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EXPERT ANALYSIS

Washington Follows *Qualcomm*

By Steven Plitt, Esq., Kunz, Plitt, Hyland & Demlong, and Jordan R. Plitt, Esq.
Meagher & Geer

Standard excess insurance policies often require the insured to exhaust primary insurance through the payment of judgments or settlements before coverage is triggered under the excess policy.[1] Where the insured's settlement of a claim does not exhaust the primary layer of insurance, a gap in coverage can be created representing the shortfall between the amount actually paid and the attachment point for the excess policy.

Courts have split on how to view the "gap problem." A few courts have held that the "gap problem" can be satisfied by a "gap credit."[2]

Courts supporting the "gap credit" approach rely upon an ambiguity in the definition of "exhaustion" — where the excess contract lacks specificity on how the primary insurance is to be discharged — to reach a result that the excess policy is triggered when full payment of the primary limits has not been paid.[3]

The modern view, however, rejects the "settlement plus credit" or "gap credit" approach to exhaustion. As an example, the court in *Comerica Inc. v. Zurich American Ins. Co*.[4] found that while the "settlement plus credit" approach to exhaustion had the same practical effect as payment of full policy benefits, it was not consistent with the plain language of the policy, which unambiguously required exhaustion "by payment of judgments or settlements."

The court found that to displace the policy language would essentially require a holding by the court that the parties simply could not contract for an excess policy to be triggered only upon full, actual payment by the underlying insurer.

Similarly, in *Qualcomm Inc. v. Certain Underwriters at Lloyd's, London,*[5] the court found that the policyholder forfeited all excess coverage as a matter of law by settling with its primary insurers for less than the policy limits, even though the policyholder agreed to pay the entire shortfall and to seek from the excess insurer only the coverage that the excess insurer agreed to provide, *i.e.,* a "gap credit" approach. A significant number of courts have followed the *Qualcomm* approach.[6]

The Washington Court of Appeals recently held that an insured's failure to exhaust the underlying policy limits of the primary policy, through payment, precluded coverage under the available excess policies.

In *Quellos Group LLC v. Federal Insurance Co*.,[7] the Washington Court of Appeals refused to permit "gap crediting" when it enforced the plain language of the excess insurance policies, which required exhaustion through actual payment.

The court in *Quellos* joined the growing number of courts that had found that the clear and unambiguous language of the insurance policy was not to be contravened by public policy favoring settlements.[8]

In *Quellos*, the insured purchased an investment management insurance policy from American International Surplus Lines Insurance Co. The policy had a $10 million liability limit that was subject

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to a $2.5 million self-insured retention. The insured also obtained excess coverage from Federal Insurance Co. and second-tier excess coverage from Indian Harbor Insurance Co.

The first-tier Federal policy provided a $10 million liability limit after exhaustion of the AISLIC policy limits. The second-tier Indian Harbor policy provided excess coverage of $20 million after exhaustion of AISLIC and Federal policy limits. The Federal policy coverage attached "only after the insurers of the underlying insurance [AISLIC] shall have paid in legal currency the full amount of the underlying limit."[9]

The Indian Harbor policy provided that its coverage would "attach only after all the underlying insurance [AISLIC and Federal] [had] been exhausted by the actual payment of loss by the applicable insurer's thereunder."[10]

Because the plain and unambiguous language of both the Federal and Indian Harbor excess policies required exhaustion by actual payment before coverage was triggered and because there was no dispute that the underlying insurers did not pay their policy limits, the appellate court affirmed the trial court's grant of summary judgment in favor of Federal and Indian Harbor, finding that there had been a failure to exhaust the underlying coverage of policy limits.[11]

On appeal, the insured argued that a literal interpretation of the language in the excess policies as precluding the insured from paying the gap contravened Washington's public policy in favor of settlements and produced an absurd result.[12]

The court rejected this assertion finding that case law did not support the argument that public policy should override the unambiguous exhaustion language in the Federal and Indian Harbor policies.[13]

Finding that the exhaustion language in the Federal and Indian Harbor policies were clear and unambiguous, the court enforced them as written and affirmed the summary judgment dismissal.

NOTES

[1] Steven Plitt and Jordan R. Plitt *Practical Tools for Handling Insurance Cases,* Section 4:6 (Thomson Reuters, 2013 Supp., pp. 113-114).

[2] *See, e.g., Zeig v. Massachusetts Bonding & Ins. Co.,* 23 F.2d 665 (2d Cir. 1928); *Pereira v. National Union Fire Ins. Company of Pittsburgh,* 2006 WL 1982789 (S.D.N.Y. 2006); *HLTH Corp. v. Agricultural Excess & Surplus Ins. Co.,* 2008 WL 3413327 (Del. Super. Ct. 2008); *Trinity Homes LLC v. Ohio Cas. Ins. Co.,* 629 F.3d 653 (7th Cir. 2010) (applying Indiana law).

[3] *Supra* note 1 at 114.

[4] 498 F. Supp. 2d 1019, 1031 (E.D. Mich. 2007).

[5] 161 Cal. App. 4th 184, 73 Cal.Rptr.3d 770 (Cal. Ct. App., 4th Dist. 2008).

[6] *See, e.g., Fed. Ins. Co. v. Estate of Gould,* 2011 WL 4552381 at *7 (S.D.N.Y. 2011); *Goodyear Tire & Rubber Co. v. Nat'l Union Ins. Company of Pittsburgh,* 2011 WL 5024823 (N.D. Ohio 2011); *JP Morgan Chase & Co. v. Indian Harbor Ins. Co.,* 31 Misc.3d 1240(A), 930 N.Y.S.2d 175 (N.Y. Sup. Ct., N.Y. County 2011); *Intel Corp. v. Am. Guar. & Liab. Ins. Co.,* 2010 WL 5176088 at *10 (N.D. Cal. 2010); *City Group v. Nat'l Union Fire Ins. Company of Pittsburgh,* 2010 WL 2179710 at *2 (S.D. Tex. 2010); *Great Am. Ins. Co. v. Bally Total Fitness Holding Corp.,* 2010 WL 2542191 at *4-5 (N.D. Ill. 2010).

[7] 312 P.3d 734 (Wash. Ct. App., Div. 1 2013).

[8] *See, e.g., Danbeck v. Am. Family Mut. Ins. Co.,* 2001 WI 91, 245 Wis.2d 186, 629 N.W.2d 150, 156 (Wis. 2001) (noting that while the public policy favoring settlement existed, the public policy favoring settlement, "as important as it is, cannot supersede unambiguous policy language or impose obligations under the contract that otherwise do not exist. The generalized public policy favoring settlements is insufficient to justify voiding or refusing to enforce the clear language of the policy in this case.")

[9] *Quellos*, 312 P.3d at 741.

[10] *Id.* at 742.

[11] *Id.* at 743, 745.

[12] *Id.* at 743.

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[13] Distinguishing *Zeig, supra* at n.2, the court noted that unlike the facts before the court in *Zeig*, the plain and unambiguous language of the excess insurance policies issued by Federal and Indian Harbor unambiguously stated how the underlying insurance was to be exhausted. *Quellos*, 312 P.3d at 744-745 (citing by contrast *Citigroup Inc. v. Federal Insurance Co.,* 649 F.3d 367, 372 (5th Cir. 2011) (the plain language of the [excess insurance] policies dictate that the primary insurer pays the full amount of its limits of liability before excess coverage is triggered"); *Qualcomm Inc. v. Certain Underwriters at Lloyd's, London,* 161 Cal. App.4th 184, 73 Cal.Rptr.3d 770, 785 (Cal. Ct. App., 4th Dist. 2008) (because the exhaustion language in the excess policy unambiguously precluded coverage, the court rejected the argument that the public policy promoting settlement contravened the policy language). *Quellos*, 312 P.3d at 744 referring to *Seafirst Center Ltd. Partnership v. Erickson,* 127 Wash.2d 355, 898 P.2d 299 (Wash. 1995); and *Zeig v. Massachusetts Bonding & Insurance Co.,* 23 Fed. 2d 665 (2d Cir. 1928).

Steven Plitt (L) is the current successor author to "Couch on Insurance 3d." A founding partner of the coverage boutique law firm **Kunz Plitt Hyland & Demlong** in Phoenix, Plitt serves as chairman of the insurance practice group and maintains a national practice. He is frequently called upon as an expert witness in insurance-related cases on subjects including bad faith, coverage issues, insurance agent errors and omissions and legal malpractice. He can be reached at sp@kunzlegal.com. **Jordan R. Plitt** (R) is an associate in the Scottsdale, Ariz., office of **Meagher & Geer**. His practice focuses on complex insurance coverage issues and litigation. He is a co-author of the book "Practical Tools for Handling Insurance Cases" published by Thomson Reuters. He is an associate author of "Couch on Insurance 3d." He can be reached at jplitt@meagher.com

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