Excess Carriers’ Duty to Defend:

When “Follow Form” Means “Drop Down” and Other Issues

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I. Sample Policy Provisions

A. Follow Form Provision

This Policy is subject to the same terms, definitions, exclusions and conditions (except as regards the premium, the amount and Limits of Liability and except as otherwise provided herein) as are contained in or as may be added to the Underlying Policies prior to the happening of an occurrence for which claim is made hereunder.

B. Follow Form Provision with express disclaimer of duty to defend

The insurance afforded by this certificate shall follow that of the primary insurance except . . . anything in this certificate or the primary insurance to the contrary notwithstanding, the Company shall not be obligated to assume charge of the settlement or defense of any claim or suit brought or proceeding instituted against the Insured . . .

II. When Does “Follow Form” Mean “Drop Down”?

A. Wisconsin Supreme Court Decision: Johnson Controls, Inc. v. London Market, 2010 WI 52, 325 Wis. 2d 176, 784 N.W.2d 579

1. Key Facts
   - In the 1980s, the EPA identified Johnson Controls as a potentially responsible party (PRP) with respect to several clean-up sites around the country
   - Johnson Controls notified its insurers and sought defense and indemnification under various primary, umbrella and excess comprehensive general liability (CGL) policies
   - Insurers refused to provide defense or indemnification, because the law in Wisconsin at the time was that insurance coverage did not exist for this type of liability, and Johnson Controls filed a coverage suit
   - After a series of appeals, Johnson Controls succeeded in convincing the Wisconsin Supreme Court to revisit the issue, and in 2003 it overruled prior precedent and found that costs incurred by a PRP to restore and remEDIATE damaged property were covered under its CGL policies
   - Court also found that an insurer’s duty to defend is triggered when a policyholder receives a PRP letter from the government
   - Johnson Controls went back to its insurers and sought reimbursement for remediation and defense costs
• London Market, one of Johnson Controls’ excess insurers, continued to deny any duty to defend under the terms of its excess policy, which sat atop primary and umbrella policies issued by Travelers.
• London Market’s policy included a “follow form” provision, stating it was subject to the same terms, definitions, exclusions and conditions of the underlying policies “except as otherwise provided”

2. Key Holdings
a. Excess insurer that issues a “follow form” policy has a duty to defend absent an explicit exclusion of such a duty
   • London Market’s “follow form” language imported into the excess policy the same duty to defend that was contained in the underlying Travelers policies.
   • London Market’s excess policy did not expressly disclaim the duty to defend.
b. Excess insurer’s duty to defend is triggered when primary insurer declines to provide a defense, even if underlying policy limits have not been exhausted
   • London Market’s duty to defend was triggered when Travelers declined to provide a defense, even though the limits of the underlying Travelers policies were not exhausted.
   • London Market’s policy provided that its “liability” did not attach until the underlying policy limits were exhausted, but the court found that the term “liability” referred to the duty to indemnify, not the duty to defend.

3. The Dissent
a. The London Market policy did not contain a promise to defend
   • London Market policy insuring agreement: “[London] Market hereby agree[s], subject to the limitations, terms and conditions hereinafter mentioned, to indemnify [Johnson Controls] for all sums, which [Johnson Controls] shall be obligated to pay . . .”
   • The follow form provision in the Conditions section of the London Market policy: “This policy is subject to the same terms, definitions, exclusions and conditions (except as regards the premium, the amount and Limits of Liability and except as otherwise provided herein) as are contained in [the underlying Travelers policy] . . .”
   • The plain language of the London Market policy promises indemnification, not defense. As stated in the dissent, “the London Market policy: (1) promises to indemnify its insured; (2) subjects that promise of indemnification to various conditions; and (3) points to the Travelers policy for additional ‘terms, definitions, exclusions and conditions’ to which the duty to indemnify is subject. The follow form provision, however, does not incorporate the entire Travelers policy by reference” (emphasis in original)
• Absent an express promise to defend, no reasonable insured would expect an excess insurance policy to provide a duty to defend, especially in light of the general rule that excess policies do not include a duty to defend.

• The majority incorporates a portion of the Travelers’ “other insurance” clause into the London Market policy, and states that, under that clause, “London Market would be required to ‘respond under [its] policy as though such other insurance were not available’ in the event that the underlying insurer ‘denies primary liability under its policy’ - unless the London Market policy otherwise provides.” The majority’s conclusion that the London Market policy incorporated the Travelers “other insurance” provision was erroneous because the London Market policy contains its own “other insurance” provision which expressly limits coverage to excess coverage.

b. Even if the London Market policy did contain a promise to defend, the defense obligation would not arise until the exhaustion of all underlying insurance.

• The London Market policy makes clear that any duty owed to Johnson Controls is conditioned upon the exhaustion of the Travelers policy.

• The majority of jurisdictions hold that an excess insurer has no obligation to defend its insured until the primary insurer’s limits are exhausted, absent express policy language otherwise.

4. Impact

• Excess coverage is not necessarily as limited as it may first appear.

• Excess coverage may provide a policyholder rights and create obligations for the insurer beyond the mere duty to indemnify upon exhaustion of underlying limits.

• Policyholder should provide notice to excess carriers of any claim that appears even remotely likely to trigger excess coverage.

• Going forward, insurers will likely include explicit disclaimers of the duty to defend in excess policies.

• Johnson Controls pertained to older policies, so the specific form at issue there is not likely to appear in many other cases.

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B. Does an explicit disclaimer of the duty to defend absolve an insurer’s duty to pay defense costs?

   - 3M settled numerous lawsuits brought by women alleging implants manufactured by 3M caused injury and then turned to its liability insurers for coverage, seeking defense and settlement costs exceeding $1 billion
   - Excess liability insurers brought an action against 3M for a declaratory judgment; 3M counterclaimed
   - Excess policies contained follow form provisions but expressly disclaimed the obligation to investigate and defend; however, excess policies contained differing provisions as to the duty to pay defense costs
   - Underlying policies required payment of defense costs and treated them separately from the duty to defend
   - Court held the follow form provisions were ambiguous, since the policies could exclude a duty to defend while requiring the insurer to pay defense costs; therefore, excess liability policies required insurer to pay defense costs

   - Excess policy followed form to a primary professional liability policy “except as regards the obligation to investigate and defend and for costs and expenses incident to the same”
   - Primary insurer incurred $5,500,000 defending the insured, and sought partial reimbursement from the excess insurer
   - Excess insurer filed complaint for declaratory relief seeking declaration that its policy excluded payment of defense costs
   - Court held that the language in the excess policy unambiguously stated that the excess policy would not cover defense costs

C. Follow Form Endorsements may require drop down earlier than umbrella or excess carrier intended

   - Policyholder brought declaratory judgment action against umbrella insurer as to whether defense costs incurred by policyholder, which were included in the limit of liability of the underlying policy, were also included in calculating the attachment point of the umbrella policy
   - Umbrella policy included “follow form endorsement,” which provided that “coverage” under the umbrella policy “shall follow and be subject to the same terms and conditions of the underlying policy”
   - Court held that a reasonable insured would have interpreted that endorsement to mean that the manner by which the retained limit would be calculated was determined by reference to the limit of liability of the underlying policy
• Absent an expression of intent not to look to the underlying policy in order to calculate the “retained limit” of the umbrella policy, such incorporation is mandated by the express terms of the endorsement to the umbrella policy.


- Policyholder had $3,000,000 SIR, and excess policies which stated that they would “not attach unless and until [Harnischfeger or its insurer] shall have paid the amount of the underlying limits on account of such occurrence.” The underlying limits were “$1,000,000.00 combined single limit each occurrence[,] $3,000,000.00 combined single limit in the aggregate.”
- A company administered the policyholder’s obligations under the SIR, and that company paid $3,000,000 in its administrative role, including legal fees and costs. After the administrator paid $3,000,000, the policyholder tendered its defense of claims to the excess insurer.
- Issue was whether excess policy triggered where the policyholder (through its administrator) was out of pocket $3,000,000, or only when it paid $3,000,000 in claims.
- Court held the excess insurer is responsible only after policyholder pays out $3,000,000 in claims. The excess policy’s “loss payable” paragraph states that the excess insurer’s obligation does not “attach” until the policyholder or the primary has “paid the amount of the underlying limits.” Nothing in the policy suggests that it was designed to trigger the excess insurer’s exposure before $3,000,000 in indemnity has been paid.

D. Is There a Duty to Drop Down and Defend in the event of Primary Insurer’s Insolvency?

1. Courts are split over whether excess carriers have the duty to drop down and defend (or indemnify^3^, for that matter) in the event of the underlying insurer’s insolvency.

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Some courts have held that an underlying insurer’s insolvency may constitute “exhaustion,” requiring excess policies to drop down where duty to indemnify is triggered by exhaustion. *See, e.g., Federal Ins. Co. v. Scarsella Bros., Inc.*, 931 F.2d 599, 604 (9th Cir. 1991); *Fageol Truck & Coach Co. v. Pacific Indem. Co.*, 117...
insolvency. Courts interpreting the same policy language have reached opposite conclusions.

2. Key policy language (absent specific language regarding insolvency)
   a. “Limit of Liability/Retained Limit” provision
   b. “Maintenance of Underlying Insurance” provision
   c. “Loss Payable” provision
   d. “Other Insurance” provision


III. Targeted Tender/Selective Tender Rule and “Armstrong Elections”

A. Targeted Tender/Selective Tender Rule

1. Rule: policyholder may select which policy, and therefore which insurer, it wants to defend and indemnify, and those duties rest solely with that insurer (insurer cannot seek contribution from other insurers)

2. Limited Doctrine
   a. Illinois
      - Insurer that issued CGL policy to contractor brought declaratory judgment action against insurer that issued project-specific policy, seeking to have its coverage deemed excess to the coverage provided by the project-specific policy with respect to claims brought against contractor by injured workers
      - Targeted tender rule allowed policyholder to deselect coverage under its project-specific policy and seek coverage only under its CGL policy
      - CGL policy’s “other insurance” provision did not supersede contractor’s right to deselect coverage under project-specific policy, because “other insurance” clause only applies when other insurance is
“available,” and project-specific policy was not “available” because its coverage was never invoked by the contractor

- Most recent decision in Illinois on targeted tender rule – summarizes earlier decisions by Illinois Supreme Court and Illinois Courts of Appeals (see John Burns Construction Co. v. Indiana Insurance Co., 189 Ill. 2d 570, 717 N.E.2d 211 (2000) (named insured under both policies had right to choose which insurer would be required to defend and indemnify it, and targeted insurer could not seek contribution from other insurer, notwithstanding “other insurance” clause in the policy); Pekin Insurance Co. v. Fidelity & Guaranty Insurance Co., 357 Ill. App. 3d 891, 830 N.E.2d 10 (Ill. App. Ct. 2005) (policyholder was not named or additional insured under policy it wanted to select; therefore, it could not deselect its own policy and select the other policy)

- Note: cases involved concurrent policies

b. Washington

- Two settling insurers in construction defect litigation brought contribution and subrogation action against non-participating insurer
- Selective tender rule precludes insurer from seeking contribution from another insurer if the policyholder never invoked coverage under the other policy (where a policyholder has not tendered a claim to an insurer, that insurer is excused from its duty to contribute to a settlement of the claim)
- Policyholder has the prerogative not to tender to a particular insurer
- Insurers could still bring conventional subrogation claim against the non-participating insurer, since that claim rests on a contractual assignment of the insured’s rights to the insurer (and therefore the “insured’s right to control tender” rationale for the “selective tender” rule is not persuasive in this context and, in fact, would limit an insured’s right to assignment under its insurance policies)
- Note: case involved concurrent policies

(2) Weyerhauser Co. v. Insurance Co. of the State of Penn., et al., 2009 WL 2461163 (W.D. Wash., Aug. 10, 2009)
- Weyerhauser settled three asbestos bodily injury claims and sought reimbursement for defense costs and settlement payments
- Insurance Company of the State of Pennsylvania (ICSP) brought third-party complaint against other insurers, including Fireman’s Fund, alleging claims for contribution
- Upon receiving underlying complaints, Weyerhauser had sent notice and tender letters to Fireman’s Fund, listing 11 policies, stating it was tendering the lawsuits for defense and indemnity (2006 letters)
- Following its settlements of the underlying lawsuits, Weyerhauser sent Fireman’s Fund new letters requesting reimbursement for the
defense and indemnity costs under Fireman’s Fund’s 1975 policy only (2008 letters)

- Fireman’s Fund paid under its 1975 policy for the first two cases, at which point its policy limit was exhausted
- Court held Fireman’s Fund had satisfied its duty to indemnify, since Weyerhauser had only selected the 1975 policy year, and the duty to indemnify had not arisen until the underlying case was settled; therefore, Weyerhauser selectively tendered the claims for indemnity under the 1975 Fireman’s Fund policy only (2008 letters)
- The 2006 letters, which requested defense and indemnity, did not create a legal obligation for Fireman’s Fund to indemnify, because the duty to indemnify only arises when an insured is actually liable to a claimant (and that claimant’s injury is covered by the policy)
- Fireman’s Fund was excused from indemnifying Weyerhauser through its other policies or policy years, and ICSP could not seek contribution from those policies
- Note: case involved successive policies

c. Wisconsin
   (1) *Westport Ins. Corp. v. Appleton Papers Inc.*, 2010 WI App 86, 327 Wis. 2d 120, 787 N.W.2d 894
   - Appleton Papers, Inc. (API) was identified as a PRP with respect to the Fox River clean-up in Wisconsin
   - API’s insurers filed a declaratory judgment action, claiming there was no coverage based on various policy exclusions
   - API’s excess insurers sought a ruling that there was no excess liability unless and until all of the underlying policies had been exhausted
   - Court held there was coverage under API’s policies, and it adopted “vertical exhaustion” – where policies were triggered for multiple years, policyholder could select which policy year would respond to a loss and then go up the tower into excess layers without first exhausting all primary coverage that might apply
   - Court did not explicitly refer to the “selective tender rule” but appears to have adopted the notion that an insurer can “select” a year of coverage to respond to a loss – it remains to be seen whether the insurers in that year can seek contribution from insurers in other years
   - Note: case involved successive policies

3. Limitations on Doctrine
   b. Insurer’s “Other Insurance” clause may prevent selection. *See River Village I, LLC v. Central Insurance Companies*, 396 Ill.App.3d 480, 919 N.E.2d 426 (1st Dist. 2009) (holding that primary policy could not be selected where its “other insurance” clause rendered it excess to other available insurance)
B. “Armstrong Election”

1. Policyholder may select a policy to provide full defense and indemnity under an “all sums” allocation approach. The selected insurer then has contribution rights against non-selected insurers (based in equity and its policy’s “other insurance” clause).

   - Dispute over coverage for claims alleging bodily injury and property damage caused by asbestos
   - Court adopted “all sums” allocation – each policy (and each insurer) has independent obligation to respond “in full” to a claim up to policy limits
   - Selected insurer may then seek contribution from non-selected insurers pursuant to equitable contribution and its “other insurance” clause
   - Policyholder need not exhaust all applicable deductibles or SIRs before receiving benefits from any of several triggered policies – policyholders may target policies with low levels of self-insurance when seeking coverage for a continuous damage claim (“Armstrong Election”)

IV. Other Issues

A. Horizontal vs. Vertical Exhaustion

1. Whether a jurisdiction has adopted horizontal exhaustion\(^4\) or vertical exhaustion\(^5\) could be key for a policyholder’s strategy to maximize coverage.
   a. Avoiding policies with large deductibles, SIRs, reimbursement endorsement provisions or retrospective premium adjustments
   b. Avoiding excess policies explicitly disclaiming a duty to defend and/or payment of defense costs
   c. Depending on the nature of the coverage at issue, you may see policyholders and insurers alike making arguments that appear counter-intuitive to their interests

2. Policy language is key in determining vertical or horizontal exhaustion – even where courts have declared one or the other to be the law of a jurisdiction (and many courts have not yet decided this issue one way or the other), their decisions are rooted in policy language


a. Sample horizontal exhaustion language – attachment point references all available or collectible insurance

Limits of Liability . . . the company’s liability shall be only for the ultimate net loss in excess of:

. . . the underlying limits of liability of the underlying insurance policies as stated and described in the declarations and those of any underlying insurance collectible by the insured as to each occurrence insured by said underlying policies of insurance . . .

b. Sample vertical exhaustion language – attachment point references specific underlying policies

Limit of Liability – Underlying Limits

It is expressly agreed that liability shall attach to the Company only after the underlying Umbrella Insurers have paid or have been held liable to pay the full amount of their respective ultimate net loss liability as follows...

3. Selective/Targeted Tender may be impacted by state’s adoption of horizontal exhaustion

      • Targeted tender rule does not allow a policyholder to select an excess policy before primary coverage is exhausted (Illinois has adopted “horizontal exhaustion,” which preempts the targeted tender rule)

B. Allocation Between Insurers Where Settlement is in Excess of Primary Policy Limits


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