Negotiating Less than Policy Limits Settlements: An "Exhaustive" Examination in the Wake of Recent Court Decisions

14 October 2010

Kevin T. Coughlin, Esq.
Robert J. Kelly, Esq.
Michael E. Carrer, Esq.

350 MOUNT KEMBLE AVENUE
P.O. BOX 1917
MORRISTOWN, NEW JERSEY 07962-1917
PHONE: (973) 267-0058
FACSIMILE: (973) 267-6442

WALL STREET PLAZA
88 PINE STREET, 28TH FLOOR
NEW YORK, NEW YORK 10005
PHONE: (212) 483-0105
FACSIMILE: (212) 480-3899

WWW.COUGHLINDUFFY.COM

TABLE OF CONTENTS

I. Factual Scenario 1

II. The *Zeig* Rule: A Majority Of Jurisdictions Allow Triggering of Excess Policies Even When an Underlying Insurer Settles For Less Than Policy Limits 2

III. The *Comerica*/*Qualcomm* Rule: A Minority Of Jurisdictions Do Not Allow Triggering of Excess Policies When an Underlying Insurer Settles for Less Than Policy Limits 4

A. *Comerica Inc. v. Zurich American Insurance Company* 4

B. *Qualcomm, Inc. v. Certain Underwriters at Lloyd's London* 7

C. *Danbeck v. American Family Mutual Insurance Company* 10

D. *Wright v. Newman* 12

E. Recent Cases Rejecting *Zeig* 13

IV. Potential Issues Created By The *Comerica*/*Qualcomm* Line Of Cases 14

A. Insureds May Seek To Include Policy Language Drafted To Avoid a *Comerica*/*Qualcomm* Situation 15

B. Insureds Will Be More Apt To Require Global Settlements With All Insurers In A *Comerica*/*Qualcomm* Jurisdiction 16

C. Excess Insurers May Be Less Willing To Settle With Their Insureds For Fear That Reinsurance Will Be Denied 17

D. Insurers That Have Both Primary And Excess Lines Of Business Will Be In A Difficult Legal Situation In States That Have Not Chosen A Side In *Zeig* v. *Comerica*/*Qualcomm* 17

I. Factual Scenario

Consider the following situation: A corporation's employees file a class action against the corporation, seeking damages resulting from alleged rights to unvested company stock options. During the litigation, the corporation settles the class action for $30 million dollars. The corporation then seeks coverage from its primary and excess insurers. The primary insurer issued a policy with $20 million limits while the excess insurer issued a policy with $20 million limits excess of $20 million.

Both the primary and excess insurers dispute coverage and litigation ensues. The corporation eventually settles the claim against the primary insurer for $16 million, $4 million less than policy limits. The corporation then demands that the excess insurer pay $10 million, the difference between the $30 million settlement with the underlying plaintiffs and the $20 million policy limits of the primary policy. The corporation agrees to absorb the $4 million gap between the settlement it received from the primary insurer and the primary insurance policy limits.

Is the excess insurer required to pay the $10 million? While a majority of jurisdictions in the United States answer this question in the affirmative, a growing number of jurisdictions look to the specific policy language at issue and, based upon this language, require that the primary insurer pay the full policy limits before the excess policy is triggered.

This paper describes the two approaches, known as the *Zeig* Rule (majority) and the *Comerica*/*Qualcomm* Rule (minority), focusing on the reasoning adopted by those courts that have rejected the majority approach and require actual payment of policy limits by an underlying insurer in order to trigger excess coverage. The paper then discusses various issues the minority

rule creates and hurdles that insurers and insureds must consider prior to entering into a settlement for less than policy limits.

II. The *Zeig* Rule: A Majority Of Jurisdictions Allow Triggering of Excess Policies Even When an Underlying Insurer Settles For Less Than Policy Limits

A majority of jurisdictions throughout the United States have adopted the rule that a settlement between an insured and an underlying insurer for less than the underlying insurance policy limits does not prevent the insured from collecting additional coverage from its excess carriers. Instead, the insured effectively becomes self-insured for any gap between the settlement amount and the underlying policy limits. Any damages in excess of the underlying policy limits are borne by the excess carriers to the extent covered by the excess policies.

This rule was first articulated by the Second Circuit Court of Appeals in *Zeig v. Massachusetts Bonding & Insurance Company*, 23 F.2d 665 (2nd Cir. 1928). In *Zeig*, the insured, Louis Zeig, had obtained four insurance policies covering losses from burglary totaling $20,000. Massachusetts Bonding and Insurance Company ("Massachusetts Bonding") issued one of the four policies, with policy limits of $5,000 excess $15,000. According to the terms of the Massachusetts Bonding policy, coverage was "excess and not contributing insurance, and shall apply and cover only after all other insurance herein referred to shall have been exhausted in the payment of claims to the full amount of the expressed limits of such other insurance." *Id.* at 665.

Zeig incurred losses covered by the policies in excess of $15,000 and settled the first three insurance policies for $6,000, $7,000 less than the combined policy limits. Massachusetts Bonding refused to cover Zeig's damages in excess of $15,000, arguing that "it was necessary for the plaintiff actually to collect the full amount of the policies for $15,000, in order to 'exhaust" that insurance." *Id.* at 666. The Second Circuit rejected this argument that an excess

insurance policy is triggered only if the insured actually collects the full amount of the underlying policy limits from the underlying insurer. The court held that:

> Such a construction of the policy sued on seems unnecessarily stringent. It is doubtless true that the parties could impose such a condition precedent to liability upon the policy, if they chose to do so. But the defendant had no rational interest in whether the insured collected the full amount of the primary policies, so long as it was only called upon to pay such portion of the loss as was in excess of the limits of those policies. To require an absolute collection of the primary insurance to its full limits would in many, if not most, cases involve delay, promote litigation, and prevent an adjustment of disputes which is both convenient and commendable. A result harmful to the insured, and of no rational advantage to the insurer, ought only to be reached when the terms of the contract demand it.

Id. The *Zeig* Court concluded that the policy at issue did not require that the underlying policies be exhausted by actual payment by the underlying insurers, stating that "[t]here is no need of interpreting the word 'payment' as only relating to payment in cash. It often is used as meaning the satisfaction of a claim by compromise, or in other ways." *Id.*

Although the court did construe the excess policy language as not requiring actual payment of the underlying limits, it is clear from the above-quoted language and the cases that have followed *Zeig* that the primary motivation was the public policy argument that "[t]o require an absolute collection of the primary basis for the ruling to its full limits would in many, if not most, cases involve delay, promote litigation, and prevent an adjustment of disputes which is both convenient and commendable." *Id.*

Allowing the insured to become self-insured for a gap between a settlement amount and an insurer's policy limits has been adopted in a majority of United States jurisdictions. *See*, *e.g.*, *Federal Ins. Co. v. Srivastava*, 2 F.3d 98 (5th Cir. 1993); *Stargatt v. Fidelity & Cas. Co. of New York*, 67 F.R.D. 689 (D. Del. 1975), *aff'd*, 578 F.2d 1375 (3d Cir. 1978); *Siligato v. Welch*, 607

F. Supp. 743 (D. Conn. 1985); *Reliance Ins. Co. v. Transamerica Ins. Co.*, 826 So. 2d 998 (Fla. Ct. App. 2001). As such, a majority of United States jurisdictions would answer the question posed in Section I, *supra*, in the affirmative, allowing the insured to become self-insured for the $4 million gap and require the excess insurer to pay $10 million.

III. The *Comerica/Qualcomm* Rule: A Minority Of Jurisdictions Do Not Allow Triggering of Excess Policies When an Underlying Insurer Settles for Less Than Policy Limits

Although the *Zeig* Rule is followed in a majority of states, a growing number of jurisdictions reject the Second Circuit's conclusion. These cases reject *Zeig*'s public policy analysis and choose, instead, to focus on the policy language at issue. The courts often support their holdings by citing to the *Zeig* Court's statement that "[i]t is doubtless true that the parties could impose such a condition precedent to liability upon the policy, if they chose to do so." *Zeig*, 23 F.2d at 666. This section discusses those cases that have rejected *Zeig*, instead holding that the express language of an excess policy requires the actual payment by the underlying insurer before the policy is exhausted such that excess coverage may be found to exist.

A. *Comerica Inc. v. Zurich American Insurance Company*

One of the leading cases to adopt the minority rule is *Comerica Inc. v. Zurich American Insurance Company*, 498 F. Supp. 2d 1019 (E.D. Mich. 2007). The facts of *Comerica* are as follows: on July 17, 2002, Comerica issued a press release announcing financial results for the 2002 second quarter. Comerica then announced on October 2, 2002 that the July 17 press release had been incorrect and five securities class action lawsuits were soon filed against it. The class actions were consolidated into two actions and were eventually settled by Comerica for $21 million. By the time of the settlement, Comerica had incurred a total of $2.6 million in defense costs.

Comerica had obtained a $20 million primary insurance policy from Federal Insurance Company ("Federal") covering the period at issue in the class action securities lawsuits. Comerica had also obtained a $20 million insurance policy from Zurich American Insurance Company ("Zurich"), which was excess to the Federal policy. Comerica sought coverage under the two policies, which both Federal and Zurich disputed. On December 30, 2004, Comerica and Federal settled their coverage dispute, agreeing that Federal would pay $14 million towards the settlement of the underlying litigation. They also agreed that "the policy shall be deemed fully exhausted and is null and void and has no force or effect whatsoever." *Id.* at 1025-26.

After settling with Federal, Comerica sought coverage from Zurich for $3.6 million, the difference between the $21 million settlement in the underlying lawsuits and the $20 million Federal policy limits plus the $2.6 million in defense costs. Zurich refused coverage, contending that the Federal policy was not exhausted. Comerica then brought suit against Zurich for payment under the excess policy. Zurich filed a motion for summary judgment, arguing that it was not obligated to pay because Federal did not actually pay the full $20 million primary policy limits. *Id.* at 1026. The Zurich policy provided that:

> In the event of the depletion of the limit(s) of liability of the "Underlying Insurance" solely as a result of actual payment of loss thereunder by the applicable insurers, this Policy shall . . . continue to apply to loss as excess over the amount of insurance remaining . . . In the event of the exhaustion of the limit(s) of liability of such "Underlying Insurance" solely as a result of payment of loss thereunder, the remaining limits available under this Policy shall . . . continue for subsequent loss as primary insurance . . . .
>
> This Policy only provides coverage excess of the "Underlying Insurance." This policy does not provide coverage for any loss not covered by the "Underlying Insurance" except and to the extent that such loss is not paid under the "Underlying Insurance" solely by reason of the reduction or exhaustion of the available "Underlying Insurance" through payments of loss thereunder . . . .

Id. at 1022 (alterations in original). Comerica opposed Zurich's motion, arguing, among other things, that public policy supported its argument that Zurich pay any amount in excess of the $20 million underlying limits.

In granting Zurich's motion, the court first rejected the analysis adopted in *Zeig*, stating that "[t]he cases that follow *Zeig* generally rely on an ambiguity in the definition of 'exhaustion' or lack of specificity in the excess contracts as to how the primary insurance is to be discharged." *Id.* at 1030. The court concluded that "[a] different result occurs when the policy language is more specific." *Id.*

> Payments by the insured to fill the gap, settlements that extinguish liability up to the primary insurer's limits, and agreements to give the excess insurer "credit" against a judgment or settlement up to the primary insurer's liability limit are not the same as actual payment. Zurich's policy requires "actual payment of losses" by the underlying insurer and states that its "policy does not provide coverage for any loss not covered by the 'Underlying Insurance' except and to the extent that such loss is not paid under the 'Underlying Insurance' solely by reasons of the reduction or exhaustion of the available 'Underlying Insurance' through payments of loss thereunder." That never happened in this case.

Id. at 1032.

Finally, the court also cited the *Zeig* Court's statement that "[i]t is doubtless true that the parties could impose such a condition precedent to liability upon the policy, if they chose to do so." *Id.* (quoting *Zeig*, 23 F.2d at 666). According to the *Comerica* Court, "[t]he contract language here states that is exactly what the parties did, and Comerica's argument to the contrary would require a contract rewrite, which this Court is not inclined to do." *Id.*

The court rejected the purely public policy argument, instead deciding to enforce the clear and unambiguous terms of the insurance policy at issue. The court stated that Comerica chose to settle its dispute with Federal, accepting a less than policy limits settlement in order to

avoid the possibility of losing all its coverage at trial. *Id.* In seeking coverage from Zurich, "Comerica seeks the certainty that its settlement brought and the benefit of coverage from its excess carrier as if it has won its dispute with the primary insurer, despite language in the excess policy to the contrary." *Id.* The policy language controlled and, since the primary insurer had not actually paid its full limits, the primary policy was not exhausted such that there was no coverage under the excess policy.

B. *Qualcomm, Inc. v. Certain Underwriters at Lloyd's London*

On March 25, 2008, the California Court of Appeal for the Fourth Appellate District also rejected the holding of *Zeig*, concluding that acceptance by an insured in settlement of less than primary policy limits precludes the insured's ability to recover from its excess insurers. *Qualcomm, Inc. v. Certain Underwriters at Lloyd's, London*, 161 Cal. App. 4th 184 (Cal. Ct. App. 2008), *review denied*, 2008 Cal. LEXIS 6969 (Cal. Jun. 11, 2008) ("*Qualcomm*").[1] In *Qualcomm*, the California Court of Appeal addressed the following facts: Qualcomm purchased a D&O policy from National Union Fire Insurance Company of Pittsburgh, P.A. ("National Union") with policy limits of $20 million for the policy period of 15 March 1999 to 15 March 2000. Qualcomm also obtained a first layer excess "following form" policy from Certain Underwriters at Lloyd's, London ("Underwriters"). The Underwriters policy was excess to the National Union primary policy.

In May 1999, Qualcomm employees filed a class action lawsuit against Qualcomm related to asserted rights to unvested company stock options. Other employees filed separate lawsuits against Qualcomm seeking acceleration of stock option vesting. After protracted litigation, Qualcomm settled these lawsuits, incurring defense and settlement costs of

[1] The facts of the Factual Scenario in Section I, *supra*, were taken from the facts presented to the court in *Qualcomm*.

approximately $30 million. Qualcomm sought coverage under the National Union and Underwriters policies. Both insurers disputed coverage. Eventually, National Union settled with Qualcomm for $16 million in exchange for a release. Qualcomm then sought coverage under the Underwriters policy for defense and settlement in excess of $20 million, Qualcomm agreeing to absorb the $4 million difference between the settlement payment by National Union and the National Union policy limits. Underwriters refused coverage, arguing that the excess policy had not been triggered because National Union had not "paid" its $20 million policy limits as required. Qualcomm sued Underwriters for breach of contract and declaratory relief, arguing that

> when an insured settle[s] with its primary insurer for an amount below the primary policy limits but absorbs the resulting gap between the settlement amount and the primary policy limit, primary coverage should be deemed exhausted and excess coverage triggered, obligating the excess insurer to provide coverage under its policy.

Id. at 188.

Qualcomm argued that allowing the insured to absorb the difference between the amount paid by the underlying insurer and the underlying limits of the excess policy would not put Underwriters in any worse position than if National Union had actually paid its policy limits. Additionally, Qualcomm contended that denying coverage in this situation would violate public policy by working a forfeiture, providing a windfall to the excess carrier, and encouraging litigation by discouraging settlements between insureds and their primary insurers. The trial court disagreed, holding that the Underwriters policy was not triggered, and Qualcomm appealed.

The Court of Appeal affirmed the trial court's decision, holding that the unambiguous language of the Underwriters policy required National Union to pay the $20 million policy limits

and did not allow Qualcomm to make up the $4 million gap created by its settlement. The court began its analysis by discussing the principles of insurance policy interpretation. Under these rules, "a court must give effect to the mutual intention of the parties when they formed the contract." *Id.* at 191. This intent is primarily controlled by the "clear and explicit" terms of the contract.

The Underwriters policy stated that "Underwriters shall be liable *only after* the insurers under each of the Underlying policies *have paid* or *have been held liable to pay* the *full amount* of the Underlying Limit of Liability." *Id.* at 195. The court concluded that the clear and explicit meaning of "the phrase 'have paid . . . the full amount of [$20 million],' particularly when read in the context of the entire excess policy and its function as arising upon exhaustion of primary insurance, cannot have any other reasonable meaning than actual payment of no less than the $20 million underlying limit." *Id.* (alterations in original).

In reaching this decision, the court was not swayed by the public policy arguments in favor of allowing Qualcomm to assume responsibility for the difference between its settlement with National Union and the National Union policy limits, thereby triggering Underwriters' liability. The California Court specifically refused to follow the holding in *Zeig*.

> First, the [*Zeig*] court appeared to place policy considerations (i.e., the promotion of convenient settlement or adjustment of disputes) above the plain meaning of the terms of the excess policy, and for that reason . . . we reject its reasoning. Second, we disagree with its strained interpretation of the word "payment." Third, the *Zeig* court acknowledged that parties in these circumstances may include excess policy language explicitly requiring actual payment as a condition precedent to coverage and that a court may reach a contrary result "when the terms of the contract demand it." The exhaustion clause here compels us to conclude that the parties expressly agreed that National [Union] was required to pay (or be legally obligated to pay) no less than $20 million as a condition of Underwriters's liability.

Id. at 197-98 (citations omitted). The court similarly rejected other authorities adopting *Zeig*'s reasoning because "most of these decisions have as a 'common thread' the [public] policy rationale favoring the efficient settlement of disputes between insurers and insureds, a rationale that in our view cannot supersede plain and unambiguous [insurance] policy language." *Id.* at 199 (citations omitted).

Even in the face of unambiguous language to the contrary, Qualcomm argued that public policy should control, overcoming any policy language that would result in eliminating insurance coverage. Again, the court disagreed, explaining that "[w]hatever merit there may be to conflicting social and economic considerations, they have nothing whatsoever to do with our interpretation of the unambiguous contractual terms. If contractual language in an insurance contract is clear and unambiguous, it governs, and we do not rewrite it 'for any purpose.'" *Id.* at 204 (citations omitted).

Just as in *Comerica*, the court in *Qualcomm* looked beyond the public policy arguments adopted by *Zeig* and its progeny, choosing instead to enforce the unambiguous terms of the insurance contract. Based on these terms, the insured was entitled to coverage under the excess policy only after the underlying insurer had actually paid the full limits of the primary policy. Absent such actual payment, the excess insurer was not obligated to provide coverage to the insured.

C. *Danbeck v. American Family Mutual Insurance Company*

Although *Comerica* and *Qualcomm* are cited as the principal cases adopting the majority rule, there are two cases that pre-date both decisions upon which the *Comerica* and *Qualcomm* courts relied in their analysis. One of these cases is *Danbeck v. American Family Mutual Insurance Company*, 629 N.W.2d 150 (Wis. 2001). In *Danbeck*, the insured, Dan Danbeck, was

seriously injured when a car driven by George Horne struck him while riding his bicycle. Horne had $50,000 of automobile liability coverage and Danbeck had underinsured motorist coverage of $100,000 from his insurer, American Family Mutual Insurance Company ("American Family"). The American Family policy stated that it "will pay under this coverage only after the limits of liability under any bodily injury liability bonds or policies have been exhausted by payment of judgment or settlements." *Id.* at 152. Danbeck settled with Horne and his insurer for $48,000 and then pursued coverage from American Family. American Family refused the claim, arguing that Horne's policy had not been exhausted per the terms of the American Family policy, and litigation ensued.

The trial court found that the exhaustion language in the American Family policy was ambiguous and that allowing coverage in this situation would promote the purposes of underinsured motorist coverage. The appellate division reversed the trial court, holding that the exhaustion clause was unambiguous and required the payment of full underlying policy limits before the American Family policy was triggered. Danbeck appealed to the Wisconsin Supreme Court.

The Supreme Court affirmed the appellate division, holding that the policy language required actual payment of the full policy limits. The court stated:

> while the "settlement plus credit" approach to exhaustion has the same practical effect as payment of full policy limits, it is not consistent with the plain language of the policy, which unambiguously requires exhaustion "*by payment of judgements* [sic] *or settlements*," not settlement plus credit.

Id. at 154 (emphasis in original). According to the Court, "a 'settlement plus credit' does not constitute 'payment' of liability limits as that term is commonly and ordinarily understood." *Id*

at 155. As such, the underlying policy was not exhausted and no coverage was owed under the American Family policy.

The Court also rejected the argument that the public policy of fostering settlements should control the resolution of the case. Specifically, the Court held that "this public policy, as important as it is, cannot supersede unambiguous policy language or impose obligations under the contract which otherwise do not exist." *Id.* at 156. The Court went on to explain that "[t]o choose an interpretation that furthers the public policy of encouraging settlements but contradicts the clear language of the contract would be to substitute our policy preferences regarding UIM insurance for the agreement of the parties." *Id.*

D. *Wright v. Newman*

The other case cited by the *Comerica* and *Qualcomm* courts is *Wright v. Newman*, 598 F. Supp. 1178 (W.D. Mo. 1984). In *Wright*, a woman was killed and two others seriously injured when a car the defendant was towing came loose from the tow, crossed the center line, and struck the plaintiff's vehicle. Through its affiliation with American Auto Shippers, Inc. and corporate insurance policies, the defendant had a $300,000 primary policy issued by Commercial Union Insurance Company ("Commercial Union"), a $300,000 excess policy issued by Guaranty National Insurance ("Guaranty"), a $200,000 excess policy issued by Bellefonte Insurance Company ("Bellefonte"), and a $3,000,000 excess policy issued by Mission Insurance Company ("Mission").

The plaintiffs entered into a partial settlement with the driver and the driver's insurer for $300,000, which was paid by Commercial Union. The case then proceeded to trial and resulted in a bench award of $5,775,000. The plaintiff attempted to enforce the judgment against Mission, whose policy stated that:

> [l]iability . . . shall not attach unless and until the Primary and Underlying Excess Insurers shall have admitted liability for . . . [their] Limit(s) or unless and until . . . and only after the Primary and Underlying Excess Insurers have paid or been held liable to pay the full amount of . . . [their] Limits.

Id. at 1196. Mission argued that its excess policy was not triggered because neither of the underlying excess insurers, Guaranty and Bellefonte, had admitted liability or been found liable to pay their policy limits. The plaintiffs responded by arguing that, pursuant to *Zeig*, Mission had no rational interest in requiring actual payment by Guarantee and Bellefonte. Applying Colorado law, the court agreed with Mission, holding that:

> I could not very well apply *Zeig*'s reasoning here, even if I personally accepted that reasoning, since to do so would appear to run headlong into the clear Colorado rule that an insurance policy must generally be enforced as written. . . . I do not believe *Zeig* can be applied in a situation where – as in this case – the policy contains an express provision requiring resort to underlying insurance.

Id. at 1197.

E. Recent Cases Rejecting *Zeig*

Certain courts continue to reject the *Zeig* Rule, choosing instead to enforce the terms of excess policies as written, thereby denying coverage when an insured enters into a below underlying limits settlement. Over the past year, at least three courts have followed the *Comerica*/*Qualcomm* Rule. *Trinity Homes LLC v. Ohio Cas. Ins. Co.*, 2009 WL 3163108 (S.D. Ind. Sep. 25, 2009); *Schmitz v. Great Am. Assurance Co.*, 2010 WL 2160748 (Mo. Ct. App. Jun. 1, 2010); *Great Am. Ins. Co. v. Bally Total Fitness Holding Corp.*, 2010 WL 2542191 (N.D. Ill. Jun. 22, 2010).

In *Trinity Homes LLC*, the court held that, "[p]ursuant to the clear terms of [the insurance p]olicy, the availability of an underlying policy turns on whether the applicable limits of that

underlying policy have been exhausted, or merely reduced by payment of claims." 2009 WL 3163108, at *11. Based on the language of the excess policy, only actual payment by the underlying insurer was sufficient to exhaust the excess policy. Notably, the court specifically stated that it held "narrowly" that the excess policy was not exhausted. *Id.* at *12. Based on this language, it seems likely that the court would find exhaustion if faced with different policy language that was not as express.

Similarly, in *Schmitz*, the court held that an excess carriers obligation applies only after the underlying policy is "exhausted solely by payment of those specified amounts of money actually paid in settlement or satisfaction of a claim." 2010 WL 2160748, at *4. The settlement agreement between the insured and the primary insurers was for less than primary policy limits and, therefore, the primary policy limits were not "actually paid." Again, driven exclusively by the policy language at issue, the court held that the excess insurer was not responsible for providing coverage.

Finally, in *Bally Total Fitness*, the court noted the differences between those courts applying *Zeig* and those courts following *Comerica*/*Qualcomm* as follows:

> If an excess insurance policy ambiguously defines exhaustion, as in *Zeig*, courts generally find that settlement with an underlying insurer exhausts the underlying policies. However, in cases when the policy language clearly defines exhaustion, the courts tend to enforce the policy as written. Even the Second Circuit in *Zeig* noted that parties are free to clearly define how an underlying policy must be exhausted and can preclude settlement as a method of exhaustion.

2010 WL 2542191, at *4 (internal citations omitted).

IV. Potential Issues Created By The *Comerica*/*Qualcomm* Line Of Cases

Zeig and the courts that have continued to apply its holding often focus on the public policy against requiring an insured to recover full, actual payments from a primary insurer before

an excess policy is triggered for coverage. When refusing to follow *Comerica* and *Qualcomm*, the Delaware Superior Court explained that:

> [s]ettlement avoid costly and needless delays and are desirable alternatives to litigation where both parties can agree to payment and leave other separately underwritten risks unchanged. The Court sees unfairness in allowing the excess insurance companies in the instant case to avoid payment on an otherwise undisputedly legitimate claim.

HLTH Corp. v. Agricultural Excess & Surplus Ins. Co., 2008 WL 3413327, at *15 (Del. Super. Ct. Jul. 31, 2008).

Application of the *Comerica/Qualcomm* Rule does present a myriad of issues that will likely challenge both insureds and insurers in the years to come. As the *Zeig* Court noted, application of the *Comerica*/*Qualcomm* Rule may stifle settlement discussions between the insured and the underlying insurer. However, additional issues exist that insurers must be prepared to face in *Comerica*/*Qualcomm* jurisdictions. Below are just some of these potential issues:

A. Insureds May Seek To Include Policy Language Drafted To Avoid a *Comerica*/*Qualcomm* Situation

In an effort to avoid the *Comerica*/*Qualcomm* Rule, insureds may begin demanding inclusion of endorsements during the underwriting process that are specifically drafted to allow it to enter into less than policy limits settlements with underlying insurers. The courts that follow the *Comerica*/*Qualcomm* Rule do so by focusing exclusively on policy language. As discussed above, the language requires that the underlying policy limits be exhausted by actual payment of policy limits by the underlying insurer. It is reasonable that these courts would have allowed partial payment by the underlying insurers if there was an endorsement to the policy that

expressly allowed such partial payments. This type of endorsement would likely avoid application of the *Comerica/Qualcomm* Rule.

However, insurers may be unwilling to affix such an endorsement to insurance policies. Less than policy limits settlement between an insured and a primary insurer present the real possibility of collusion between the two at the expense of the excess insurer. For example, consider the following situation: an insured is sued for a covered claim by a third-party for $1,000,000 in damages. If the primary insurer settles a $1,000,000 policy for $700,000, there is little incentive for the insured to settle for $1,000,000 and may "roll the dice" on getting a verdict less than $700,000, risking an award in excess of $1,000,000, thereby invading the excess policy.

Similarly, an insurer with a good relationship with its underlying insurer may agree to settle with the underlying insurer early in litigation for an amount significantly below underlying policy limits. This may have the effect of triggering an excess policy earlier than it would have otherwise been triggered and may require the excess carrier to pay defense costs and other fees that it would otherwise not have been obligated to pay.

B. Insureds Will Be More Apt To Require Global Settlements With All Insurers In A *Comerica/Qualcomm* Jurisdiction

If an insured is in a jurisdiction that follows the *Comerica/Qualcomm* line of cases, it is likely that it will refuse to settle with their underlying insurers for less than policy limits. In these situations, the insured will likely require a global settlement to avoid having to face the *Comerica/Qualcomm* defense from excess carriers. Depending on how badly a primary insurer wishes to settle a claim, the insured may put the burden on the underlying insurer to approach the various excess carriers in order to settle a claim.

This may not be a significant hindrance in cases with only one underlying and one excess carrier. However, the problem becomes significantly more severe in long-tail cases involving

decades of insurers and various layers, which is often found in environmental contamination and asbestos cases. In those cases, it is possible to have dozens of insurers with policies at various levels of coverage. Negotiating a global settlement may be impossible or, at the very least, extremely time consuming and expensive.

C. Excess Insurers May Be Less Willing To Settle With Their Insureds For Fear That Reinsurance Will Be Denied

Excess insurers may be less willing to settle with insured in a *Comerica*/*Qualcomm* jurisdiction due to reinsurance considerations. There may be situations when an excess carrier will want to settle with an insured even if that insured settled for less than policy limits with the underlying insurer (to avoid litigation costs, continuing business with the insured, etc.) However, while the excess insurer may be willing to settle, the potential exists that the excess carrier's reinsurer will see such a settlement as gratuitous and not covered by the reinsurance contract. The excess carrier may not be willing to risk its reinsurance coverage such that an otherwise agreeable settlement would be rejected.

D. Insurers That Have Both Primary And Excess Lines Of Business Will Be In A Difficult Legal Situation In States That Have Not Chosen A Side In *Zeig* v. *Comerica*/*Qualcomm*

For those insurers that have both primary and excess lines of business a significant problem exists when faced with a less than policy limits settlement in a jurisdiction that has yet to weigh-in on the *Zeig* versus *Comeria*/*Qualcomm* debate. In a given case, the insurer will either be better served by application of *Zeig* or *Comerica*/*Qualcomm*, depending on whether it issued a primary or excess policy. However, once a court reaches a decision, that decision will likely become binding precedent on future courts in that jurisdiction. The insurer may find itself on the other side of the primary versus excess carrier argument in the next case and suffer for the position it took in the prior litigation.