

Failure To Exhaust Precludes Excess Coverage

July 2010

The United States District Court for the Northern District of Illinois has granted summary judgment in favor of third and fourth layer excess insurers who sought a declaratory judgment that the insureds' settlement with underlying insurers below the underlying limits did not satisfy the exhaustion conditions of the third and fourth-layer excess policies. *Great Am. Ins. Co. v. Bally Total Fitness Holding Co.*, 2010 WL 2542191 (N.D. Ill. June 22, 2010).

The insureds incurred \$33 million in legal costs defending suits resulting from a financial restatement and sought coverage from their primary and first, second, third and fourth layer excess directors and officers insurance carriers, each of which issued a policy with a \$10 million limit of liability. The primary and first and second layer excess insurers settled with the insureds for a total of \$19.5 million, with the first and second layer excess insurers paying \$8 million and \$1.5 million, respectively. The third and fourth layer excess insurers refused to contribute anything towards the insureds' legal costs, contending that they are liable for coverage only after the first and second layer excess insurers have made payment of covered claims equal to their policy limits. The insureds contended that the third and fourth layer excess policies cover claims above \$30 million, regardless of who makes payments below \$30 million.

The court agreed with the third and fourth layer excess insurers. The court noted that, where an excess policy's exhaustion provision is ambiguous, an insured's settlement with an underlying insurer may exhaust the underlying policy. Where, however, the relevant language clearly requires exhaustion, it must be enforced as written. The third layer excess policy defined exhaustion as actual payment of "the full amount of the Underlying Limit" by the "insurers of the Underlying Policies." The court found this language to be unambiguous. It also determined that the exhaustion requirement in the fourth layer excess policy was clear because the policy defined the method of exhaustion as "actual payment of loss or losses thereunder" by "all Underlying Insurance" and described that payment as "the total underlying limit of insurance." Accordingly, the court held that the primary and first and second layer excess insurers themselves must make actual payment of \$10 million each for covered claims prior to the insureds accessing coverage under the third layer excess policy. Similarly, the primary and first, second and third layer excess insurers themselves must make payment of \$10 million each for covered claims prior to the insureds accessing coverage under the fourth-layer excess policy.