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Settlements with Underlying Insurance Companies Discouraged by Some Courts

By Robert M. Horkovich and Robert Y. Chung

The insurance industry's promise of "seamless coverage" is anything but. A revived strategy is for an excess company to avoid paying based upon a policyholder's reasonable settlement with a lower-level insurance company. Excess insurance companies argue that the underlying insurance is unexhausted absent 100% payment of full policy limits by the underlying company.

Long-existing case law sensibly has held that the actual recovery against the underlying insurance company has no bearing on the excess insurance company's obligations once a claim reaches its layer. Recently, however, some courts have abandoned this long-held principle, arguably requiring policyholders to obtain 100% payment of full limits from every underlying insurance company before becoming eligible to recover under an excess policy.

Presently, a majority of jurisdictions follow the "Zeig rule" requiring an excess insurance company to pay its portion of a policyholder's covered loss once that loss exceeds the underlying insurance limits, regardless of the policyholder's recovery of underlying insurance proceeds. In the seminal 1928 United States Court of Appeals case, Judge Augustus Hand in *Zeig v. Mass. Bonding & Ins. Co.* held that an excess insurance company must pay if its layer of coverage has been pierced, even if the policyholder has settled with its underlying insurance company for less than the underlying

policy's limits. Judge Hand observed that the excess insurance company "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." The Second Circuit reasoned that requiring "an absolute collection of the primary insurance to its full limit would, in many if not most cases, involve delay, promote litigation, and prevent an adjustment of disputes which is not convenient and commendable."

Numerous jurisdictions follow the well-settled Zeig rule. A few courts, however, recently have disregarded these principles. These decisions discourage policyholders from entering into any settlements of underlying insurance for fear of negating excess policies.

Most recently, in 2011, the Fifth Circuit's decision in *Citigroup, Inc. v. Federal Ins. Co.* (Texas law) has encouraged excess insurance companies to assert that they need not pay for losses that penetrate their excess layer until the underlying insurance companies pay 100% of their entire policy limits, regardless of insolvency or settlement. These arguments overstate the breadth of the Fifth Circuit's holding and are contrary to long-standing insurance law.

Any anti-Zeig case flouts public policy by discouraging settlements between a policyholder and an underlying insurance company

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for anything less than full limits. These decisions ignore practical realities and allow an excess insurance company to avoid its obligations based on irrelevant circumstances.

How can policyholders try to avoid forfeiting excess insurance coverage when entering into reasonable settlements with a lower level company?

1. Review your current excess policies. If they state that the underlying coverage has to be paid or be held liable to pay their limits before the excess insurance attaches, make sure that language is deleted on the next renewal.
2. If you currently have both a claim and such language in an excess tower, and are in one of the minority jurisdictions not following *Zeig*, consider a top down settlement strategy: settle with the higher level excess insurance companies before the underlying companies.
3. If excess insurance companies refuse to settle, consider legal proceedings against underlying insurance companies, holding them liable before settling with excess insurance companies. While this additional litigation is a costly result of a few shortsighted anti-*Zeig* decisions, it may be less expensive than forfeiting excess insurance coverage.▲

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