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A Regrettable Insurance Decision From The 9th Circ.

By **William Corbett Jr. and Michael Aiello** (March 8, 2019, 3:13 PM EST)

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A recent decision from the United States Court of Appeals for the Ninth Circuit creates considerable uncertainty in the evaluation of the rights and obligations of excess casualty insurers in the context of sexual abuse claims.

In Westport Insurance v. California Casualty Management,[1] published Feb. 20, 2019, the Ninth Circuit affirmed the Northern District of California's order granting summary judgment for plaintiff Westport Insurance Corp. over defendant California Casualty Management Co. in a diversity insurance contribution case decided under California law.

The coverage action arose out of three underlying lawsuits filed by three students of Moraga School District against the district and three of its school administrators for failing to prevent a teacher from molesting them over various periods in the 1990s, referred to as the underlying actions.

Westport, through a predecessor company, issued primary general liability insurance policies to the district from 1991 to 1997. Westport also issued a series of annual excess policies covering the district and its employees from Oct. 1, 1994, to Oct. 1, 1997. During the same period, California Casualty issued successive annual liability policies to the Association of California School Administrators providing excess liability coverage to the administrators who were sued.

In the underlying actions, Doe 1 alleged that she was molested during policy periods 1993-94, 1994-95 and 1995-96; Doe 2 alleged that she was molested in the 1995-96 and 1996-97 periods; and Doe 3 alleged that she was molested in the 1996-97 period. Westport settled the three underlying actions on behalf of the district and the administrators for a total of $15.8 million, and California Casualty refused to contribute to the settlements. On cross-motions for summary judgment, the district court awarded Westport $2.6 million in contribution from California Casualty, along with $755,637.20 in prejudgment interest.

The California casualty policies covered "all damages in excess of the required underlying primary collectible insurance or self-insurance." Administrator excess liability was capped at $150,000 per occurrence per insured, applying as excess over a $1 million each occurrence underlying primary layer, and the policy had a $2 million aggregate limit per annual policy period. An exclusion stated, "[t]here

shall be no insurance afforded under this policy until the required $1 million limit of liability afforded the insured by such other insurance or self-insurance is exhausted."

The circuit court noted that the California casualty policies were certainly excess policies, but required only that the "underlying primary collectible insurance or self-insurance" be exhausted before its coverage attached. The California casualty policies required the exhaustion of only "primary" or "self" insurance as opposed to "all other" insurance or "primary and excess" insurance.

Westport's excess policies stated, "[i]f there is any other collectible insurance available to the insured ... [this insurance] will apply in excess of other collectible insurance." Based on this language distinction, the circuit court panel construed the California casualty policies to attach upon the exhaustion of the Westport primary policies, not upon exhaustion of all other insurance, including the Westport excess policies.

California Casualty complained on appeal that the district court erred in assigning any liability to its policies because the settlements of the underlying actions did not allocate liability among the insured administrator defendants and the district. The circuit court rejected that argument, holding that because California Casualty declined to participate in the settlements despite demands exceeding the primary coverage, it waived its ability to require a contemporaneous allocation. Further, the panel found the district court to have acted within its discretion is assigning an equal 25 percent allocation to each of the four underlying actions defendants based upon the fact that the pleadings in those cases asserted all claims against all of the defendants.

Regarding contribution, the district court held that because the defendant administrators were insureds under the California casualty policies, California Casualty was required to pay $150,000 per occurrence per administrator for each policy period. The district court found an “occurrence” per administrator per student in each period in which abuse took place regardless of the number of incidents, a finding that was not challenged on appeal.

Conversely, Westport's primary policies contained a condition stating that while the policy applied separately to each insured, "nothing herein shall operate to increase the Company's liability ... beyond the amount or amounts for which the Company would have been liable if only one person or interest had been named as insured." Based on that provision, the district court held that Westport was only required to cover $1 million per occurrence per student for each policy period, but not per administrator.

On appeal, California Casualty argued that Westport should have been required to pay $3 million per policy period because there were three insured administrators, in the same manner the district court ordered California Casualty to pay up to $450,000 per policy period. Ultimately, the court found this argument unpersuasive, citing the aforementioned severability of interest condition in the Westport primary policies.

Under similar rationale, California Casualty argued that Westport only paid $333,333.33 per each insured and thus its policies did not attach until $1 million was paid per insured regardless of source (i.e. the Westport primary policy, any other policy, or through self-insurance). Once again, the circuit court rejected California Casualty’s contention, finding that the California casualty policies did not explicitly require that the underlying primary limit be exhausted on a per insured basis. Rather, the California casualty policies required only that the underlying insurance of $1 million “afforded the insured by such other insurance or self-insurance is exhausted." In the Ninth Circuit panel’s view, this language did not

clearly require that $1 million be exhausted per insured or even for the same occurrence, just that it be exhausted.

Finally, California Casualty contended that its excess coverage should be prorated with that of the Westport excess policies instead of being placed in a position of priority. While acknowledging prior California law requiring proration in cases of conflicting excess “other insurance” clauses, the panel rejected the argument and found significant that the California casualty policies’ condition stated they "shall not be construed to be pro rata, concurrent or contributing with any other insurance or self-insurance which is available to the Insured." It then bolstered its conclusion with its own prior holding that the California casualty policies do not occupy the same level of coverage as either of Westport's policies. Accordingly, the circuit held that there was “no conflict between the California Casualty Policies and either of Westport's policies such that they should prorate.”

The decision of the Ninth Circuit in Westport Insurance is regrettable in several significant respects. First, it exacts an untoward toll in the form of waiver against an excess insurer without a defense obligation that declines to participate in settlements based on what appear to be bona fide positions regarding underlying exhaustion and priority of coverage. While a public policy argument in favor of waiver could perhaps be constructed in a situation where an excess insurer’s refusal results in tangible harm to the rights or interests of its insured, that factor is absent in this intercarrier dispute. Instead, the lever of waiver is deployed merely to lift from the primary insurer its ordinary burden to demonstrate the reasonableness of its settlements and its allocation of those settlements among insured and noninsured (by the excess carrier) parties.

Furthermore, the court’s rulings regarding excess attachment and priority are difficult to square with the language of the respective policies. There is no question that the California casualty policies were designed to apply upon exhaustion of $1 million in per occurrence coverage, nor is it the least bit unusual that a severability of interest condition required that such per occurrence coverage be applied on an “each insured” basis. Recall that the district court held that there was a separate “occurrence” per student, per administrator, per year (a holding that the authors do not take up here). That holding, which was not challenged on appeal, should have been applied as well to the Westport primary policies, subject only to any applicable aggregate limits in those policies (apparently $3 million annually).

But the Ninth Circuit panel extracted language from a severability of interests clause (designed to prevent expansion of the each occurrence limit based upon multiple insureds) to create an artificial $1 million aggregate primary limit. And it ignored language in the California casualty policies requiring that $1 million in each occurrence primary coverage be in force and exhausted before those policies attached. In so doing, the circuit court fundamentally altered the deal, and provided a windfall to Westport, by essentially amending the California casualty policies to accelerate their attachment.

Lastly, the circuit court’s ruling regarding proration is thoroughly unconvincing. Both the California casualty policies and the Westport excess policies contain “other insurance” conditions that can only fairly be described as “excess” clauses. In such situations, as the panel recognizes, California courts typically regard the clauses as mutually repugnant and require proration.

But the panel instead sweeps aside that established law relying on nothing more than its own prior (and dubious) conclusion that the California casualty policies should be “sandwiched” between the Westport policies because they require the exhaustion of primary and self-insurance (an attachment provision set forth in an exclusion) instead of all other collectible insurance (an “other insurance” provision of the

Westport excess policies). The circuit court's conflation of the "other insurance" clause with an attachment provision led it clearly to err.

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[1] Westport Insurance v. California Casualty Management, 2019 U.S. App. LEXIS 4889, __ F.3d __, 2019 WL 692668