Gilbert LLP

How to Avoid Turning a Settlement with Your Primary Insurer Into a "Get Out of Jail Free" Card for Your Excess Insurer – The *Qualcomm* Dilemma

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By Kami Quinn and Tyechia White

Imagine for a moment that you have two customers, Diane and George. Diane and George each owe you money for products they have purchased. Each of them raises some concerns about the bill. Being a wise business owner, you assess your likelihood of collection. Due to some concerns about Diane's ultimate ability to pay, you confidentially agree to resolve the matter and release your claim against her for 75% of her bill and initiate a collection action against George.

George's lawyer argues that his obligation is entirely excused because you released Diane without full payment. Absurd, right? In the insurance context, the answer is: not always. In a small but growing number of cases, courts have held that a below-limits settlement with one carrier has the effect of releasing all of the insurers excess that policy of their obligations. *Qualcomm, Inc. v. Certain Underwriters at Lloyd's, London*, 161 Cal. App. 4th 184 (2008); *Forest Labs., Inc. v. Arch Ins. Co.*, 953 N.Y.S.2d 460 (2012); *JP Morgan Chase & Co. v. Indian Harbor Ins. Co.*, 2012 WL 2105915, at *2-3 (N.Y. App. Div. June 12, 2012); *Bally Total Fitness Holding Corp.*, No. 06 C 4554, 2010 WL 25452191, at *5 (N.D. Ill. June 22, 2010); *Comerica Inc. v. Zurich Am. Ins. Co.*, 498 F. Supp. 2d 1019 (E.D. Mich. 2007).

The problem arises where excess policies contain language that describes the level at which they attach not in terms of the liability incurred by the policyholder, but in terms of the amount paid by the underlying carrier for such liability. In that case, when a policyholder settles and releases the underlying carrier without payment of full limits, the underlying carrier will never pay the specified "attachment" amount and the excess carrier is freed from any obligation to pay, ever. In other words, if a policyholder with a tower of coverage worth $100 million, and $100 million in covered liability, but settles with the primary carrier for $4.5 million out of the full $5 million in applicable limits because of defenses (meritorious or not) related only to the primary carrier, all of the excess carriers could be released from their obligation to pay a single dollar. Not surprisingly, we think these cases are wrongly decided for a number of reasons, but for now, they are the law in some jurisdictions.

Fortunately, there are ways to protect your business against the risk that settling with a lower level or primary insurer will eliminate the obligations of higher level excess carriers to pay their share of a claim. A non-exhaustive list of possibilities follows:

- Carefully analyze the language of your excess policies before you purchase them. Many of the cases in this area turn on very specific language issues. Understand the particular state law that is likely to apply to your policies on this issue.

- If you're dealing with existing liability and coverage, consider the following possibilities:

    - Analyze carefully the level of risk you face on this issue based on the specific language of the policy, the applicable state law and the type of coverage at issue, and incorporate that risk into your settlement analysis;

    - Consider a settlement strategy that approaches a coverage tower from the top down;

    - Make settlement agreements contingent on eventual settlements with other higher-lying carriers;

    - Consider creative settlements that include an obligation on behalf of the carrier to pay full limits in return for a release and some other consideration.