

No Excess Coverage When Insured Fails To Exhaust Primary Policy

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The United States District Court for the Southern District of Texas, applying Texas law, has held that a policyholder is not entitled to coverage under its excess policies because it failed to exhaust the limit of the primary policy. *Citigroup, Inc. v. Nat'l Union Fire Ins. Co.*, 2010 WL 2179710 (S.D. Tex. May 28, 2010). Although the amount the policyholder paid to settle the underlying actions against it exceeded the total amount of the tower, the court held that the insured's less-than-limits settlement with the primary carrier failed to satisfy the exhaustion requirements in the excess policies.

The insured, a mortgage lender, purchased \$200 million in errors and omissions insurance consisting of a \$50 million primary policy and excess policies totaling \$150 million. The insured was the subject of various private lawsuits alleging violations of truth in lending statutes as well as a lawsuit by the Federal Trade Commission. The insured notified its insurers of the actions but subsequently settled the actions without obtaining the consent of all of the insurers. The insured paid a total of \$240 million to settle the underlying lawsuits.

The primary carrier initially denied coverage for the settlement. Four years later, however, the primary carrier agreed to pay \$15 million of its \$50 million limit toward the settlement of the underlying actions. The insured then brought suit against the excess carriers. The insured subsequently entered into settlements with the first and second excess carriers, and its claims against the third excess carrier were stayed pending arbitration.

The remaining excess carriers moved for summary judgment, arguing that the policyholder failed to satisfy the exhaustion requirements of the excess policies because the primary carrier did not actually pay its entire limit of liability. The policyholder argued that it should not be penalized for settling with the primary carrier and that, because it had "filled the gap" with its own money, the excess carriers were not prejudiced by the settlement.

The court sided with the excess insurers. It held that the "excess policies clearly state they do not apply until the underlying policy has actually been paid to the total of its liability limit. . . . The unambiguous terms of the policies prevent Citigroup from circumventing the payment requirement by functional exhaustion—a label without substance or rigor. Here, because [the primary carrier] did not pay its limit of \$50 million, the excess carrier are not required to pay." The court rejected the policyholder's argument that the law should favor settlements, stating "[t]he law does not need to supply an answer. The parties agreed on one."

The court also held that the applicable statute of limitations barred the insured's claim against those excess carriers who had denied coverage more than four years before the insured filed suit.