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Exhaustion Implications for Multi-Policy Settlements

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In *JP Morgan Chase & Co. v. Indian Harbor Ins. Co.*, 2012 N.Y. App. Div. LEXIS 4627 (N.Y. App. Div. June 12, 2012), the Appellate Division of the New York Supreme Court, applying Illinois law, affirmed the lower court's grant of summary judgment in favor of certain upper-level excess insurers, agreeing that the insured failed to prove that certain underlying policies had been properly exhausted. The result: the insured was precluded from even potentially accessing $95 million in excess bankers professional liability/securities coverage.

In one sense, *JP Morgan* marks just another instance of an increasingly common result reached by courts across the country, in which courts hold that an insured's below-limits settlement precludes coverage so long as the specific exhaustion requirements of the excess policies are unambiguous (which typically require actual payment of the full underlying limit). *JP Morgan* is noteworthy and unlike other recent cases because the insured here actually settled certain underlying policies for aggregate amounts in *excess* of the respective limits of those policies. Those settlements, however, simultaneously served to settle other insurance policies that were not part of the excess insurance tower. Moreover, because there had been no allocation of the settlement between the multiple policies, the court held that the insured could not meet its burden of proving the proper exhaustion of the underlying policies — even though the actual settlement figure was for an amount well in excess of the underlying policy limits.

In 2002, lawsuits were filed against Bank One and its affiliates in connection with their roles as indenture trustees on certain notes. Bank One had available a potential $175 million in bankers professional liability and securities claim coverage that potentially responded to the claims. The Bank One insurance program was structured in seven layers that sat above Bank One's SIR. At the time, JP Morgan was also named as a defendant in some of those same actions and in other related actions. JP Morgan did not own Bank One at that time. In 2004, while the litigation was still pending, Bank One merged into JP Morgan. JP Morgan had its own coverage that was also relevant to the claims. *Id*. at *4.

Between 2006 and 2008, JP Morgan settled six underlying actions for an aggregate $718 million. As part of the settlement, JP Morgan settled with Bank One's sixth-level excess carrier for $17 million, although that policy had limits of $15 million. The same settlement also extended to another policy issued by an affiliate of that same carrier, but that was not part of the Bank One insurance program. Similarly, and once the coverage suit was filed, JP Morgan settled with Bank One's third-layer excess carrier — also for $17 million on a policy with limits of $15 million — and that settlement also extended to an unrelated policy of an affiliated carrier in addition to the policy issued to Bank One. Neither settlement agreement made any allocation or otherwise distinguished between claims under the Bank One policies versus the policies of the affiliated companies (i.e., the non-Bank One policies). *Id*. at *4-5. Bank One's fourth, fifth, and seventh layer excess carriers moved for summary judgment on the ground that the settlements failed to exhaust the underlying Bank One coverage.[1]

Bank One's fourth layer policy provided that "liability for any loss shall attach … only after the Primary and Underlying Excess Insurers shall have [1] duly admitted liability and [2] shall have paid the full amount of their respective liability." Siding with the insurer, the court agreed that the settlement failed to satisfy both of the foregoing exhaustion conditions, namely: (1) admission of liability and (2) actual payment of limits by that underlying carrier. In fact, the court pointed out that the settlement agreement provided that "the negotiation, execution and performance of this Agreement shall not

1 The fourth layer excess policy provided limits of $15 million, the fifth layer comprising three quota-share excess insurers with combined total limits of $30 million, and the seventh (and final) layer of coverage contained a policy with limits of $50 million.

constitute, or be construed as an admission of liability …." Additionally, there was no way to determine whether the underlying carrier paid its full limit because the settlement provided for no allocation of the $17 million payment as between the settled policies. *Id*. at *7.

The exhaustion provisions of the other excess policies at issue provided as follows:

- [The insurance] shall apply only after all applicable Underlying Insurance with respect to an Insurance Product has been exhausted by actual payment under such Underlying Insurance ….
- [The insurer] shall only be liable to make payment under this policy after the total amount of the Underlying Limit of Liability has been paid in legal currency by the insurers of the Underlying Insurance as covered loss thereunder.
- [The insurance applies] only after exhaustion of the Underlying Limit solely as a result of actual payment under the Underlying Insurance in connection with Claim(s) and after the Insureds shall have paid the full amount of any applicable deductible or self insured retentions.
- [The insurance applies] only when the Underlying Insurer(s) shall have paid or have been held liable to pay, the full amount of the Underlying Limit(s) ….

The court concluded that the settlements failed to satisfy the foregoing provisions. In so holding, the court expressly rejected JP Morgan's attempt to cast ambiguity on the exhaustion provisions by relying on the seminal case of *Zeig v. Massachusetts Bonding & Ins. Co.*, 23 F.2d 665 (2d Cir. 1928). The court explained that the holding in *Zeig* was based on perceived ambiguity in the term "payment" as it appeared in the exhaustion provision at issue in *Zeig*, and that the provisions here were distinguishable due to their specificity. Additionally, the court explained that *Zeig* was contrary to 7th Circuit precedent and Illinois law "insofar as it stands for the proposition that exhaustion of the primary policies' payments does not require collection of the primary policies as a condition precedent to the right to recover excess insurance." *Id*. at *12 (citation omitted).

The court relied on several recent cases in which federal courts concluded that the same or similar attachment provisions unambiguously required proof of actual payment by an underlying insurer in order to trigger excess coverage. *Id.* at *8-9 (citing *Citigroup, Inc. v Federal Ins. Co.*, 649 F.3d 367 (5th Cir. 2011); *Great Am. Ins. Co. v Bally Total Fitness Holding Corp.*, No. 06 Civ C 4554, 2010 U.S. Dist. LEXIS 61553 (N.D. Ill. June 22, 2010)). Because the court was unable to determine whether JP Morgan actually collected the full underlying limits due to the absence of any allocation in the settlements, it concluded that the insured had failed to carry its burden of proving exhaustion. *Id*. at *9-10. Furthermore, the court relied on *Qualcomm, Inc. v. Certain Underwriters at Lloyds*, 161 Cal. App. 4th 184 (2008) to reject the insured's argument that it was entitled to excess coverage because it effectively "filled the gap" (i.e., paid any difference between the actual settlement amount and the underlying limits required to trigger the excess coverage) by entering into the $718 million settlement.[2]

JP Morgan, like many recent cases addressing below-limits settlements, illustrates the importance of the specific exhaustion language in an excess policy. The case also highlights the trend in which courts refuse to give too narrow a reading to clear exhaustion language or find ambiguity where none exists. Perhaps most fundamentally, *JP Morgan* serves as a stark reminder of the serious implications that lower-level insurance settlements may have on a large insurance program as a whole — especially when policies from separate insurance programs or policies that were issued to different insured entities are involved in such settlements (an increasingly common scenario with D&O and other financial professional liability coverages). JP Morgan settled for aggregate amounts in excess of the underlying policy limits, but because no allocation had been made and because the excess policies contained specific exhaustion requirements, the insured forfeited the chance to access $95 million in excess coverage.

To discuss any questions you may have regarding the opinion discussed in this Alert, or how it may apply to your particular circumstances, please contact:
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2 For a more detailed discussion of below-limits settlements and the implications for policyholders and excess insurers, including discussion of all cases cited above, *see* A. Savino & M. Klebanoff, "Below-Limits Settlements and the Coverage Obligations of Excess Insurers – The Diminished Reach of *Zeig*," Professionals', Officers and Directors' Liability Committee Newsletter (Winter 2012), available online at: http://www.americanbar.org/content/dam/aba/uncategorized/tips/podl/podl_winter2012c.authcheckdam.pdf.