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ALERT

Settlement with Primary Insurer for Less Than Policy Limits Does Not Trigger Excess Coverage

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Applying Texas law, the United States Court of Appeals for the Fifth Circuit has held that coverage under excess insurance policies did not attach where the insured had settled with the primary insurer for less than the policy limits. *Citigroup, Inc. v. Fed. Ins. Co.*, 2011 WL 3422073 (5th Cir. Aug. 5, 2011).

In 2001, the insured bank settled a consumer class action and an action by the Federal Trade Commission for $240 million. The bank had $50 million in coverage with its primary insurer and a combined $150 million in coverage with various excess insurers. When the bank sought coverage for the settlement, the insurers all initially denied coverage. The bank eventually settled with the primary insurer, and the primary insurer paid the bank $15 million of its $50 million policy in exchange for a release from coverage for the claims. The bank also settled with all but four of the excess insurers. The remaining four insurers took the position that their policies had not attached because the primary insurer had not paid out the full $50 million limits of the primary policy. The district court agreed, granting summary judgment for the excess insurers.

The Fifth Circuit affirmed, holding that the bank's $50 million settlement with the primary insurer did not constitute exhaustion of the primary policy. The bank urged the court to apply the Second Circuit's holding in *Zeig v. Massachusetts Bonding & Insurance Co.*, which provides that where an excess policy fails clearly to define "exhaustion," an insured's settlement with a primary carrier constitutes exhaustion of the underlying policy as long as the insured fills the gap created by the below-limits settlement. The court stated that it

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need not determine whether Texas courts would follow this rule, as each of the four excess insurance policies unambiguously defined "exhaustion."

One of the policies stated that it attached only after the underlying insurers "have paid in cash the full amount of their respective liabilities." The second policy required that "the total amount of the Underlying Limit of Liability has been paid in legal currency by the insurers." The third policy attached only after each underlying insurer "pa[id] the full amount of its respective limits." And finally, the fourth policy was triggered only after "exhaustion of all of the limits of liability of such Underlying Insurance solely as a result of payment of loss thereunder." The court held that each of the policies unambiguously required actual payment of the full amount of the limits of the primary policies, and thus the insured bank's settlement with the primary insurer did not qualify as exhaustion sufficient to trigger coverage under the excess policies.

In addition, the court addressed whether the insured bank's claims against one of the excess insurers were time barred. Under Texas law, the court stated, the statute of limitations for breach of an insurance contract begins to run on the date of the insurer's denial. The bank argued that its claims accrued at the time of the insurer's October 2002 denial letter, not an earlier April 2002 letter. The court rejected this argument, holding that a denial need notuse any "magic words," but instead need only state that no coverage is available and explain the reasons for that determination. In this regard, the court found that the April 2002 letter clearly communicated the insurer's denial of coverage and the reasons for the denial, and thus the bank's claims accrued as of the date of that letter.