

Underlying Policies Must Be Read As a Whole When Incorporated Equally Into Excess Policy

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The United States Court of Appeals for the Sixth Circuit, applying Tennessee law, has held that a second-layer excess policy, incorporating the terms of its underlying policies, did not provide coverage for punitive damages because the first-layer excess policy expressly precluded coverage for such damages, even though the underlying primary policy was ambiguous as to whether such amounts were covered. *Chad Youth Enhancement Center, Inc. v. Colony Nat'l Ins. Co.*, 2012 WL 1059404 (6th Cir. March 30, 2012).

After a resident of a youth behavioral center died as a result of actions by the youth center's staff, the estate of the deceased brought a wrongful death action against the insured youth center. The parties ultimately settled, stipulating to payments "attributable to punitive damages." The insured sought a declaratory judgment that its second-layer excess liability insurance policy covered punitive damages. The second-layer excess policy incorporated the terms and conditions of both the underlying primary insurance policy and the underlying first-layer excess policy, except as otherwise specifically set forth in the second-layer excess policy. The primary policy excluded "[s]anctions, fines, or penalties" from the definition of "claims." An endorsement to the first-layer excess policy provided that "[t]his insurance does not apply to fines, penalties, [or] punitive damages."

The insured argued that the primary policy's exclusion was ambiguous and that it should be read separately from the first-level excess policy. The insured asserted that because all ambiguities must be construed in favor of the insured, the court must conclude that punitive damages were covered by the primary policy. The insured then argued that there was a conflict between the primary policy's coverage for punitive damages and the first-level excess policy's exclusion of punitive damages, and contended that this conflict should also be resolved in the insured's favor.

In rejecting the insured's position, the court stated that Tennessee law prohibited courts from applying this type of multi-step method of construction. Rather, the court was required to read the entire policy as a whole, from the perspective of the second-layer excess policy's contracting parties, taking into account all of the provisions of the two underlying policies. The court found that there was no conflict between the first-layer excess policy's express exclusion of punitive damages and the primary policy's silence regarding punitive damages, and held that the second-level excess insurer excluded punitive damages irrespective of any ambiguities in the primary policy.