Your Coverage Advisor

Settling with Your Primary Insurer Could Be a Multi-million Dollar Mistake

Caroline L. Marks

Vol. II, Fall 2013

Federal and state courts in Ohio are currently divided as to whether a policyholder, by virtue of settling with its primary insurer, loses its right to select from among triggered policies to receive payment, with the resulting effect being the forfeiture of excess coverage. Recently, the Ohio Supreme Court has accepted a case which is likely to settle this split of authority. *Lincoln Elec. Co. v. Travelers Cas. & Sur. Co.*, No. 2013-1088.

While the issue is complex, it is of paramount importance to understand, because no one wants to be the policyholder who settles with its primary insurer, only to later find out that its excess coverage has been reduced or even eliminated as a result of the settlement.

HOW THE ISSUE ARISES

Assume that a policyholder has CGL coverage from 2006 to 2010. As is typical, it has primary insurance with relatively low limits – $5 million per year – and overlying excess coverage with much greater limits that attach above the $5 million level. Recently, the policyholder has been sued in a high-stakes case seeking many millions in damages over a claim that spans multiple years. As a result of the dispute over coverage,

Continued on page 2

IN THIS ISSUE

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Settling with Your Primary Insurer

Continued from page 1

the policyholder settles the underlying case, incurring $20 million in defense and indemnity costs. Thereafter, the primary insurer, which has certain unique coverage defenses available to it, offers to settle the coverage dispute for $4 million. A prompt settlement is attractive to the policyholder, but it will leave the policyholder with significant unreimbursed costs, which it would like to collect from its excess insurers.

SHOULD THE POLICYHOLDER SETTLE?

The answer to this question depends on a variety of considerations, but a policyholder needs to understand how settling with its primary insurer for less than the total limits of the primary coverage potentially could reduce or eliminate available excess coverage. This question implicates four cornerstones of the Ohio coverage law system:

TRIGGER

Under Ohio's continuous-trigger law, all policies from 2006-2010 are eligible to respond to the underlying claim, because they represent those policies in effect when the alleged continuing bodily injury or property damage took place.

ALLOCATION

Because Ohio has adopted the "all sums" allocation approach, the policyholder is allowed to select the policies from which to receive payment on the claim.

DROP DOWN LIABILITY

If the full amount of underlying coverage is not available for any reason, the attachment point of the overlying coverage is preserved, and the overlying coverage is not required to "drop down" to pay claims below the bargained-for level.

CONTRIBUTION

If an insurer is selected by the policyholder and pays a claim on an "all sums" basis, that insurer has certain equitable rights of contribution against other triggered insurers.

THE POLICYHOLDER'S PERSPECTIVE:

Here, the policyholder has $16 million in unreimbursed costs – $20 million minus the $4 million settlement. Under "all sums," the policyholder selects the 2010 policy year, because that year has the most available coverage. As a result, the policyholder should expect to receive $15 million from its excess insurers:

- **$4 million (paid by primary insurer)**
- **$1 million (paid by policyholder)**
- **$15 million (paid by excess insurers)**
- **$20 million (total costs)**

Applying vertical exhaustion, the umbrella and excess policies will pay $10 million and $5 million respectively. The policyholder will absorb $1 million, which represents the variance between the settlement amount and the full limit of the primary policy, because Ohio law generally does not require excess policies to "drop down."

THE INSURERS' PERSPECTIVE:

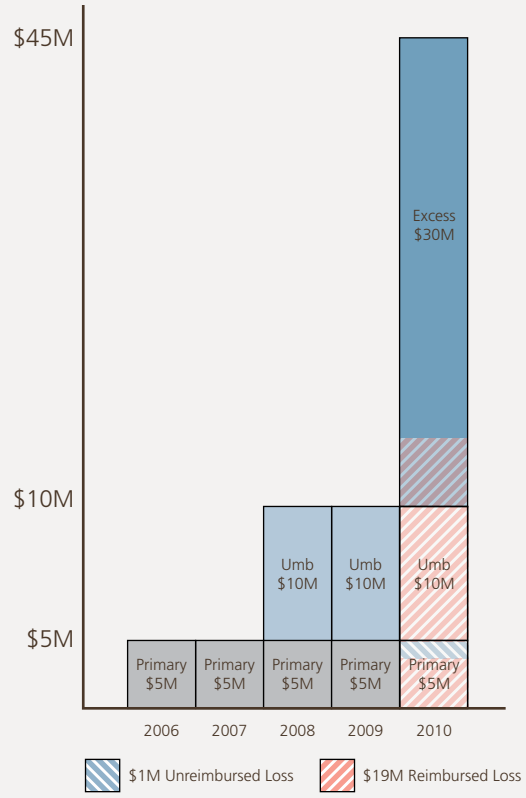
Everything is the same, except that the insurers assert that by settling with the primary insurer, which had five years of triggered coverage, the policyholder forfeited its right to use "all sums" allocation. According to the insurers, the policyholder now must exhaust the limits of all triggered primary policies before reaching the excess layers. Under this scenario, the policyholder will receive nothing from its excess insurers:

- **$4 million (paid by primary insurer)**
- **$16 million (paid by policyholder)**
- **$0 million (paid by excess insurers)**
- **$20 million (total costs)**

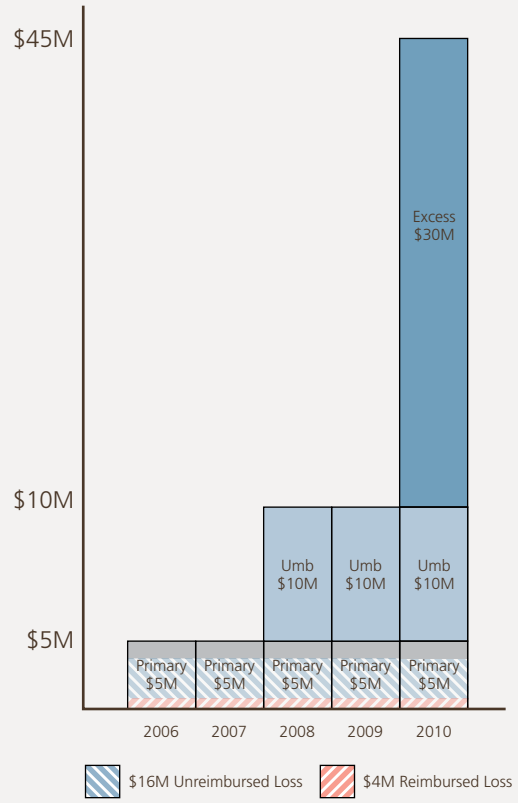
This unfair result should occur, certain insurers would argue, because the combined limits of the triggered primary policies ($25 million) exceed the total costs of the underlying claims. Insurers have had some success with this argument in

Continued on page 4

POLICYHOLDER'S PERSPECTIVE



INSURERS' PERSPECTIVE



Settling with Your Primary Insurer

Continued from page 3

some jurisdictions, notwithstanding the fact that it creates a strong disincentive to settle, undermines judicial economy, and fails to make a policyholder whole, all in contravention of long-standing Ohio public policy.

KNOWLEDGE IS POWER.

When faced with the question of whether to settle with a primary insurer, a policyholder would be well-advised to:

- **Recognize that settling with its primary insurer potentially could reduce or eliminate available excess coverage.**
- **Understand that although Ohio law appears clear, it is not completely settled and that not all states take the same approach. "Choice of law," referring to which state's law will apply to a given dispute, can be critical.**
- **Fully analyze the situation and the potential ramifications of any decision before settling with any insurer, including considering the policy language, the magnitude of the claims, and the financial impact of those claims on the policyholder.**

Doing these things at the earliest opportunity will give the policyholder important information needed to make an informed decision on the question of whether to risk forfeiting excess coverage by settling with a primary insurer.

Litigation Preservation Obligations

Kerri L. Keller

When a policyholder has been sued, and has provided notice of that claim to its insurer, the policyholder should keep in mind the potential for a coverage dispute when preserving relevant documents related to the litigation. If an insurer has either denied coverage for the claim, or is defending under a reservation of rights, the possibility of a coverage lawsuit arises, triggering preservation obligations for the policyholder.

With regard to document preservation, savvy businesses know they need to preserve documents related to litigation.

DOCUMENT RETENTION PLAN

Most businesses have a document retention plan to provide for the review, retention, and destruction of documents created or received in the ordinary course of business. Document retention plans enable businesses to comply with their retention requirements and preserve necessary documents, while ensuring that they are not retaining useless documents.

LITIGATION HOLD

At times, businesses must stop the routine destruction of documents and implement a "litigation hold." A litigation hold is the mechanism used to suspend a document retention plan and notify employees of preservation obligations. Typically, a litigation hold must be issued when a business knows, or reasonably should know, that a suit is about to be filed against it, when it plans to file a lawsuit, when a suit is actually filed, when a discovery request has been made, or when a court issues a discovery order. It can arise before a complaint is actually filed, such as when a demand letter is sent. If a business fails to issue a litigation hold, the consequences can be severe.

RAMIFICATIONS OF FAILING TO PRESERVE

Spoliation occurs when documents are destroyed or not preserved. Penalties can include the cost of recreating the information, an adverse instruction at trial, the exclusion of favorable testimony, a judgment against the spoliating party, monetary sanctions, and even criminal sanctions.

WHO SHOULD BE NOTIFIED?

Recipients of a litigation hold notice are those who are likely to have relevant information. While this will typically result in the notice being distributed to employees, a litigation hold notice can extend to third-party agents, such as independent contractors, vendors, suppliers, and brokers, as Rule 34 of the Federal Rules requires that a party to litigation produce documents that are within that party's "possession, custody, or control." Courts interpret the term "control" to extend to all documents that a business has the right, authority, or ability to obtain. Accordingly, a business may be required to extend its litigation hold to include documents that are in the physical possession of a third-party, such as an insurance broker or agent. To determine whether a party has the ability to "control" documents that are in the possession of a third-party, courts will look at the contract between the business and its third-party agent. In other words, if the contract between the business and its third-party agent allows for inspection of the documents upon demand, the business will likely be deemed to have "control" over the documents and may have to extend the litigation hold accordingly.

THE BOTTOM LINE

With regard to document preservation, savvy businesses know they need to preserve documents related to litigation. If a coverage dispute is likely, a policyholder should also issue appropriate litigation hold letters to all custodians of insurance-related documents, including those who have custody of the historical, underwriting, and claims documents.

Frack-Quakes: Will Your Policy Provide Coverage for Injection-Well Earthquakes?

Matthew K. Grashoff

NEW RESEARCH LINKS FRACKING TO SEISMIC EVENTS

The rapid growth of hydrofracturing, better known as "fracking," in Ohio has produced aftershocks throughout numerous industries and communities. Some of these aftershocks have been more literal than others, however. Recent scientific studies indicate that fracking companies' use of injection wells, the underground wells used to dispose of wastewater produced in the fracking process, is connected to the occurrence of earthquakes in areas that had not previously experienced any seismic activity. For example, the city of Youngstown, Ohio, which had not experienced an earthquake since record-keeping began in 1776, experienced more than 100 seismic events in the year following the opening of the nearby Northstar 1 injection well in December 2010. These events culminated in a magnitude 4.0 earthquake on December 31, 2011.

While the New Year's Eve earthquake produced only a few reports of minor property damage, property owners may not be so lucky in the future. In Oklahoma, on November 5, 2011, a magnitude 5.7 injection-well earthquake injured two people, destroyed 14 homes, and was felt in 17 states. If a major injection-well earthquake struck Ohio, would your insurance cover the damage? While no cases have addressed the issue to date, the answer may end up echoing the old adage: it depends—you have to read the language of your policy.

POTENTIALLY APPLICABLE POLICY LANGUAGE

Most all-risk, first-party insurance policies, such as a typical homeowner's policy, deal with earthquakes under an "earth movement" exclusion. Earth movement exclusions usually provide that the insurer is not liable for damage caused by or attributable to earthquakes, landslides, mud flows, or other forms of earth shifting, sinking, or rising. As at least one federal district court opinion explains, earth movement exclusions are designed to protect the insurer from major, unpredictable disasters that cannot be insured against without specialty coverage. Insurers might argue that such a rationale would seem to cut against coverage for an injection-well earthquake: though insurers can more readily anticipate where injection-well earthquakes may strike, the earthquakes themselves are still difficult to predict with certainty.

Policyholders, however, have had success defeating earth movement exclusions by arguing that the language of the exclusion is ambiguous. Courts ranging from the Pennsylvania, Alaska, West Virginia, and Florida Supreme Courts to the Third Circuit and various federal district courts have held that where an earth movement exclusion could reasonably be read to apply to only "natural" earth movements, rather than to any earth movements, the exclusion must be narrowly interpreted in favor of the insured. These cases involved fact patterns relating to subsiding mines, burst pipes leading to mudslides or erosion of a building's foundation, nearby excavations leading to earth shifting, and other activities where the causation of the earth movement was clearly "man-made." The evidence surrounding injection-well earthquakes suggests that they should likewise be considered "man-made" and, accordingly, losses arising from these events would not be barred by the earth movement exclusion.

It does not appear any Ohio courts have yet analyzed the ambiguity, or lack thereof, of an earth movement exclusion. However, in the context of analogous water damage exclusions, the First, Fourth, and Twelfth Appellate Districts have refused to find any ambiguities regarding natural or man-made causation.

In one 2005 case, the Eighth Appellate District found in favor of the policyholder, denying application of an earth movement exclusion where the damage was caused by "lateral earth [and] hydrostatic pressure" which caused a wall to collapse. The court held that the policyholder was entitled to coverage because none of the eight specifically listed types of "earth movement" were lateral earth or hydrostatic pressure. It is possible that this reasoning could be used in an injection-well earthquake case by arguing that an injection-well earthquake is not really an "earthquake" at all, and thus is not covered by the specifically enumerated types of earth movement.

In the absence of guidance from Ohio courts, policyholders are advised to carefully read their insurance policies' earth movement exclusions. For those policyholders who wish to avoid the uncertainty, the Mayor of Youngstown, the Honorable Charles P. Sammarone, may have other advice: two days after the New Year's Eve earthquake in his city, he purchased earthquake insurance.

Attorney Highlights

HONORS AND APPOINTMENTS

David Schweighoefer joined the firm as a partner in our Health Care Practice Group, while partner **Irv Sugerman** has joined the firm's Litigation Practice Group.

Elizabeth Collins, **Matthew Grashoff**, and **Andrew Moses** recently joined Brouse McDowell as new associates in the Litigation Practice Group.

Chair of Brouse McDowell's Labor and Employment Group, **Chris Carney** was recently appointed Partner-in-Charge of the firm's Cleveland Office.

Eleven Brouse attorneys were selected by their peers for inclusion in The Best Lawyers in America© 2014: **Christopher Carney, Keven Drummond Eiber, Daniel Glessner, Richard Harris, David Hunter, Christopher Huryn, David Lum, Marc Merklin, Paul Rose, Michael Sweeney,** and **Thomas Ubbing**. *(Copyright 2013 by Woodward/White, Inc., of Aiken, S.C.)*

Twenty-five Brouse attorneys were included in the 2013 Edition of American Lawyer Media and Cleveland's Legal Leaders.

COMMUNITY INVOLVEMENT

Kerri Keller is a member of Leadership Hudson's 2013-2014 Class. Leadership Hudson is a nine-month program that introduces participants to Hudson city, business, and community leaders.

Amanda Leffler was recently elected as a member of the Board of Directors of the Battered Women's Shelter of Summit and Medina Counties.

Keven Drummond Eiber, Sallie Lux, Caroline Marks, and **Gabrielle Kelly** attended the American Bar Association, Insurance Coverage Litigation Committee's Women in Insurance Networking Conference in October.

In September, **Amanda Leffler** joined 60 Akron leaders for the Greater Akron Chamber of Commerce's Inter-City Leadership Visit in Omaha, Nebraska.

ARTICLES

Kerri Keller's article, ERISA Plan Fiduciaries, How to Avoid ERISA Retirement Plan Liability, was published in the October issue of Smart Business Akron/Canton.

Stephen Bond's article, Final Rules for Wellness Programs, was published in the September-October issue of Akron/Canton MD News and, Exempt or Nonexempt? How Wage and Overtime Exemption Laws Affect Your Business, was published in the July issue of Smart Business Akron/Canton.

PRESENTATIONS

Litigation Group Chair **Keven Drummond Eiber** recently spoke at the Cleveland Metropolitan Bar Association's Continuing Legal Education Program, Ohio Insurance Law Unmasked: Scary Coverage Concepts, on the topic of Crime Policies.

Partner **Stephen Bond** recently served as a panelist at Crain's Health Care Summit where he discussed, Reform 101: Changes Your Business Must Make Now and Before the Next Wave Hits.

Brouse McDowell Insurance Coverage Practice Group attorneys **Lucas Blower, Keven Drummond Eiber, Amanda Leffler, Meagan Moore**, and **Paul Rose** recently presented, Essential Tools for Brokers and Their Clients, a continuing legal education and insurance continuing education program for local insurance agents and brokers.