-

222. *Id.*

223. *See, e.g.*, *Allstate Ins. Co. v. Dana Corp.*, 759 N.E.2d 1049, 1063 (Ind. 2001).

224. *E.R. Squibb & Sons, Inc. v. Accident & Cas. Ins. Co.*, No. 82 CIV. 7327(JSM), 1997 WL 251548, at *2 (S.D.N.Y. May 13, 1997).

225. *Id.*

226. *Id.*

227. *Id.* at *2-3.

228. *Id.* at *2 (noting that *Squibb* "ran the risk that the amount it received in those settlements would be less than it was ultimately obligated to pay"). It should be noted that, even though courts have more or less uniformly required the policyholder to fill coverage gaps caused by below-limits settlements, there is far less consensus that a policyholder should reap any benefit caused by an above-limits settlement. These courts have recognized a public policy prohibiting a policyholder to reap a profit from its commission of tortious conduct through advantageous settlements with its liability insurers. *See supra* note 25 (noting that *Chemical Leaman Tank Lines v. Aetna Casualty & Surety Co.*, recognized the public policy against permitting a policyholder to reap a double recovery whereby it recovers more from its insurers than the amount of the loss it has suffered). 177 F.3d 210, 228-29 (3d Cir. 1999).

low-limits settlements: that an excess insurer cannot be required to pay amounts that would have been chargeable to an underlying insurer in the absence of a settlement of the underlying coverage.²²⁹ Even so, policyholders continued to invoke *Squibb* as support for the possibility of a “nightmare scenario” where an excess insurer is required to fill a significant gap in coverage, even with the possibility of perpetual, first-dollar coverage obligations for claims not subject to the policies’ aggregate limits.²³⁰

Efforts by policyholders to rely on the *Squibb* trial court decisions, however, were once and for all dashed by the Second Circuit’s opinion on appeal.²³¹ In *E.R. Squibb & Sons, Inc. v. Lloyd’s & Companies*, the Second Circuit considered an appeal from Judge Martin’s ruling concerning the appropriate attachment point of nonsettled excess insurers. First, the Second Circuit characterized the trial court’s ultimate ruling as holding the nonsettling excess insurers liable for precisely the amounts that they would have been liable for in the absence of settlements by underlying insurers.²³²

Having so characterized the district court’s treatment of underlying settlements, the Second Circuit then approved of Judge Martin’s approach, explicitly recognizing that the policyholder bears the risk of a below-limits settlement with its insurers. The court characterized the excess insurers’ argument regarding a double recovery by *Squibb* as “ultimately unpersuasive” because:

[*Squibb*] undoubtedly took the risk that the size of the settlements would be inadequate to cover the settling insurers’ pro rata share. In such a case, *Squibb* would have been left holding the bag. . . . *Under the court’s approach, the settling parties are the ones who took the risk of settlement, and the nonsettling parties are left precisely as they would have been had no settlement occurred.* That hardly seems unfair.²³³

If that were not enough, the Second Circuit cited as legal support for its ruling the Third Circuit’s decision in *Koppers Co. v. Aetna Casualty & Surety Co.*,²³⁴ perhaps the leading modern case concerning the appropriate treatment of below-limits settlements. The *Squibb* court ap-

229. *E.R. Squibb & Sons, Inc.*, 1997 WL 251548, at *2.

230. *E.R. Squibb & Sons, Inc. v. Lloyd’s & Cos.*, 241 F.3d 154, 173 (2d Cir. 2001) (per curiam) (explaining that “the settling parties are the ones who took the risk of settlement, and the nonsettling parties are left precisely as they would have been had no settlement occurred”).

231. *Id.*

232. *Id.* at 172.

233. *Id.* at 173 (footnote omitted) (emphasis added).

234. 98 F.3d 1440 (3d Cir. 1996).

provingly characterized *Koppers* as requiring courts to “reduc[e] the excess insurers’ liability by the settling primary insurers’ *pro rata* shares by relying on the policy limits of the primary policies, not the actual settlement amounts.”²³⁵

Thus, even if the trial court rulings in *Squibb* supported the notion that an excess insurer must provide coverage for amounts in excess of any reasonable underlying settlement (a proposition that is far from clear from the trial court decisions themselves), the Second Circuit’s decision on appeal drives a stake through the heart of such a reading. Not only does the Second Circuit characterize the trial court’s ruling as treating the excess insurers’ obligations as being unaffected by the existence of underlying settlements, but the Second Circuit expressly noted that the settling parties (and the policyholder in particular) bear the risk that a primary insurer’s settlement payment turns out to be less than the settling insurer’s actual policy obligations.²³⁶

III. THE RATIONALE UNDERLYING THE TREATMENT OF A NONSETTLING EXCESS INSURER’S OBLIGATIONS IN LIGHT OF SETTLEMENTS BY UNDERLYING INSURERS

As the foregoing analysis has demonstrated, courts overwhelmingly have held that a nonsettling excess insurer’s obligations begin only when the policyholder has exhausted the policy limits of the underlying insurers, even if one or more of those insurers settled for some lesser amount. Courts have not made a nonsettling excess insurer drop down to provide coverage that would have been available under a settling insurer’s policy, even if the underlying insurer’s settlement was objectively reasonable.²³⁷ This treatment makes sense because it is consistent with the risks assumed by an excess insurer and prevents a policyholder and its lower-level insurers from transferring obligations (collusively or innocently) from themselves to a nonsettling excess insurer.²³⁸

235. *E.R. Squibb & Sons, Inc.*, 241 F.3d at 173.

236. Indeed, a more recent decision from the United States District Court for the Southern District of New York held that the *Squibb* trial court decisions did not require an excess insurer to provide coverage for any gap between the underlying settled insurer’s actual policy obligations and the amount paid by that underlying insurer in settlement. *United States Fid. & Guar. Co. v. Treadwell Corp.*, 58 F. Supp. 2d 77, 110-11 n.28 (S.D.N.Y. 1999). Moreover, the *Treadwell* court expressly held that a nonsettled excess insurer’s obligations would not begin until either the policyholder or the settled carrier had paid amounts exceeding the actual limits of the settled policy. *Id.* at 112-13.

237. *See, e.g.*, *Allstate Ins. Co. v. Dana. Corp.*, 759 N.E.2d 1049, 1063 (Ind. 2001).

238. *E.R. Squibb & Sons, Inc.*, 241 F.3d at 173.

Most fundamentally, when an excess policy is written to apply excess to the coverage provided by an underlying policy, the only reasonable way in which that obligation can be measured is in relation to the coverage obligations of the underlying policy.²³⁹ Requiring an excess insurer to provide coverage immediately excess of any reasonable underlying settlement, even if the underlying insurer's actual obligations were greater, would distort the excess insurer's policy to apply excess to underlying *payments* or underlying *settlements* where the excess policy is written to apply excess to the underlying *coverage*.²⁴⁰

If policyholders were permitted to have their way, thereby requiring excess policies to attach immediately excess of a reasonable underlying settlement, it would break down the very principles upon which insurance policy premiums are based.²⁴¹ As discussed previously, primary insurance is more expensive than excess insurance, per dollar of coverage provided, in part because of the increased likelihood that the policyholder will incur liability that will implicate the primary insurer's policy.²⁴² In the absence of a deductible or self-insured retention, *every* covered claim involving bodily injury or property damage during the policy period will implicate the primary insurer's policy.²⁴³ By contrast, an excess insurer issuing coverage in the same year will have to pay a covered claim only if the policyholder's liability is sufficiently high that it exceeds the limits of underlying coverage.²⁴⁴ Therefore, if an excess insurer were required to attach at a lower point based on the policyholder's below-limits settlement with an underlying insurer, it would pervert the premium structure of the excess policy. Consequently, the excess insurer would be required in effect to provide coverage at a lower attachment point (which is more expensive per dollar of coverage) than the attachment point upon which the excess insurer's premium was calculated.²⁴⁵

239. See *Chem. Leaman Tank Lines v. Aetna Cas. & Sur. Co.*, 177 F.3d 210, 227 (3d Cir. 1999). The Third Circuit wrote: "The excess insurer cannot be made liable for any part of this difference [between the underlying policy's actual limits and the amount recovered from the underlying insurer in settlement] because the excess insurer never agreed to pay for losses below a specified floor (*i.e.*, below the limits of the underlying policy)." *Id.* (quoting *Chem. Leaman Tank Lines v. Aetna Cas. & Sur. Co.*, 978 F. Supp. 589, 602 (D.N.J. 1997), *rev'd*, 177 F.3d 210 (3d Cir. 1999)).

240. *Koppers Co. v. Aetna Cas. & Ins. Co.*, 98 F.3d 1440, 1454 (3d Cir. 1996).

241. *Westchester Fire Ins. Co. v. Heddington Ins. Ltd.*, 883 F. Supp. 158, 163-64 n.11 (S.D. Tex. 1995), *aff'd mem.*, 84 F.3d 432 (5th Cir. 1996). Excess insurance can be characterized by lower policy premiums and reduced risk of payout. *Id.*

242. Bower, *supra* note 56, at 21.

243. Marick, *supra* note 4, at 716.

244. *Seaman & Kittredge*, *supra* note 5, at 672.

245. The same principle applies to differing levels of excess insurance. The higher the attachment point, the cheaper the insurance per dollar of coverage, the rationale being

Moreover, where an excess policy is written to apply excess of one or more underlying policies, the attachment point of the excess policy is known—or at least knowable—at the time of policy issuance by reviewing the coverage provided by the lower-level policies.²⁴⁶ If the amount of a reasonable settlement governed the excess insurer's attachment point, the excess insurer would not be able to determine its coverage obligations at the time of policy issuance, but instead might not know its coverage obligations until many years later, when the policyholder has reached coverage settlements with the underlying carriers.

Indeed, such a state of affairs would allow an excess insurer's coverage obligations to be subject to the whims (within the bounds of a reasonable settlement) of the policyholder in that the policyholder unilaterally would be able to transfer obligations to the nonsettling excess insurer through its release of underlying insurers. This is the "hot potato" scenario described above, where a policyholder could coerce advantageous settlements by asserting an ability to impose perpetual, first-dollar liability on any insurer it chooses by entering into reasonable settlements that release all of the underlying coverage.²⁴⁷ This is hardly the sort of litigation dynamic the law should encourage, particularly where, as here, such a rule would be contrary to the basis upon which excess coverage is written.²⁴⁸ For these reasons, an attempt to require a nonsettling excess insurer to provide coverage excess of a below-limits settlement—instead of excess of the applicable policy limits of the underlying policies—should be viewed for what it is, an attempt to transfer obligations from the settling parties to the nonsettling excess insurer. Moreover, the sophism that a reasonable settlement of primary or lower-level coverage is a reasonable resolu-

that there is less likelihood that a higher-level excess policy will be implicated by the policyholder's liability. See *Hartford Accident & Indem. Co. v. Cont'l Nat'l Am. Ins. Co.*, 861 F.2d 1184, 1187 (9th Cir. 1988) (stating that "[a]n excess insurer predicates the premiums it charges upon the obligations that it and the primary insurer assume, including the primary insurer's obligation to defend all suits until exhaustion of its liability limits. . . . Equity cannot require [the excess insurer] to provide coverage for which it was not paid"); see also *supra* note 57 (citing cases recognizing that excess policies are less expensive than primary and lower-level excess policies because of their reduced risk of claims exposure).

246. See *Commonwealth Edison Co. v. Nat'l Union Fire Ins. Co.*, 752 N.E.2d 555, 568 (Ill. App. Ct. 2001). The court explained: "Excess or secondary insurance coverage is coverage in which liability attaches under the policy only after a *predetermined* amount of primary coverage has been exhausted." *Id.* (internal quotation marks omitted).

247. See *supra* notes 167-171 and accompanying text (rejecting the policyholder's ability to transfer perpetual liability to any excess insurer by settling with and releasing all underlying insurers).

248. *Westchester Fire Ins. Co. v. Heddington Ins. Ltd.*, 883 F. Supp. 158, 163-64 n.11 (S.D. Tex. 1995), *aff'd mem.*, 84 F.3d 432 (5th Cir. 1996).

tion *vis-a-vis* a nonsettled excess insurer, just because it is reasonable *vis-a-vis* the settling parties, is based on the fallacy that insurance coverage disputes involve the policyholder versus a monolith of insurers, when an excess insurer often has coverage interests that are diametrically opposed to those of the underlying insurers.²⁴⁹ Therefore, it is not reasonable to treat an underlying insurer as *de facto* representing an excess insurer's reasonable interests in its settlement dealings with the policyholder.²⁵⁰

The following examples will demonstrate why an excess insurer's obligations should not begin until the policyholder's liability exceeds the policy limits of underlying settled insurers lest the settling parties transfer obligations from themselves to the nonsettled excess insurers. One reason why a policyholder and its primary insurer settle an insurance coverage dispute is because of questions as to whether the insurer has a valid coverage defense to the policyholder's claim.²⁵¹ Imagine the case of a building contractor with a \$1 million primary policy and a \$1 million excess policy issued for the same policy period. The policyholder is sued by a building owner alleging that his building has been damaged because of the health hazards associated with the policyholder's use of lead paint in the building many decades ago. Assume that under the relevant case law, all of the alleged property damage is treated as having taken place during the policy period in which these two \$1 million policies are in effect.

Assume further that the policyholder eventually settles with the building owner for \$1.5 million and then seeks coverage from its insurers. Because both of the insurance policies contain identical absolute pollution exclusions, both insurers decline coverage and litigation ensues. At the commencement of the litigation, the insurers know that if their pollution exclusions apply, they owe the policyholder nothing; if their exclusions do not apply, the primary insurer must pay the first \$1 million of the policyholder's liability and the excess insurer is liable for the remaining \$500,000. However, courts

249. See *supra* notes 15-17 and accompanying text (asserting that primary or lower-level excess insurers often have conflicting arguments with excess insurers in disputes with the policyholder).

250. Indeed, the policyholder's settlement with some of its underlying insurers, without settling with one or more excess insurers, does not advance the public interest in promoting settlement of disputes because the policyholder *still* must litigate its claim against the nonsettled excess insurers, who in all likelihood have the same or similar coverage defenses as those of the settling insurers, with the nonsettling insurer also having a defense that the underlying coverage is not exhausted. See Greenwald, *supra* note 115, at 560 (explaining why the policyholder's settlement with a primary insurer, but not with its excess insurers, does not materially advance the public's interest in promoting settlement).

251. Seaman & Kittredge, *supra* note 5, at 708, 711-12.

have come to opposite conclusions as to whether lead paint discharges are necessarily excluded by the terms of a standard pollution exclusion,²⁵² meaning that both the primary insurer and the excess insurer have potential coverage defenses.

In such a case, the policyholder and the primary insurer may settle their differences based on the possibility that each might lose if the applicability of the pollution exclusion were litigated.²⁵³ Assume the policyholder and the primary insurer settle their coverage dispute for \$750,000, and the policyholder sought to require the excess insurer to provide coverage for amounts in excess of the \$750,000 settlement. Given the uncertainty over whether the primary insurer's pollution exclusion would bar coverage, the \$750,000 settlement of the primary insurer's coverage might be perfectly reasonable from the standpoint of the policyholder and the primary insurer.

Nevertheless, even if this settlement were reasonable as between the policyholder and its primary insurer, it is not reasonable to import the terms of the primary insurer's settlement into the excess insurer's policy by requiring the excess insurer to provide coverage for liability in excess of the primary insurer's \$750,000 settlement. Prior to the primary insurer's settlement, the excess insurer either paid nothing (if the insurers' pollution exclusion applied) or paid \$500,000 (if the exclusion did not apply). If, however, the excess insurer were required to provide coverage immediately excess of the primary insurer's settlement payment, it still would pay nothing if the pollution exclusion applied, but now would be liable for \$750,000 if the pollution exclusion did not apply. Thus, if the pollution exclusion ultimately were found inapplicable, the primary insurer would have received a \$250,000 coverage discount because the insurers' pollution exclusions provided a colorable coverage defense, but the excess insurer's exposure actually would have *increased* by \$250,000 because the insurers had a potential coverage defense.

In such a case, the policyholder and its primary insurer would have every incentive to settle their dispute because they are simply transferring their risk to the excess insurer. By settling, the primary insurer gets a discount on its policy based on the existence of a colorable

252. Compare *Sullins v. Allstate Ins. Co.*, 667 A.2d 617, 621-23 (Md. 1995) (holding that the standard absolute pollution exclusion does not unambiguously exclude coverage for lead paint-related bodily injury claims), with *United States Liab. Ins. Co. v. Bourbeau*, 49 F.3d 786, 787-89 (1st Cir. 1995) (holding that the absolute pollution exclusion unambiguously excludes coverage for lead paint-related property damage claims).

253. See *supra* notes 71-73 and accompanying text (noting that policyholders and insurers frequently settle where the dispute concerns whether a particular claim is covered under the insurer's policy).

ble coverage defense. For its part, the policyholder gets a guaranteed payment from the primary insurer regardless of how the coverage dispute plays out, and would not have to fill any gap in coverage caused by its below-limits settlement with the primary insurer. By contrast, the excess insurer would see its coverage exposure increased by \$250,000 through no action of its own, based on the supposed ability of the policyholder and its primary insurer to transfer the risks associated with their own settlement onto the nonsettling excess insurer.

It is for this reason that courts have recognized that the settling parties, who have the ultimate control over their own settlement, should be the ones who bear the risks associated with the terms of their settlement.²⁵⁴ If the policyholder settles with an underlying insurer for less than that underlying insurer's actual policy obligations, whether through stupidity, bad luck, or in recognition that the settling insurer has a potential coverage defense, the policyholder should bear the consequences of its own conduct, and the consequences of a below-limits settlement cannot be foisted upon an excess insurer who had no role in the underlying settlement.²⁵⁵

A similar transfer of obligations occurs when the parties dispute the applicability of policy limits.²⁵⁶ Consider the case of a policyholder that has a primary policy and an excess policy in a given policy period, each with a \$1 million per occurrence limit and a \$1 million aggregate limit. The aggregate limits of both policies are written to apply only to products hazard and completed operations hazard claims. Assume that the policyholder faces 10,000 mass tort claims, with the parties disputing whether the claims fall within the hazards to which the policies' aggregate limits apply, and that there are no other applicable coverage defenses. The policyholder eventually settles the 10,000 claims for \$10,000 each, or a total of \$100 million.²⁵⁷

254. See *E.R. Squibb & Sons, Inc. v. Lloyd's & Cos.*, 241 F.3d 154, 173 (2d Cir. 2001) (*per curiam*) (setting forth that “[u]nder the court’s approach, the settling parties are the ones who took the risk of the settlement, and the non[-]settling parties are left precisely as they would have been had no settlement occurred. That hardly seems unfair.”); *Koppers Co. v. Aetna Cas. & Sur. Co.*, 98 F.3d 1440, 1455 (3d Cir. 1996) (reasoning that “[t]he beneficial consequences of this formula are that the insured bears the risk of settling too low”).

255. See *Sec. Ins. Co. v. Lumbermens Mut. Cas. Co.*, No. CV 960475565S, 1999 WL 545745, at *6 (Conn. Super. Ct. July 12, 1999) (noting that a policyholder who settles with and releases an insurer in effect elects to become self-insured for the coverage that would have been provided by the settling insurer in the absence of the settlement and release).

256. See *supra* notes 65-66 and accompanying text (providing a litany of cases showing that some courts hold that multiple asbestos claims arise out of a single occurrence while others hold that multiple asbestos claims arise from multiple exposures).

257. Further assume that the policyholder either was authorized by its policies to settle these claims, or that the insurers are not permitted to avoid coverage based on the policy-

If the insurers' aggregate limits apply, the primary insurer's liability is capped at \$1 million, and the excess insurer's liability is capped at \$1 million. The remaining \$98 million is the obligation of higher-level excess insurers, or the obligation of the policyholder to the extent that the liability exceeds the available coverage for the policy period. The same result would occur if all of the 10,000 claims against the policyholder are held to arise out of a single occurrence,²⁵⁸ as the primary insurer would be liable up to its \$1 million per occurrence limit, and the excess insurer's coverage would exhaust upon payment of its own \$1 million per occurrence limit. If, however, the insurers' aggregate limits do not apply, and each claim is held to arise out of a separate occurrence, then the primary insurer is liable for the entire \$100 million because no claim involves liability greater than the primary policy's per occurrence limit. Because the primary insurer's obligations would never exhaust under this scenario, the excess insurer would pay nothing on these claims.

What happens, then, if the policyholder settles with its primary insurer for \$10 million, and then the court hearing the dispute between the policyholder and the excess insurer holds that the claims are not subject to the insurers' aggregate limits, and that each claim arises out of its own occurrence? In the absence of a settlement, the primary insurer would have been obligated to pay the entire \$100 million, with the excess insurer having no liability. Nonetheless, if the law in the relevant jurisdiction were unsettled, a \$10 million settlement between the policyholder and the primary insurer might be a perfectly reasonable compromise.

If a court held that the excess insurer must provide excess coverage immediately excess to the amount of the primary insurer's reasonable settlement, the excess insurer would be liable for \$90 million because its own aggregate limit and per occurrence limit would never exhaust. That such a state of the law would constitute a transfer of

holder's settlement with the underlying tort claimants, and that all bodily injury occurred during the relevant policy period.

258. Courts have held in some insurance coverage litigation concerning mass tort liabilities that the policyholder's liability for thousands of products liability claims arise out of a single occurrence—the policyholder's decision to become involved with the defective product at issue. See *supra* note 65 and accompanying text (providing a series of cases all holding that the underlying asbestos claims arise out of a single occurrence—the policyholder's decision to become involved with asbestos-containing products). On the other hand, other courts have rejected this principle and held that each claimant's injuries arise out of a separate occurrence. See *supra* note 66 and accompanying text (listing cases that have determined that the relevant occurrence is each claimant's exposure to that policyholder's asbestos-containing products).

obligations from the primary insurer to the excess insurer is beyond dispute.

Using the example described above, the policyholder and the primary insurer would be able to transfer \$90 million in liability from the primary insurer to the excess insurer by virtue of a private settlement between the policyholder and primary insurer over which the excess insurer had no control. With respect to the primary insurer's settlement, the policyholder traded away its claim that the primary insurer had perpetual, first-dollar liability for the 10,000 tort claims in return for the payment of \$10 million. However, if the policyholder then were able to transfer to the excess insurer the consideration given by the policyholder for the \$10 million payment from the primary insurer (a released claim of perpetual, first-dollar coverage for the claims at issue), the policyholder would have received \$10 million from the primary insurer for free, as any fallout from the policyholder's settlement with the primary insurer would be borne by the excess insurer.²⁵⁹

Beyond being a naked transfer of obligations from the policyholder and its primary insurer to the excess insurer, imposing such obligations on the excess insurer is fundamentally at odds with the risks assumed by the excess insurer in issuing coverage to the policyholder.²⁶⁰ When an excess policy is written to apply excess of an underlying primary policy, the excess insurer knows that its policy can never incur the perpetual, first-dollar obligations that a primary insurer can face when claims arising out of multiple occurrences fall outside the policies' aggregate limits.²⁶¹

The reason why an excess insurer does not face this threat is because its coverage attaches only upon exhaustion of the underlying insurance. If a series of claims have the effect of exhausting the per occurrence or aggregate coverage available under the primary policy,

259. The reason why this is true is that the policyholder, by settling with its primary insurer, accepts an agreed-upon payment in return for giving away its claim that the primary insurer has perpetual, first-dollar liability for the underlying mass tort claims. If the policyholder can then transfer this risk of perpetual, first-dollar liability to the excess insurer, the policyholder really has not given up anything in return for the \$10 million because it could transfer its cost of settlement to the excess insurer.

260. *Westchester Fire Ins. Co. v. Hedington Ins. Ltd.*, 883 F. Supp. 158, 163-64 n.11 (S.D. Tex. 1995), *aff'd mem.*, 84 F.3d 432 (5th Cir. 1996).

261. *See supra* notes 167-168 and accompanying text (stating that where excess insurers are liable only if the individual claim exceeds the primary policy's per occurrence limit, the limits of the primary policy would *never* exhaust, and would be liable in perpetuity for each claim up to the primary policy's per occurrence limit).

the same will eventually occur under the excess policy.²⁶² In such a case, the excess insurer's first-dollar liability is temporary, lasting only until such time as the claims exhaust the applicable limits of the excess policy. At that point, coverage obligations rest with the next-lowest-layer excess policy, or with the policyholder if there is no further excess coverage.²⁶³ On the other hand, if a series of claims do not exhaust the underlying primary policy, the excess insurer *never* has first-dollar liability because that obligation will remain with the unexhausted primary policy.²⁶⁴ Thus, an attempt by a policyholder to hold a nonsettled excess insurer liable, as a result of underlying settlements, for perpetual, first-dollar coverage is nothing more than an attempt to allow the policyholder's own settlements with other insurers to impose upon the excess insurer a liability that it could *never* incur in the absence of the policyholder's release of underlying insurance coverage.

In holding that an excess insurer's coverage applies excess of the actual limits of the underlying insurers, even if the underlying insurers settled for less than their policy limits, courts have recognized that it is unreasonable to allow the policyholder and its settling insurers negatively to affect the coverage obligations of a nonsettled excess insurer.²⁶⁵ Because the policyholder has the ultimate control over the terms of its settlements, the policyholder (and not the nonsettled excess insurer) should bear the risk of a below-limits settlement.²⁶⁶ It is, after all, the policyholder who provides the release that eliminates the settled insurers' coverage obligations.

Indeed, if a court simply accepted the views of the policyholder and the settled insurer as to the coverage provided by the settled insurer's policy, the excess insurer's obligations would be held hostage to the self-serving interpretations of the policyholder and the settled insurer, both of whom have an incentive to minimize the coverage available under the settled policy. The primary insurer has an incentive to urge a judicial interpretation that minimizes the coverage avail-

262. This conclusion assumes that there are no material differences in the application of the per occurrence and aggregate limits between the primary policies and the excess policies.

263. See, e.g., *Feld v. Zale Corp.*, 62 F.3d 746, 749 n.1 (5th Cir. 1995).

264. *Stargatt v. Fid. & Cas. Co.*, (D. Del. 1975), *aff'd mem.*, 578 F.2d 1375 (3d Cir. 1978).

265. See *Koppers Co. v. Aetna Cas. & Sur. Co.*, 98 F.3d 1440, 1454 (3d Cir. 1996) (explaining that "by settling the policyholder loses any right to coverage of the difference between the settlement amount and the primary policy's limits. The excess insurer cannot be made liable for any part of this difference because the excess insurer never agreed to pay for losses below a specified floor").

266. *Sec. Ins. Co. v. Lumbermens Mut. Cas. Co.*, No. CV 960475565S, 1999 WL 545745, at *6 (Conn. Super. Ct. July 12, 1999).

able under its policies for precedential reasons. The policyholder has a similar incentive in order to avoid (or minimize) a gap in coverage caused by a below-limits settlement.²⁶⁷ The easiest way for a policyholder to avoid the entire problem of a below-limits settlement is to convince the court that the underlying settlement amount was not less than the settling insurer's actual policy obligations. That way, the policyholder need not litigate the legal effect of a below-limits settlement. Because of this incentive, courts must permit the nonsettled excess insurer to contest the policyholder's self-interested reading of the settled policy, without a predisposition toward favoring the policyholder's proffered interpretation based on its status as a party to the settled policy.

CONCLUSION

Ironically, the parties that originally pushed for, and obtained, the policy limits set-off rule in cases such as *Zeig* and its progeny were policyholders.²⁶⁸ Policyholders sought this rule in countering arguments that an excess policy could not be implicated unless the policyholder actually collected from the underlying insurers amounts equal to the excess insurer's attachment point, even if the policyholder's overall liability clearly exceeded the excess insurer's attachment point.²⁶⁹ The policyholders' basic argument was that such a rule made sense in that the policyholder's settlement with its underlying insurers would have no effect on the excess insurer's obligations.²⁷⁰

Now that this treatment of underlying settlements has become widely accepted by courts, at least where the policyholder's *actual* obligations exceed the excess insurer's attachment point,²⁷¹ policyholders

267. *Allstate Ins. Co. v. Dana Corp.*, 759 N.E.2d 1049, 1060 (Ind. 2001). In *Dana*, the policyholder would not have a gap in coverage if the primary policies ultimately were found to have aggregate limits, thus giving the policyholder an incentive to join with its settled primary insurer in arguing for the existence of aggregate limits in the settled primary policies. *Id.* at 1059-60; *see supra* notes 200-211 (describing the rule that an excess insurer is liable only when the policyholder's liabilities exceed the actual limits of the underlying policies, even if the policyholder received less than such limits in underlying settlements).

268. *See Zeig v. Mass. Bonding & Ins. Co.*, 23 F.2d 665, 666 (2d Cir. 1928) (explaining that a policy holder sought such a rule in what turned out to be the seminal case in this area).

269. *Id.*

270. *Id.*

271. *Compare supra* notes 111-114 and accompanying text (discussing where the policyholder's actual obligations exceed the primary policy's limit), *with supra* notes 115-119 (demonstrating that where the policyholder's settlement of its tort liability results in the tort plaintiff's agreement not to execute on a portion of the settlement amount, some courts have held that the settlement amount does not represent the policyholder's *true*

aggressively have sought to retreat from the *Zeig* rule in order to require nonsettling excess insurers to provide coverage immediately above the amounts actually received from underlying insurers' settlements. Of course, such a rule, if accepted, would pervert the entire theoretical underpinning of *Zeig* and its progeny. Where the *Zeig* rule's driving principle was that excess insurers should be no worse off on account of the policyholder's settlement with its underlying insurers,²⁷² policyholders today seek to hold excess insurers liable for amounts they never would have to cover in the absence of settlements by underlying insurers.²⁷³ In some cases, policyholders even seek to hold excess insurers perpetually liable for first-dollar coverage, contrary to the basic essence of excess coverage that the insurer is *never* subject to such liability.²⁷⁴

Fortunately, courts generally have rebuffed these blatant attempts to transfer to an excess insurer the policyholder's cost of settling with its underlying insurers.²⁷⁵ Even in the context of so-called "modern" insurance coverage litigation—with its attendant uncertainties as to allocation of the policyholder's loss and the applicability of policy limits—courts have held that an excess insurer is entitled to litigate with its policyholder over the coverage that *would have been available* under settled and released underlying policies.²⁷⁶ Only by vigorously enforcing this principle can courts avoid converting relatively inexpensive excess insurance into more valuable primary or lower-layer excess insurance in complete contravention of the premium structure under which excess policies are sold.

liability and therefore cannot be used to determine whether the policyholder's liabilities exceed the excess insurer's attachment point).

272. *Zeig*, 23 F.2d at 666.

273. See *Westchester Fire Ins. Co. v. Heddington Ins. Ltd.*, 883 F. Supp. 158, 163-64 n.11 (S.D. Tex. 1995), *aff'd mem.*, 84 F.3d 432 (5th Cir. 1996).

274. See Marick, *supra* note 4, at 731 (stating that an excess insurer's duty to pay usually only arises once the underlying policy is exhausted).

275. See, e.g., *E.R. Squibb & Sons, Inc. v. Lloyd's & Cos.*, 241 F.3d 154, 173 (2d Cir. 2001) (per curiam).

276. See Bower, *supra* note 12, at 538-43 (canvassing cases that allow excess insurers to litigate this issue).