RECENT COURT DECISIONS

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Express Terms of Policy Preclude Duty to Drop Down

Hudson Insurance Co. v. Gelman Sciences, Inc., 921 F.2d 92 (7th Cir. 1990).

In the first of two cases by the Seventh Circuit triggered by the Mission Insurance Company insolvency, the court concluded that explicit policy language precluded the assertion that an excess carrier had to drop down into coverage when a preceding excess carrier was declared insolvent. The insured in this case, Gelman, carried a $1 million primary policy, a $20 million excess insurance policy from Mission, and a $4 million excess insurance policy from Hudson. Gelman faced four lawsuits within the coverage of the policies, one of which it settled for $2 million. In the meantime, Mission was declared insolvent and could not provide payments under its policy. Gelman demanded that Hudson drop down and provide coverage in place of Mission. Citing its policy's definition of liability, Hudson refused. The trial court agreed with Hudson, and the court of appeals affirmed the lower court's decision.

The court of appeals initially rejected Gelman's argument that the insurance contract was ambiguous. Relying on the insurance contract's definition of liability, the court found that Hudson was liable if the underlying insurers had paid or been held liable to pay the total amount of underlying coverage. The court further noted that the policy stated that a failure to maintain collectible underlying policies did not affect Hudson's liability. Thus, the Mission insolvency did not lower the threshold at which Hudson became responsible for Gelman's losses.

Supporting its conclusion, the court distinguished the Hudson insurance contract from those that provided for coverage in excess of amounts "recoverable" from the prior carriers. Courts interpreting "recoverable" had concluded that the excess insurer had to drop down when the prior carrier became insolvent since the insolvent's benefits were not available to pay claims. In this case, however, the policy anticipated the possibility that prior coverage would not be available and directed that the excess coverage was not affected.

The court also rejected Gelman's second argument that public policy required Hudson to drop down. The court felt that the important public policy to protect was the parties' contractual intent. Since the contract did not protect against the prior carrier's insolvency, the court refused to contravene the parties' expressed intentions.

Excess Insurer's Duty to Drop Down for Insolvent Excess Insurer

New Process Baking Co. v. Federal Insurance Co., 923 F.2d 62 (7th Cir. 1991).

In the second case related to the Mission Insurance insolvency, the contract language was different but the result the same. In this case, the Seventh Circuit concluded that an excess insurer was not required to drop down because its policy excluded coverage until all underlying insurance was exhausted. The insured, New Process, carried a $500 thousand policy for primary coverage, a $20 million policy issued by Mission as a first level of excess coverage, and a $10 million policy issued by Federal as a second level of excess coverage. New Process settled a case against it for $850 thousand and sought to recover the amount exceeding its primary coverage from its excess carriers. It could not assert a claim against Mission because it was insolvent. Federal refused to pay the claim on the theory that its liability did not attach until claims exceeded the sum of the primary and first level of excess insurance.

Relying on the insurance contract, the court agreed with Federal and held that it did not have to drop down and provide coverage. The policy extended coverage to amounts "in excess of and after all underlying insurance has been exhausted" and cross-referenced the Mission policy to define the underlying insurance. The court then concluded that exhaustion does not occur until the underlying insurance limits have been met through payment. As result, Federal was not obligated to drop down since the claim would not have exhausted the right to payment from Mission.

Excess Carrier's Duty to Pay Legal Fees

Continental Casualty Co. v. Pittsburgh Corning Corp., 917 F.2d 297 (7th Cir. 1990).

In a curious foray into an insurance contract's history, the Seventh Circuit in another excess coverage case concluded that a policy excepting an exception did not obligate an excess insurer to pay legal fees. The insurer sued for a declaration that its policy did not cover legal expenses incurred in defending asbestos claims. The policy extended coverage to losses defined as settlements of losses for which the insured was liable. The definition, however, excluded costs. Costs included legal expenses but excluded all expenses for salaried employees and retained counsel. The obvious problem facing the insurer was that the exception to the exception might render it liable for all legal fees since retained counsel incur most legal costs.

Rather than sort out the meaning of the provision as part of the policy, the court turned to the reason the unusual drafting occurred. The court found