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Filling In The Gaps For Excess Insurance Coverage

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On March 12, 2012, the United States District Court for the Eastern District of Virginia ruled in *Maximus Inc. v. Twin City Fire Ins. Co.*, 2012 U.S. Dist. LEXIS 32970 (E.D. Va.), that an insured subcontractor properly exhausted its primary coverage and first two layers of excess coverage by using its own money to fill coverage gaps left after it settled its coverage claims with its lower-tier insurers for less than full policy limits.

Background

Maximus Inc., a “provider of health and human services programs,” purchased professional liability insurance from five insurers, structuring a tower of insurance in which each carrier was responsible for a certain amount of indemnity costs. Maximus was self-insured for the first \$10 million of loss.

The primary policy afforded coverage for “amounts [Maximus becomes] legally obligated to pay as damages arising from a claim for wrongful acts.” Axis Reinsurance Co. issued an excess policy to Maximus, and promised to “adopt the terms and conditions of coverage in the Primary Policy ... except where otherwise noted.”

Maximus entered into a subcontract with the consulting firm Accenture Plc in connection with work that Accenture had contracted to perform for the Texas Health and Human Services Commission (HHSC). Subsequently, Accenture alleged that Maximus failed to perform as promised under the Maximus-Accenture subcontract. This resulted in Accenture “charg[ing] Maximus with default.”

Based on the failure to perform, HHSC refused to pay some of Accenture’s outstanding invoices. The three parties then entered into a settlement agreement to resolve the dispute.

Following the settlement, Maximus tendered a claim to its insurers to recover the \$78.3 million that it paid in the form of settlement payments, attorneys’ fees, “services credits” and forgiven invoices.

Maximus settled its coverage claim with its primary insurer and the insurers that provided the first two levels of excess coverage. Its retention was \$10 million, its primary coverage limit was \$20 million and its first two excess limits were \$10 million and \$20 million, respectively. The settlements were for amounts less than full limits under the settling contracts and, consequently, the insurers’ payments did not fully exhaust the available coverage.

Maximus sought to recover the policy limit of \$10 million from its third-layer excess insurer, Axis. Axis refused to provide coverage, contending that Maximus did not fully exhaust its underlying coverage since Maximus received less than the full underlying coverage amount from the settling insurers.

Maximus brought suit against Axis. Axis counterclaimed, seeking, among other things, a declaration that it was not liable to Maximus because Maximus had not exhausted its underlying policy limits. Maximus moved to dismiss the claim.

Holding

Axis argued that its duty to indemnify had not been triggered, because the underlying insurers did not pay the full amounts of their policies' limits. Maximus argued that the underlying policies were "exhausted" within the meaning of the Axis policy by a combination of payments from the insurers and its own money, which it used to "fill the gaps" between policies such that Axis would only be required to pay for amounts in excess of its \$60 million attachment.

The court considered the dispute as a matter of contract, the language of which would be applied literally to the extent it was plain, and which would be construed in favor of the insured to the extent it was ambiguous, i.e., if it was susceptible to multiple reasonable interpretations.

The court also noted that relevant, albeit nonbinding, case law holds that, absent contractual language to the contrary, it is irrelevant whether the underlying limits are exhausted solely by the insurer or by the funds of both the policyholder and the insurer. See *Zeig v. Massachusetts Bonding & Ins. Co.*, 23 F.2d 665 (2d Cir. 1928).

According to the Axis policy, coverage thereunder "shall apply only after all applicable Underlying Insurance with respect to an Insurance Product has been exhausted by actual payment under such Underlying insurance, and shall only pay excess of any retention or deductible amounts provided in the Primary Policy and other exhausted Underlying Insurance."

Axis argued that use of the phrase "actual payment" clearly required that underlying insurers make full payments up to their policy limits. The court disagreed, holding that "[t]he Axis Policy conspicuously lacks a definition of 'actual payment under such Underlying Insurance.' "

The court looked to precedent from other jurisdictions to determine the meaning, noting that it "recognize[d] the existence of competing authority on issues raised in [Axis'] motion," but none of the relevant decisions applied Virginia law and thus were not binding.

The court also referenced a Delaware decision that applied Delaware law, but which also predicted how the Virginia Supreme Court might view the impact of below-limits settlements on the exhaustion of underlying limits. As in *Zeig*, the Delaware court concluded that underlying limits can be exhausted by payments solely from the insurer or, as in the case here, the insurer and the policyholder.

Then, finding the Axis policy to be susceptible to more than one reasonable interpretation, the Maximus court found the policy to be ambiguous, requiring that it be construed in favor of Maximus. The court concluded, therefore, that Maximus properly exhausted its underlying limits through a combination of settlement proceeds from its insurers and its own money.

Implications

Maximus is significant because it underscores the policyholder's right to settle claims with one party without jeopardizing its contractual rights as to others.

The decision also correctly illustrates that, absent specific contract language to the contrary, an excess insurer cannot impose a draconian bar to excess coverage simply because a policyholder absorbs a portion of its liability by settling its claim for underlying coverage for less than full value.

Rather, the decision highlights the purpose of the underlying limit as a threshold below which the excess insurer need not respond. But where the excess insurer is not asked to “drop down” to fund any gaps in the underlying coverage, or provide any more coverage than it contractually agreed to provide, there is no prejudice to the excess insurer.

As in *Maximus*, therefore, excess coverage should remain available to the extent the total liability exceeds the underlying limits.

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