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The California Court of Appeal decision in *Qualcomm Inc. v. Certain Underwriters at Lloyd's London*, 161 Cal. App. 4th 184 (2008) is a cautionary tale for those intending to settle complex cases with insurance money. An agreement with the primary insurer cannot be made in a vacuum. Defense and coverage counsel also must understand whether and how the excess policies are triggered if the insured settles with the primary insurer.

Qualcomm was sued by employees in a class action lawsuit concerning rights to unvested company stock options. Qualcomm sought coverage for defense and indemnity payments in the action under its Directors and Officers ("D&O") liability insurance program. As is common with D&O programs for public companies, Qualcomm purchased several layers of D&O insurance coverage to provide protection for such claims ("the D&O tower"). A "D&O tower" consists of a primary insurance policy and one or more excess layers which typically "follow form" to the primary policy. The primary policy, with limits of $20 million, was issued by National Union; the first excess layer (also for $20 million) was issued by Certain Underwriters at Lloyd's, London ("Underwriters").

While excess policies typically incorporate the terms and conditions of the underlying primary policy unless specifically stated to the contrary, they are considered separate contracts. Excess insurers are not bound by the actions of the primary insurer. Further, excess policies are not triggered until the primary and any other underlying insurance limits are "exhausted." Underwriters' policy stated that it was triggered only after "the underlying insurers [National Union] had paid or been held liable to pay" the full underlying limits.

Mary McCutcheon

Qualcomm settled the employee class action, and made a claim against its insurers for defense and settlement expenses on those actions. It settled with National Union for payment of $16 million of the $20 million primary limit. Qualcomm then sought reimbursement from Underwriters for an unpaid portion of the claim in excess of $20 million, contending that payments by National Union, Qualcomm "or other third parties" had satisfied exhaustion of the National Union primary limit. In other words, Qualcomm did not assert that Underwriters should pay all sums in excess of National Union's $16 million payment. Rather, Qualcomm conceded that it "or other third parties" would satisfy the $4 million gap.

Nevertheless, the trial court and the Court of Appeal agreed that Underwriters escaped their

coverage allegations because the full underlying limit was not paid by National Union. It found that the “exhausted” provisions were unambiguous. According to the Court of Appeal, nothing in the settlement terms between National Union and Qualcomm, or any other documents, indicated that National Union had paid or been “held liable” to pay the full primary limits. Thus, the excess policy coverage was never triggered, and Underwriters was not obliged to respond to the portion of the claim that exceeded $20 million.

The Court rejected Qualcomm’s argument that it had a “reasonable expectation” of coverage. It also rejected the argument that failure to require Underwriters to pay covered sums above the $20 million primary limit inhibited the public policy of “promoting settlement and risk-spreading by insurance.”

This case is a reminder that a litigator must consider excess policy language when negotiating a settlement, even if the excess coverage “follows form.” It is extremely common for a primary insurer, especially when there is any potential coverage dispute, to seek a discount off its full limits. If the insured expects to tap into the excess insurance, it has two choices. First, it can hang tough and insist that the primary insurer pay full limits or risk excess for failure to settle. In the alternative, the insured can try to persuade all insurers, excess as well as primary, that there are serious risks of exposure if the case is not settled, and that each insurer should pay some portion of its limits to settle the case. In that instance, each insurer may agree that all insurers get a discount off their policy limits in recognition of the coverage issue. It also is likely, however, that the insured will be expected to contribute as well, in recognition of the value of the insurers’ alleged coverage defenses.

Finally, it is now considered best practices for brokers to demand that excess policies provide that the excess coverage is triggered if either the primary insurer *or* the insured pays the full primary limits. Alternatively, some excess insurers offer “limit shavings endorsements” that allow the primary insurer to settle at a discount while preserving coverage by the excess carriers, but also require that the excess carriers receive at least as favorable a discount as the primary insurers.

Attorneys seeking to settle a case which may require contribution from more than one D&O insurer may be tempted to approach the task in a linear fashion, “knocking off” one insurer at a time. This approach ignores the interplay between the various layers of coverage. Coverage can be lost if these complexities are not properly appreciated.

Ms. McCutcheon is a partner with the San Francisco office of Farella Braun & Martel LLP.
mmccutcheon@fbm.com