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ALERT

Payments by Captive Insurer Count as Loss for Purposes of Excess Coverage

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A trial court in Massachusetts has held that payments by an insured's captive insurer, which provided the primary layer of insurance, count as loss for purposes of triggering an excess insurer's coverage obligation. *UMass Memorial Health Care, Inc. v. Lexington Insurance Co. et al.*, 2010 WL 4941693 (Mass. Super. Ct. Nov. 1, 2010).

The policies at issue afforded claims-made coverage to a medical center and its physicians for successive one-year policy periods beginning in 2000. The underlying claim arose out of the birth of a child on December 29, 2000, who allegedly suffered brain damage as a result of alleged malpractice by personnel of the medical center. Beginning in 2003, the parents filed several actions against the medical center and others, all of which ultimately settled in 2008 for a payment of $4.9 million and after the medical center had incurred just over $1 million in defense costs.

At the time the medical center was served with the initial complaint in 2003, it was under the impression that its broker had not previously provided notice of a potential claim to its insurers. The medical center therefore proceeded to treat the claim as implicating its 2003 insurance program. For that year, the medical center's wholly-owned captive insurer provided a $5 million primary layer of coverage. The limit of liability for the primary layer in the prior years, however, was $2.5 million. For all policy periods at issue, the medical center's excess policies afforded coverage "for 'loss' in excess of the limit of the underlying insurance," with "loss" defined as "amounts paid, net of all recoveries . . . in settlement of claims or in satisfaction of judgment."

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Following the settlement of the malpractice claim, the medical center recovered payments totaling approximately $1.5 million from insurers not participating in its program but which insured other defendants in the suits, thereby reducing the total amount incurred by medical center to approximately $4.5 million. The medical center also discovered evidence suggesting that its broker in fact had provided notice of a potential claim under the 2001 insurance program. Because the captive's primary layer that year was $2.5 million, the medical center sought the remaining $2 million from its excess insurer.

In the coverage litigation that followed, the parties agreed that a material factual dispute existed as to whether notice in fact had been provided under the 2001 program. Nonetheless, the excess insurer sought summary judgment on the theory that regardless of which program was implicated by the claim, the medical center had not suffered any loss because the captive satisfied the entire settlement payment and this amount, combined with the amounts recovered from the other insurers actually resulted in a nearly $500,000 windfall for the insured. In response, the medical center argued that the entirety of any amount paid by the captive constituted a loss because the captive was wholly-owned by the medical center. The court disagreed with this, noting that the excess policy specifically defined underlying insurance to include self-insurance arrangements as well as insurance provided by any captive insurance company. The court also found, however, that the amount incurred by the medical center in excess of the captive's applicable limit of liability constituted loss for which the medical center could recover from the excess insurer. In this regard, the court further noted that the possible "fortuity" of the captive's treatment of the claim under the 2003 program did not excuse the excess insurer's coverage obligation should it turn out that the claim actually implicated the 2001 program. According to the court, in that event, and "as a matter of bookkeeping," the medical center could refund $2.5 million to the captive.