

CAVEAT SETTLOR: INSURANCE COVERAGE SETTLEMENTS
AND THE TRIUMPH OF POLICY LANGUAGE OVER
PRECEDENT

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ABSTRACT

For eight decades, courts uniformly followed the Second Circuit's 1928 decision in *Zeig v. Massachusetts Bonding & Insurance Co.* as it related to insurance coverage settlements. *Zeig* and its progeny held that a policyholder could settle insurance coverage disputes with its primary and lower-layer insurers for less than their policy limits without forfeiting coverage under non-settling excess policies. The past decade, however, has seen a number of courts reject that result and hold that a policyholder could not pursue excess insurers if it collected less than full limits from its lower-layer insurers. The thesis of this article is that this change in results does not reflect a change in judicial approach. Rather, it reflects a change in policy language that has required courts to reach different results. Excess policy provisions conditioning coverage on the payment of full limits from lower-layer insurers complicate the settlement of complex insurance coverage disputes, and make piecemeal settlements virtually impossible. Nevertheless, this is a predictable and appropriate result where required by the excess insurer's policy language.

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I. INTRODUCTION

Large businesses often buy insurance coverage in a tower, with a primary insurer responding first to any covered loss, and excess insurers responding in a predetermined order if the loss exceeds the coverage provided by the primary policy.¹ Each excess policy thus has an “attachment point,” which is the amount of loss the policyholder must incur before the excess insurer provides coverage.² What happens, however, when coverage is disputed and the policyholder settles with a primary or lower-layer excess insurer for less than the insurer’s policy limits? To use a simple example, assume a policyholder has a \$1 million primary policy and, because of disputes over coverage, settles with that insurer for \$500,000. Does the first-layer excess insurer, which has an attachment point of \$1 million, cover the portion of the loss in excess of the settlement amount (\$500,000), the portion in excess of the primary insurer’s policy limit (\$1 million), or pay nothing because the primary insurer did not pay its full limit?

Until a few years ago, the answer to this question was more or less clear. Courts generally held that a policyholder’s below-limits settlement functionally exhausted the settled policy, so that excess coverage could be accessed, but that the policyholder was responsible for the gap in coverage caused by its below-limits settlement.³ So, in the example above, the primary insurer would pay the first \$500,000 of the loss by virtue of its settlement payment, the policyholder would be responsible for the \$500,000 gap caused by its settlement with the primary insurer for less than the full policy limit, and the excess insurer, subject to its own policy limit, would be responsible for the portion of the loss over \$1 million if the claim is covered.⁴

This rule had three apparent virtues: equity, finality, and fidelity

¹ KENNETH S. ABRAHAM, ENVIRONMENTAL LIABILITY INSURANCE LAW 223 (1991) (“Large businesses purchase liability insurance in ‘layers’ that begin with either primary liability insurance or a self-insured ‘retention’ that resembles a deductible Businesses then purchase additional ‘layers’ of excess liability insurance.”); 1 BARRY R. OSTRAGER & THOMAS R. NEWMAN, HANDBOOK ON INSURANCE COVERAGE DISPUTES § 6.03[a], at 503 (17th ed. 2015) (“Primary insurance is coverage that attaches immediately upon the happening of an occurrence that is covered under the terms of the policy.”); *id.* § 6.03[a], at 504 (“Excess or secondary insurance is coverage that attaches only after a predetermined amount of primary coverage has been exhausted.”).

² See *Household Int’l Inc. v. Liberty Mut. Ins. Co.*, 749 N.E.2d 1, 12 (Ill. App. Ct. 2001) (noting that an excess insurer’s “attachment point” is the dollar amount of loss the policyholder must incur before implicating the excess insurer’s policy).

³ See *infra* notes 30–62 and accompanying text.

⁴ See John F. O’Connor, *Insurance Coverage Settlements and the Rights of Excess Insurers*, 62 MD. L. REV. 30, 78, 82 (2003).

to policy language. The prevailing rule was viewed as equitable, in most cases, because it placed the non-settling insurer in the same litigation position it occupied before there were any settlements; the only difference was that the policyholder paid some amounts that would have been paid by the settling lower-layer insurer.⁵ The prevailing rule provided finality because it allowed parties that wanted to stop fighting with each other to do so, again in a way designed to protect the litigation position of non-settling excess insurers.⁶ Finally, the prevailing rule was at least arguably true to the excess insurers' policy language, which typically provided that the policy applied upon exhaustion of the lower-layer coverage, but did not explicitly specify who had to make the payments in order for exhaustion to occur.⁷

The past decade, however, has seen a perceptible shift in the judicial treatment of below-limits settlements between policyholders and their insurers. Several recent decisions have held that excess insurers have no obligation to pay *anything* on a claim if the policyholder settled with underlying insurers without obtaining a payment of full policy limits.⁸

The main thesis of this article is that this shift in results is not the result of a shift in judicial philosophy. Courts are not reaching different results because their view of the issue has changed; they are reaching different results because the policy language they are being asked to construe has changed. The cases where courts have held that below-limits settlements render excess coverage inaccessible invariably involve unambiguous policy language that permits no other result.⁹ There is an attractive simplicity and efficiency in treating settled policies as exhausted and requiring the policyholder to simply fill any gaps in coverage caused thereby. But there are reasons excess insurers might prefer to contract around such a result, and courts have enforced those contractual provisions as written, even if it complicates a policyholder's efforts to settle with other insurers.

This is not some arcane issue of little practical relevance. Any time a policyholder has both primary and excess insurance and faces a disputed claim that might exceed its primary insurance coverage, an issue arises as to whether the policyholder can settle with its primary

⁵ *Id.* at 73.

⁶ *See id.* at 34 n.26, 56.

⁷ *See id.* at 50.

⁸ *See infra* notes 102–31 and accompanying text.

⁹ *See infra* notes 124–32 and accompanying text.

and lower-layer insurers without forfeiting any attempt to pursue coverage from non-settling excess insurers. It makes it virtually impossible to settle large-scale insurance coverage disputes in a piecemeal fashion, and provides substantial leverage to excess insurers that may be able to benefit by holding out on group settlement efforts. But while all of this may be true, the reality is that this is a dilemma of a policyholder's own making.

If a policyholder purchases excess insurance with provisions unambiguously premising coverage on payment of full limits by all underlying insurers, the policyholder has no one to blame but itself when settlements become complicated. Moreover, while the settlement playing field might tilt, in some cases, in favor of excess insurers, this is just an adjustment of a playing field that long had been tilted in favor of policyholders and lower-layer insurers, as the gap-filling rule that had long prevailed came to be used in ways that prejudiced the litigation positions of non-settling excess insurers.

Part II of this article will explain why below-limits insurance coverage settlements are commonplace in complex insurance coverage disputes and provide some examples as to why below-limits settlements occur. Part III of this article will trace the development of rules concerning the effect of a policyholder's settlement with lower-layer insurers on their pursuit of coverage from excess insurers. Part III.A will address the development of the "gap-filling" rule, whereby a policyholder could settle with a lower-layer insurer for less than full policy limits, and then proceed against any excess insurers so long as the policyholder covered any gap in insurance caused by its settlement. This rule has its genesis in a 1928 Second Circuit case, and was more or less universally followed until the second half of the last decade.

Part III.B will explore decisions from the late 2000s to the present challenging the orthodoxy of the gap-filling rule. As these modern decisions make clear, they are based on changing language in excess insurance policies, and do not represent a wholesale rejection of the gap-filling rule. Indeed, the gap-filling rule continues to be applied by courts in cases where the excess insurance policy's language permits it. Finally, Part III.C will examine the effect of the change in judicial treatment of below-limits settlements. The lesson of the evolution of this case law is the fundamental lesson of contract law in general. Words matter. While conditioning excess coverage on payment of full limits by lower-layer insurers can make settlement of complex insurance disputes more difficult, courts have enforced such clauses and required policyholders to live with the contract terms to

which they have agreed.

II. WHY BELOW-LIMITS SETTLEMENTS OCCUR

Why would a rational policyholder settle with an insurer for less than the insurer's policy limit if the total loss exceeds that limit? The answer is that policyholders settle for less than policy limits for the same reasons that parties in litigation settle their lawsuits every day: uncertainty as to liability and uncertainty as to damages.¹⁰ Consider a few examples.

A building owner might have her building damaged or destroyed in a hurricane and turn to her first-party¹¹ property insurer to cover the loss.¹² Many property insurance policies, however, provide coverage for wind damage but exclude coverage for water damage.¹³ If there is a dispute as to whether the property damage was caused by wind or by flooding, a rational policyholder and a rational insurer might decide that all-or-nothing litigation is undesirable and that they should mitigate their risk by settling for some percentage of policy limits.¹⁴ The same phenomenon can occur in the third-party¹⁵ context. Different states have reached different results as to whether the "sudden and accidental" pollution exclusion common in 1970s general liability policies excludes coverage for losses caused by the gradual discharge of pollutants.¹⁶ If there was uncertainty as to how

¹⁰ See O'Connor, *supra* note 4, at 60.

¹¹ A "first-party" insurance policy "covers the insured against physical loss of or injury to his or her own property." ABRAHAM, *supra* note 1, at 23. Thus, to use a familiar example, if a driver runs a red light and hits another car, her "first-party" automobile insurance will pay for damage to her own vehicle. See Gary T. Schwartz, *Auto No-fault and First-party Insurance: Advantages and Problems*, 73 S. CAL. L. REV. 611, 644 (2000) (offering an example in which a no-fault claim is made against an insurer succeeding a car accident).

¹² See, e.g., *United Servs. Auto. Ass'n v. Lisanby*, 47 So. 3d 1172, 1175 (Miss. 2010).

¹³ *Id.* at 1175, 1176 (holding that policyholder was entitled to coverage for hurricane damage because jury verdict finding damage caused by wind, and not by water, was supported by the evidence); see also *Robichaux v. Nationwide Mut. Fire Ins. Co.*, 81 So. 3d 1030, 1036, 1041 (Miss. 2011) (holding that trial court erred in granting summary judgment to insurer because there was a genuine dispute of material fact as to whether wind damage preceded flooding damage).

¹⁴ See O'Connor, *supra* note 4, at 32–33 (discussing the frequency of disputes over aggregate limits and the types of hazards that such limits will cover).

¹⁵ "Third-party" insurance policies "cover the insured against liability to a third party." ABRAHAM, *supra* note 1, at 23. For example, if a driver runs a red light and hit another car, her "third-party" automobile insurance will provide coverage to her if the other driver sues her for bodily injury or damage to the other driver's vehicle. See Guido Calabresi, *First Party, Third Party, and Product Liability Systems: Can Economic Analysis of Law Tell Us Anything About Them?*, 69 IOWA L. REV. 833, 834 (1984).

¹⁶ *Compare* *Northville Indus. Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 679 N.E.2d 1044, 1049 (N.Y. 1997) (holding that the "sudden and accidental" pollution exclusion excludes coverage for property damage resulting from the gradual discharge of pollutants), *with*

this issue would be resolved under applicable law, a policyholder might compromise its claim for insurance coverage in return for the insurer's payment of less than policy limits, thereby eliminating the risk of losing in court and receiving nothing.¹⁷

Even where the existence of coverage is clear, a policyholder and insurer might dispute the *amount* of available coverage. Many insurance policies limit coverage to a specified amount per occurrence,¹⁸ and sometimes policyholders and their insurers dispute the number of occurrences involved in a claim.¹⁹ To use a recent example, the owner of the World Trade Center purchased property insurance "from about two dozen insurers . . . in the total amount of approximately \$3.5 billion 'per occurrence.'"²⁰ After the events of September 11, 2001, whether the attacks on the World Trade Center arose out of one occurrence or two occurrences made a \$3.5 billion difference in the amount of the policyholder's claim.²¹ In the third-party context, divergent court decisions on issues such as the number of occurrences involved in asbestos claims,²² or in claims alleging sexual abuse,²³ might motivate a policyholder and its insurers to

Queen City Farms, Inc. v. Cent. Nat'l Ins. Co. of Omaha, 882 P.2d 703, 723, 725 (Wash. 1994) (holding that the "sudden and accidental" pollution exclusion does not exclude coverage for property damage resulting from the gradual discharge of pollutants as long as the discharge was neither expected nor intended).

¹⁷ See O'Connor, *supra* note 4, at 57.

¹⁸ See 1 OSTRAGER & NEWMAN, *supra* note 1, § 9.02, at 725 ("If all applicable policy terms and conditions are satisfied, there is one set of per-occurrence policy limits available for damages during a policy year arising out of each occurrence.").

¹⁹ *Id.*

²⁰ World Trade Ctr. Props., L.L.C. v. Hartford Fire Ins. Co., 345 F.3d 154, 158 (2d Cir. 2003).

²¹ *Id.* Ultimately, the Second Circuit determined that the applicable number of occurrences varied among insurers depending on which policy form applied to the policies that they issued. *Id.* at 180 (holding that insurers providing coverage on the basis of a "WilProp" policy form owed coverage only for one occurrence); *id.* at 160, 190 (holding that the number of occurrences under policies not incorporating the "WilProp" policy form was a disputed fact issue for the jury).

²² Compare Liberty Mut. Ins. Co. v. Treesdale, Inc., 418 F.3d 330, 338–39 (3d Cir. 2005) (holding that bodily injuries arising out of exposure to the policyholder's asbestos products all arise out of a single occurrence), with *Plastics Eng'g Co. v. Liberty Mut. Ins. Co.*, 2009 WI 13, ¶ 40, 315 Wis. 2d 556, 577, 759 N.W.2d 613, 623 (Wis. 2009) (holding that each claimant's claim for bodily injury damages arising from exposure to the policyholder's asbestos products arises out of a separate occurrence).

²³ Compare *H.E. Butt Grocery Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 150 F.3d 526, 535 (5th Cir. 1998) (holding that claims by each claimant during a policy period arose from a separate occurrence), with *Safeguard Ins. Co. v. Angel Guardian Home*, 946 F. Supp. 221, 231–32 (E.D.N.Y. 1996) (holding that abuse of multiple children constituted one occurrence per policy period for agency that placed children in foster care), and *Washoe Cty. v. Transcon. Ins. Co.*, 878 P.2d 306, 310 (Nev. 1994) (holding that claims against a County for negligent monitoring of a county licensed day care provider arose out of one occurrence even where there were multiple alleged abuse victims), and *S.F. v. W. Am. Ins. Co.*, 463 S.E.2d 450, 452 (Va. 1995) ("[S]everal acts of sexual molestation, under the terms of the insurance contract, . . .

settle somewhere in the middle of the potential litigated results.²⁴

Thus, whether the issue is disputed coverage or a disputed limit, or both, the uncertainty of a litigated result might make it reasonable for a policyholder and some subset of its insurers to reach a settlement for less than the settling insurers' stated policy limits.²⁵ That settlement invariably will not equal the result that would have been achieved at the end of full-blown litigation because it is a compromise. If it turns out that the insurer's legal positions were correct, then the policyholder likely will have reaped a windfall by settling.

On the other hand, if it turns out the policyholder's litigation position was correct, the compromise will have resulted in the policyholder collecting less than was actually available from the settling insurance policies—a below-limits settlement.²⁶ If the policyholder had a claim against only one insurer, then the parties' decision to settle their differences would be similar to settlements in any other kind of litigation or business dispute.²⁷ The parties avoid the uncertainty and cost of litigation and obtain finality, recognizing that if their dispute were actually litigated, one of the parties likely would end up doing better than the settlement amount and the other party would end up doing worse.²⁸ But when a policyholder settles with some of its insurers, and seeks additional coverage under excess policies applying only after exhaustion of the settled policies, a significant dispute may arise as to whether the settlements for less than policy limits actually exhausted the lower-layer coverage.²⁹

III. THE EVOLUTION OF CASE LAW REGARDING BELOW-LIMITS SETTLEMENTS

A. *The Development of the Gap-Filling Rule*

The rule allowing policyholders to fill gaps in coverage caused by below-limits settlements, without endangering their excess insurance coverage, began as many rules do, with a case involving

constitute only one occurrence per infant claimant.”).

²⁴ O'Connor, *supra* note 4, at 42–43.

²⁵ *Id.* at 42–44.

²⁶ *Id.* at 42.

²⁷ *See id.* at 31–32.

²⁸ *See id.* at 33, 42.

²⁹ *See* Scott Seaman & Charles Kittredge, *Excess Liability Insurance: Litigation and Law*, 32 TORT & INS. L.J. 653, 672, 702–03 (1997).

clear equities.³⁰ Louis Zeig owned a dress shop, and claimed to his insurers that it had been burglarized.³¹ Zeig had \$15,000 in burglary insurance issued by three insurance companies and a fourth policy for \$5,000 issued by the Massachusetts Bonding and Insurance Company that applied excess of the other three policies.³² For reasons not detailed in the Second Circuit's opinion, Zeig settled with the three lower-layer insurers, accepting a total of \$6,000 and releasing their \$15,000 in coverage.³³ The excess insurer's policy provided that it shall apply and cover only after all other insurance herein referred to shall have been "exhausted in the payment of claims to the full amount of the expressed limits" of such other insurance.³⁴ Because the lower-layer insurers had not actually paid their full policy limits, the excess insurer refused to provide coverage.³⁵ The federal district court agreed and entered judgment in favor of the excess insurer.³⁶

On appeal, the Second Circuit reversed, holding that Zeig's release of the full policy limits of the lower-layer insurers had exhausted the coverage under those policies and constituted a payment of their limits.³⁷ Applying a freestanding federal common law that was *de rigueur* at the time but discredited today,³⁸ the Second Circuit effectively held that the exhaustion requirements in the excess policy were ambiguous and would not be construed to the policyholder's disadvantage when the court perceived no countervailing benefit to the insurer.³⁹ As the court explained:

The defendant argues that it was necessary for the plaintiff actually to collect the full amount of the policies for \$15,000, in order to 'exhaust' that insurance. Such a construction of

³⁰ See *Zeig v. Mass. Bonding & Ins. Co.*, 23 F.2d 665, 666 (2d Cir. 1928).

³¹ Douglas R. Richmond, *Functional Exhaustion Versus Actual Payment: Cases and Controversies*, in NEW APPLEMAN ON INSURANCE: CURRENT CRITICAL ISSUES IN INSURANCE LAW (Spring 2014).

³² *Id.*

³³ See *Mehdi Ali v. Fed. Ins. Co.*, 719 F.3d 83, 92 (2d Cir. 2013) (recounting the facts of *Zeig*); *Zeig*, 23 F.2d at 666.

³⁴ *Zeig*, 23 F.2d at 666.

³⁵ *Id.*

³⁶ See *id.* (reversing the judgment of the district court which found for the excess insurer).

³⁷ *Id.*

³⁸ See *Mehdi Ali v. Fed. Ins. Co.*, 719 F.3d 83, 92 n.16 ("Though not necessary to our decision, it bears recalling that the freestanding federal common law that *Zeig* interpreted and applied no longer exists.") (citing *Erie R.R. v. Tompkins*, 304 U.S. 64, 79–80 (1938)); see also *Stargatt v. Fid. & Cas. Co.*, 67 F.R.D. 689, 690–91 (D. Del. 1975) ("[T]he Second Circuit [decided *Zeig*] as a matter of general common law in the pre-*Erie-Tompkins* era."), *aff'd*, 578 F.2d 1375 (3d Cir. 1978) (mem.).

³⁹ See *Zeig*, 23 F.2d at 666.

the policy sued on seems unnecessarily stringent. It is doubtless true that the parties could impose such a condition precedent to liability upon the policy, if they chose to do so. But the defendant had no rational interest in whether the insured collected the full amount of the primary policies, so long as it was only called upon to pay such portion of the loss as was in excess of the limits of those policies. To require an absolute collection of the primary insurance to its full limit would in many, if not most, cases involve delay, promote litigation, and prevent an adjustment of disputes which is both convenient and commendable. A result harmful to the insured, and of no rational advantage to the insurer, ought only to be reached when the terms of the contract demand it.⁴⁰

Accordingly, the Second Circuit held that a release of the lower-layer policies functionally exhausted those policies and constituted payment of their limits, with the excess insurer liable only for amounts of loss exceeding the \$15,000 limits of the released policies.⁴¹

The Second Circuit's ambiguity determination in *Zeig* is at best debatable. The excess insurer's policy provided that it had no coverage obligation absent the other insurers' "payment of . . . the full amount of the expressed limits" in their policies.⁴² But nobody paid Louis Zeig the \$9,000 in lower-layer limits not paid by the settling insurers.⁴³ Functionally, the Second Circuit concluded that Zeig satisfied this by paying himself.⁴⁴ Putting aside the flimsiness of the Second Circuit's ambiguity analysis, the court's assessment of the equities seems spot on. The excess insurer in that case had no legitimate interest in ensuring that Zeig actually received the full limits from the other insurers, so long as Zeig could not pursue the excess insurer for the first \$15,000 of his loss.⁴⁵ If the lower-layer insurers paid less than full limits because they suspected fraud, or an inflated damages claim, the non-settling excess insurer remained free to pursue such defenses in its own coverage litigation against Zeig, with the other insurers' settlements having no effect on the merits of these defenses.⁴⁶

The Second Circuit also was correct that requiring the actual

⁴⁰ *Id.*

⁴¹ *See id.*

⁴² *Id.*

⁴³ *See Mehdi Ali*, 719 F.3d at 92; *Zeig*, 23 F.2d at 666.

⁴⁴ *See Zeig*, 23 F.2d at 666.

⁴⁵ *See id.* ("A result harmful to the insured, and of no rational advantage to the insurer, ought only to be reached when the terms of the contract demand it.")

⁴⁶ *See O'Connor*, *supra* note 4, at 56.

payment of full limits would “involve delay, promote litigation, and prevent an adjustment of disputes which is both convenient and commendable.”⁴⁷ If the lower-layer insurers were, for whatever reason, unwilling to pay full policy limits, the excess insurer’s construction of its policy would have left the policyholder with the unsatisfying choice of either settling with the lower-layer insurers and forfeiting the excess coverage, or litigating with everyone in order to protect his ability to pursue the excess insurer’s policy.⁴⁸

Indeed, one of the attractive features of the *Zeig* holding lies in its moderation—it gives a little something to everyone. Policyholders and lower-layer insurers can settle when they are able without the policyholder jeopardizing its ability to pursue coverage provided by non-settling excess insurers.⁴⁹ The excess insurers are protected by, at least in theory, being left exactly as they were coverage-wise before the lower-layer insurers settled. Additionally, the decision in *Zeig* left excess insurers with at least the theoretical ability to change the result by using clearer language in their policies to prohibit the policyholder from settling with lower-layer insurers for less than full policy limits.⁵⁰

For the next eighty years, the result adopted in *Zeig* was the widely-accepted rule as it related to excess insurers and the below-limits settlements of lower-layer insurers.⁵¹ While *Zeig* was a first-party property loss, the vast majority of subsequent cases applying the *Zeig* holding involved third-party liability insurance, where a policyholder faced tort liability and sought a defense and indemnification from its liability insurers.⁵² In these third-party cases, court after court has held that a policyholder could settle with lower-layer insurers for less than their full policy limits, and that the excess insurers were liable only for amounts exceeding the full policy limits of lower-layer insurance policies.⁵³

These courts adopting the gap-filling rule generally followed some or all of the analytical process undertaken by the Second Circuit in

⁴⁷ *Zeig*, 23 F.2d at 666.

⁴⁸ *See id.*

⁴⁹ *See* O’Connor, *supra* note 4, at 56.

⁵⁰ *Zeig*, 23 F.2d at 666 (“It is doubtless true that the parties could impose such a condition precedent to liability upon the policy, if they chose to do so.”).

⁵¹ *See, e.g.*, O’Connor, *supra* note 4, at 51–53.

⁵² One example of a first-party insurance dispute applying *Zeig*’s reasoning is *Union Indemnity Insurance Co. v. Certain Underwriters at Lloyd’s*, 614 F. Supp. 1015 (S.D. Tex. 1985). There the court held that excess hull insurers’ policies only provided coverage for loss amounts exceeding the stated policy limits of the policies to which they were excess, regardless of the ultimate settlement amount for the policyholder’s claim. *Id.* at 1015–16, 1016, 1017, 1019.

⁵³ *See* cases cited *infra* notes 54–59.

Zeig. Some of the courts carefully reviewed the excess insurers' policy language and concluded that it was less than clear that the excess policy required payment of the lower-layer insurer's limits *by the lower-layer insurer*, or whether a policyholder could exhaust the settled policy by paying part of the liability itself.⁵⁴ For example, in *Trinity Homes LLC v. Ohio Casualty Insurance Co.*, the excess insurer's policy provided coverage "[i]f the limits of 'underlying insurance' have been exhausted by payment of claims."⁵⁵ The Seventh Circuit held that while the excess insurer's policy "does state that a [lower-layer insurer's] policy is exhausted when the policy limit has been completely expended, it does not clearly provide that the full limit must be paid out by the [lower-layer] insurer alone."⁵⁶

Other courts relied on language in the excess insurer's policies that seemed to explicitly allow the policyholder itself to pay part of the limit of coverage provided by lower-layer insurers.⁵⁷ Many courts also justified the *Zeig* gap-filling rule, at least in part, based on the public policy considerations identified in *Zeig*—the public interest in encouraging settlement⁵⁸ and/or the excess insurer's lack of

⁵⁴ See, e.g., *Trinity Homes LLC v. Ohio Cas. Ins. Co.*, 629 F.3d 653, 658 (7th Cir. 2010); *Koppers Co. v. Aetna Cas. & Sur. Co.*, 158 F.3d 170, 174, 176 (3d Cir. 1998).

⁵⁵ *Trinity Homes*, 629 F.3d at 658.

⁵⁶ *Id.*; see also *E.R. Squibb & Sons, Inc. v. Lloyd's & Cos.*, 241 F.3d 154, 165, 172–73 (2d Cir. 2001) (stating the excess insurers' coverage obligations based on express policy language were excess of underlying policy limits without regard to the amount of settlements between the policyholder and its underlying insurers); *Kelley Co. v. Cent. Nat'l Ins. Co. of Omaha*, 662 F. Supp. 1284, 1289 (E.D. Wis. 1987) ("The policy in this case does not state that actual payment is required."); *Stargatt v. Fid. & Cas. Co.*, 67 F.R.D. 689, 690 & n.3 (D. Del. 1975) (holding that excess insurance provision requiring payment did not require actual payment of the primary policy limit, only that the limit be "entirely used up," which had resulted from the settlement); *Benroth v. Cont'l Cas. Co.*, 132 F. Supp. 270, 276 (W.D. La. 1955) ("[The excess insurer's] policy makes no requirement . . . that plaintiff must have received [the lower-layer policy limit] in cash from [the primary insurer]."); *Rummel v. Lexington Ins. Co.* 1997-NMSC-041, ¶ 26, 123 N.M. 752, 759, 945 P.2d 970, 977 (N.M. 1997) (explaining actual payment of a tort judgment by the underlying insurer is not required to trigger excess coverage where excess policy provides that excess insurer has no obligation until underlying insurer has paid policy limit, or is held liable for such limit).

⁵⁷ See, e.g., *Koppers Co.*, 158 F.3d at 176 (noting the excess insurer's policy provision required policyholder to maintain underlying insurance, but also provided that failure to do so would not void excess coverage so long as the policyholder paid the gap in coverage caused by its failure to maintain underlying insurance); *UNR Indus. Inc. v. Cont'l Cas. Co.*, 942 F.2d 1101, 1108 (7th Cir. 1991) (explaining that excess coverage is still a valid obligation, regardless of if the underlying insurer performed their obligations within the coverage terms).

⁵⁸ See, e.g., *Trinity Homes*, 629 F.3d at 659 ("Our construction of the ambiguity in Cincinnati's policy is also reinforced by Indiana public policy favoring out-of-court settlement."); *Koppers Co. v. Aetna Cas. & Sur. Co.*, 98 F.3d 1440, 1454 (3d Cir. 1996) ("Courts have adopted this rule because it encourages settlement and allows the insured to obtain the benefit of its bargain with the excess insurer, while at the same time preventing the insured from obtaining a double recovery."); *Siligato v. Welch*, 607 F. Supp. 743, 747 (D. Conn. 1985) ("A primary insurer is permitted, and should be encouraged, to settle a claim in discharge of its duties

legitimate interest in who pays the underlying limits of coverage so long as it is not the excess insurer.⁵⁹

Thus, the *Zeig* gap-filling rule provided a stable backdrop against which parties in multi-insurer coverage disputes could operate, a backdrop that provided benefits and detriments to all of the parties. In some cases, the “exhaustion” component of the *Zeig* rule benefited policyholders and lower-layer insurers because it allowed them to settle their disputes without placing the policyholder at risk of forfeiting non-settling excess insurance.⁶⁰ In other cases, the gap-filling aspect of the *Zeig* rule protected excess insurers.⁶¹ These courts required the policyholder to cover any gap in coverage caused by its release of lower-layer coverage, and rejected policyholder attempts to force excess insurers to provide coverage immediately excess of reasonable (but below-limits) settlement payments received from lower-layer insurers.⁶²

While *Zeig* involved a dispute over first-party property insurance, it is notable that almost all of the cases applying the *Zeig* rule did so in disputes involving third-party liability insurance.⁶³ This

without being impeded or prejudicing the excess insurer, which is left in the same position after a settlement by the primary insurer as before.”); *Rummel*, 1997-NMSC-041 at ¶ 44, 123 N.M. at 763, 945 P.2d at 981 (quoting *Zeig v. Mass. Bonding & Ins. Co.*, 23 F.2d 665, 666 (2d Cir. 1928)) (“[T]o require an absolute collection of the primary insurance to its full limit would in many, if not most, cases involve delay, promote litigation, and prevent an adjustment of disputes which is both convenient and commendable.”).

⁵⁹ *Trinity Homes*, 629 F.3d at 659 (“Moreover, this construction of the policy neither has a punitive effect on Cincinnati nor does it alter its underwriting considerations.”); *E.R. Squibb & Sons Inc.*, 241 F.3d at 173 (“Under the court’s approach, the settling parties are the ones who took the risk of the settlement, and the non-settling parties are left precisely as they would have been had no settlement occurred. That hardly seems unfair.”); *Siligato*, 607 F. Supp. at 747 (“[The excess insurer’s] liability cannot be increased by the fact, if true, that the present value of [the primary insurer’s] settlement agreement did not equal its \$300,000 coverage.”); *Rummel*, 1997-NMSC-041 at ¶ 44, 123 N.M. at 763, 945 P.2d at 981 (citing *Zeig*, 23 F.2d at 666) (“For example, the excess insurer has no rational interest in whether the primary policies are collected in full, as long as it is only required to pay the loss for which it would otherwise have been liable under the terms of its contract.”).

⁶⁰ See, e.g., *Trinity Homes*, 629 F.3d at 659; *Koppers Co.*, 158 F.3d at 176; *UNR Indus.*, 942 F.2d at 1107–08; *Stargatt*, 67 F.R.D. at 690–91 (quoting *Zeig*, 23 F.2d at 666); *Benroth*, 132 F. Supp. at 276.

⁶¹ See, e.g., *U.S. Fid. & Guar. Co. v. Treadwell Corp.*, 58 F. Supp. 2d 77, 112 (S.D.N.Y. 1999); *Metro. Life Ins. Co. v. Aetna Cas. & Sur. Co.*, 765 A.2d 891, 896 & n.12 (Conn. 2001); *Allstate Ins. Co. v. Dana Corp.*, 759 N.E.2d 1049, 1063 (Ind. 2001).

⁶² See, e.g., *U.S. Fid. & Guar. Co.*, 58 F. Supp. 2d at 112 (discussing obligations of the excess insurer in light of the policyholder’s settlement agreement); *Metro. Life Ins. Co.*, 765 A.2d at 896 & n.12 (Conn. 2001) (holding that the policyholder is not entitled to recover from excess insurer for asbestos liabilities because liabilities were allocable to underlying primary policy that policyholder had released, leaving policyholder responsible for gap in coverage); *Allstate Ins. Co.*, 759 N.E.2d at 1063 (Ind. 2001) (explaining how a policyholder is responsible for the portion of its liability allocable to lower-layer policies that had been settled and released).

⁶³ See cases cited *supra* note 61.

distinction, however, is one that makes a difference. From a matter of pure contract construction, the *Zeig* rule probably is more defensible in third-party insurance cases than it was in *Zeig* itself. In *Zeig*, the excess insurer's policy required "the payment of claims to the full amount of the expressed limits" of lower-layer insurance.⁶⁴ It was, at best, a judicial fiction to conclude that the \$15,000 in underlying limits were fully "paid," as the lower-layer insurers paid a mere \$6,000, and Louis Zeig received no insurance coverage for the remaining \$9,000 in primary limits.⁶⁵

By contrast, third-party liability insurance covers amounts the policyholder owes to an underlying plaintiff as the result of a judgment or settlement.⁶⁶ Absent agreement from the underlying plaintiff, *somebody* has to pay the full amount of the judgment or settlement even if the policyholder settles with an insurer for less than its full policy limit.⁶⁷ Thus, when a policyholder covers the gap in insurance caused by its below-limits settlement, it ordinarily has to make an actual payment of money to a tort plaintiff, unlike Louis Zeig's completely fictional "payment," apparently to himself, of the \$9,000 gap in coverage caused by his below-limits settlement.⁶⁸

On the other hand, some of the public policy considerations identified in *Zeig* are less compelling in the third-party context. In the first-party context, the Second Circuit was right in *Zeig* that the excess property insurer ordinarily should not care whether the policyholder collects the full limits of lower-layer insurance, so long as the excess insurer's attachment point is not affected.⁶⁹ For third-party insurance, the question is trickier, oftentimes because there is an underlying tort suit that someone is defending.⁷⁰

Primary general liability policies often include a duty by the insurer to defend suits against the policyholder that potentially are covered.⁷¹ Sometimes, the costs of defense do not count against the primary insurer's policy limits,⁷² so a primary insurer can end up

⁶⁴ *Zeig*, 23 F.2d at 666.

⁶⁵ See Howard B. Epstein & Theodore A. Keyes, 'Zeig' Still Governs Exhaustion of Underlying Policy Limits in New York, N.Y.L.J., Jun. 30, 2011, at 3, col. 1.

⁶⁶ See *supra* text accompanying note 15.

⁶⁷ See *Zeig*, 23 F.2d at 666.

⁶⁸ See *id.*; see also Epstein & Keyes, *supra* note 65 and accompanying text (describing that Zeig settled its claims under the policies for \$6,000, which is \$9,000 under the limits in the policy).

⁶⁹ *Zeig*, 23 F.2d at 666.

⁷⁰ See, e.g., *Garcia v. Century Sur. Co.*, 71 F. Supp. 3d 1184, 1185–86 (D. Colo. 2014) (detailing how third-party insurance coverage is implicated with an underlying tort).

⁷¹ ABRAHAM, *supra* note 1, at 20; 1 OSTRAGER & NEWMAN, *supra* note 1, § 5.02[a], at 327.

⁷² See, e.g., ABRAHAM, *supra* note 1, at 277 (providing a model commercial liability coverage

paying well more than its policy limit in the combined cost of defending its policyholder and paying any judgments or settlements that result.⁷³ In cases where a primary insurer is defending a tort suit against the policyholder, an excess insurer might be decidedly interested in whether the primary insurer can pay a portion of its limits and walk away from both its defense and indemnification obligations.⁷⁴

Indeed, the one fissure that developed in the eighty years following *Zeig* involved “partial settlements” in the third-party context.⁷⁵ In a “partial settlement,” the policyholder and its lower-layer insurers, for good reasons or bad, structure a settlement with a tort plaintiff so as to extract themselves from tort litigation while leaving any non-settling excess insurers fully exposed to tort liability.⁷⁶ The way it works is that the policyholder and its primary insurer reach a settlement with the tort plaintiff whereby the tort plaintiff would be paid an agreed amount, usually less than the primary insurer’s policy limits.⁷⁷ In return, the tort plaintiff would continue with its tort suit but would agree not to execute on any judgment against amounts up to the primary insurer’s policy limits, and would also agree not to execute against the policyholder for amounts exceeding the coverage of any excess insurers.⁷⁸ The result is that the only entity with any economic exposure to the result at trial is the non-settling excess insurer.⁷⁹

form which states that the payment of defense costs does not impact insurance limits).

⁷³ See *id.* (noting that an insurance company will defend its policyholder and pay for costs related to tort litigation).

⁷⁴ See, e.g., *Mehdi Ali v. Fed. Ins. Co.*, 719 F.3d 83, 93, 94 (2d Cir. 2013) (noting greater risk of settlement manipulation in the context of third-party insurance); *Fed. Ins. Co. v. Srivastava*, 2 F.3d 98, 103 (5th Cir. 1993) (noting the greater risk in the third-party context that a settlement between the policyholder and the primary insurer might implicate payment by the excess insurer); Lee M. Brewer & Barbara A. Ewing, *Exhaustion—What Does It Mean?*, 16 FIDELITY L.J. 207, 223–25 (2010) (identifying several reasons why an excess insurer might be prejudiced by a below-limits settlement by lower-layer insurers).

⁷⁵ See *Teigen v. Jelco of Wis., Inc.*, 367 N.W.2d 806, 810 (Wis. 1985) (“The desirability of *Loy*-type agreements lies in the encouragement of partial settlements in future cases, thereby fostering effective and expeditious resolution of lawsuits. Partial settlements not only benefit the parties involved, but the justice system as a whole.”).

⁷⁶ David Greenwald, *Partial Settlements by Primary Insurers: A Critique*, 29 TORT & INS. L.J. 555, 556 (1994); O’Connor, *supra* note 4, at 53.

⁷⁷ Jeanne H. Unger, *Dealing with the Devil—May an Insurer Settle Out of the Duty to Defend?*, DRI FOR THE DEF., Jan. 2015, at 14, 22.

⁷⁸ *Id.*; see also *Teigen*, 367 N.W.2d at 808 (discussing the terms of a partial settlement agreement in which plaintiff agreed not to pursue the defendant for claims in excess of the defendant’s primary and excess coverage limits).

⁷⁹ See *Teigen*, 367 N.W.2d at 808; Unger, *supra* note 77, at 22 (“This type of release has several advantages. It enables the plaintiff to access the proceeds of the primary policy without going to trial. It benefits the defendant because he or she is released from any personal liability.

A “partial settlement” is most easily understood as seeking to apply *Zeig’s* exhaustion rule without applying its gap-filling rule. The policyholder seeks a ruling that the settlement “exhausts” the primary policy on the grounds that the tort plaintiff has agreed not to pursue the portion of any judgment or settlement implicating the primary coverage.⁸⁰ But nobody pays the tort plaintiff the gap in coverage caused by the below-limits settlement.⁸¹ Instead, the tort plaintiff agrees to give a credit up to the full primary policy limits, even though she received less than that in the settlement.⁸²

It is not difficult to see why an excess insurer would resist the above arrangement.⁸³ With the primary insurer’s policy having been deemed exhausted, even though *nobody* paid the full primary limit to the tort plaintiff, the primary insurer likely will stop defending the tort suit and the excess insurer would be forced to take over the defense in order to protect its interests.⁸⁴ Moreover, even if the excess insurer’s policy does not include a duty to defend the policyholder or to pay defense costs, the excess insurer can hardly allow the policyholder to handle its own defense because the partial settlement makes the policyholder completely ambivalent as to how the tort suit turns out.⁸⁵ This leaves the excess insurer having to defend tort litigation that, absent the primary insurer’s below-limits settlement, would have been defended by the primary insurer at no cost to the

The advantage to the primary carrier is that it is permitted to pay its limits and shift the duty to defend to an excess carrier.”).

⁸⁰ O’Connor, *supra* note 4, at 66 (“Settlement with the primary insurer functionally ‘exhausts’ primary coverage and therefore triggers the excess policy – though by settling the policyholder loses any right to coverage of the difference between the settlement amount and the primary policy’s limits.”).

⁸¹ *Id.* at 36, 53–54, 66.

⁸² *Id.* at 53–54, 66.

⁸³ *Id.* at 53. Of course, this is not to say that policyholder and primary insurers are always motivated by ill intent in negotiating a partial settlement. In some cases, an excess insurer, comforted by the fact that the tort suit is being defended by the primary insurer at no cost to the excess insurer, might unreasonably refuse to approve a settlement to which it would have to make a contribution. *See id.* at 53–54. In such cases, the policyholder and primary insurer might view a partial settlement, if permitted in the jurisdiction, as the most reasonable way to deal with an excess insurer that is being intractable in settlement negotiations. *Id.* at 54.

⁸⁴ In one case, the primary insurer and policyholder entered into a pre-suit partial settlement with the tort claimant, and then the primary insurer purported to defend (and then settle) the later-filed tort suit even though the primary insurer and policyholder had already been released from liability. *See U.S. Fire Ins. Co. v. Lay*, 577 F.2d 421, 422 (7th Cir. 1978). As the Seventh Circuit observed, the wrongful death action essentially was “a sham,” as “[n]either [the policyholder] nor the primary insurer, which purported to defend the action, had any interest whatsoever in the outcome.” *Id.* at 423.

⁸⁵ *See* Thomas M. Bower, *Partial Settlements by Primary Insurers: The Law*, 29 TORT & INS. L.J. 536, 551 (1994).

excess insurer.⁸⁶ This is a far cry from *Zeig*, where the excess insurer had no legitimate economic interest in how Louis Zeig resolved his coverage claims against his lower-layer property insurers.⁸⁷ In the case of a partial settlement, the excess insurer, fairly or not, is put in a worse position as a result of the lower-layer insurer's settlement.

Courts have been split on this sub-issue of partial settlements. Some courts, most prominently those in Minnesota and Wisconsin, have endorsed partial settlements as a logical application of *Zeig*.⁸⁸ These courts have viewed partial settlements as a practical solution to the problem that arises when a policyholder and some, but not all, of its insurers want to settle a tort suit.⁸⁹

Other courts have found partial settlements to be a bridge too far.⁹⁰ In *United States Fire Insurance Co. v. Lay*, the primary insurer issued a \$100,000 policy to the policyholder, and was defending the policyholder against a tort suit.⁹¹ The policyholder and the primary insurer entered into a settlement with the tort plaintiff whereby the primary insurer paid \$70,000 to the tort plaintiff, and the tort plaintiff agreed to satisfy any subsequent judgment only from the proceeds of available excess insurance.⁹² The primary insurer then purported to continue "defending" the tort suit, even though the primary insurer and policyholder had no economic stake in its outcome, and the policyholder promptly consented to entry of a judgment for \$150,000.⁹³

The Seventh Circuit held that the partial settlement did not exhaust the primary limits because the settlement agreement capped the policyholder's actual exposure at \$70,000, which was less than the primary policy's limits.⁹⁴ The court distinguished *Zeig* on the grounds that Louis Zeig needed to show that he actually sustained a

⁸⁶ See 1 OSTRAGER & NEWMAN, *supra* note 1, § 6.03[b], at 506 ("The traditional view is that an excess insurer is not required to contribute to the defense of the insured so long as the primary insurer is required to defend."); Unger, *supra* note 77, at 22.

⁸⁷ See *Zeig v. Mass. Bonding & Ins. Co.*, 23 F.2d 665, 666 (2d Cir. 1928).

⁸⁸ See *Drake v. Ryan*, 514 N.W.2d 785, 789 (Minn. 1994); *Teigen v. Jelco of Wis., Inc.*, 367 N.W.2d 806, 810 (Wis. 1985).

⁸⁹ *Drake*, 514 N.W.2d at 789 ("Thus, [the excess insurer] is not prejudiced [by the partial settlement] because it is only being asked to fulfill its contractual obligations to its insured—to provide coverage in excess of that provided by the primary Dairyland policy."); *Teigen*, 367 N.W.2d at 810 ("The desirability of [partial settlements] lies in the encouragement of partial settlements in future cases, thereby fostering effective and expeditious resolution of lawsuits.").

⁹⁰ See, e.g., *Fed. Ins. Co. v. Srivastava*, 2 F.3d 98, 102 (5th Cir. 1993); *U.S. Fire Ins. Co. v. Lay*, 577 F.2d 421, 423 (7th Cir. 1978).

⁹¹ *Lay*, 577 F.2d at 422.

⁹² *Id.*

⁹³ *Id.*

⁹⁴ *Id.* at 423.

loss exceeding the \$15,000 limits of the underlying insurance in order to access his excess coverage.⁹⁵ By contrast, the policyholder in *Lay*, as a result of the partial settlement, was not exposed to liability greater than \$70,000, which meant that the primary policy's limits had not been exhausted.⁹⁶

The Fifth Circuit similarly rejected an argument that a policyholder and lower-layer insurers could settle litigation for a fraction of the settling insurers' limits, and still permit the underlying plaintiff to continue to pursue a judgment that would implicate excess coverage.⁹⁷ Thus the judicial record for partial settlements, where the policyholder did not actually fill the gap in coverage caused by its settlements, is decidedly mixed.

B. Chipping Away at the Zeig Gap-Filling Rule

For about eighty years, the gap-filling rule applied in *Zeig* was widely accepted.⁹⁸ In both the first-party and third-party contexts, a policyholder could settle with its lower-layer insurers for less than their policy limits and still pursue excess coverage, with the policyholder responsible for any gap in coverage caused by its settlements.⁹⁹ Only in the niche area of partial settlements, where *nobody* actually paid the full lower-layer limits to a tort plaintiff, was there an appreciable split of authority as to whether a below-limits settlement threatened the policyholder's ability to pursue non-settling excess insurers.¹⁰⁰

Buoyed by this rule, policyholders routinely winnowed down multi-insurer coverage disputes by negotiating settlements with insurers inclined to settle while preserving their rights against the other insurers. And then policyholders started losing cases against their non-settling excess insurers.¹⁰¹

⁹⁵ See *id.* at 423 (citing *Zeig v. Mass. Bonding & Ins. Co.*, 23 F.2d 665, 666 (2d Cir. 1928)).

⁹⁶ *Lay*, 577 F.2d at 423.

⁹⁷ *Fed. Ins. Co. v. Srivastava*, 2 F.3d 98, 100–01, 103 (5th Cir. 1993). In *Srivastava*, the Fifth Circuit held that an excess insurer with a \$22 million attachment point was not liable for any portion of a \$31.6 million judgment against the policyholder because the policyholder and the lower-layer insurers had paid only \$8.5 million to resolve the first \$22 million of the judgment. *Id.* As a result, the policyholder's *true* economic exposure did not exceed the excess insurer's \$22 million attachment point even though the judgment against the policyholder on its face exceeded the excess insurer's attachment point. See *id.* at 102, 103.

⁹⁸ See O'Connor, *supra* note 4, at 50, 51 ("Indeed, the case establishing what has become the predominant rule for treatment of below-limits settlements is *Zeig v. Massachusetts Bonding & Insurance Co.*").

⁹⁹ See *Zeig*, 23 F.2d at 666; O'Connor, *supra* note 4, at 51.

¹⁰⁰ See O'Connor, *supra* note 4, at 54–55.

¹⁰¹ See, e.g., *U.S. Fire Ins. Co. v. Lay*, 577 F.2d 421, 421, 423 (7th Cir. 1978).

The first warning shot occurred in 2007, when a federal district court held in *Comerica Inc. v. Zurich American Insurance Co.*¹⁰² that a policyholder's below-limits settlement with its primary insurer precluded coverage under its excess insurance policy.¹⁰³ This was not a partial settlement situation.¹⁰⁴ The primary insurer had issued a \$20 million policy and settled its coverage dispute with the policyholder for \$14 million.¹⁰⁵ Comerica agreed that it would be responsible for the \$6 million gap in coverage caused by its below-limits settlement, and sought to require its excess insurer to provide coverage only for the portion of the loss exceeding the excess policy's \$20 million attachment point.¹⁰⁶ Thus, the policyholder sought the same gap-filling ruling that a multitude of courts had made in the eight decades following *Zeig*.¹⁰⁷

But the district court held that *Zeig* and its progeny were inapplicable.¹⁰⁸ The court explained that "[t]he cases that follow *Zeig* generally rely on an ambiguity in the definition of 'exhaustion' or lack of specificity in the excess contract as to how the primary insurance is to be discharged."¹⁰⁹ The court observed that "[a] different result occurs when the policy language is more specific."¹¹⁰ In contrast to *Zeig*, Comerica's excess insurer had a clause in its policy providing that the limits of underlying insurance policies may be depleted "solely as a result of actual payment of loss thereunder *by the applicable insurers*."¹¹¹ The "applicable insurer," however, had only paid \$14 million of its \$20 million limit, leading the court to conclude that the excess insurer had no duty to provide coverage even though Comerica was willing to cover the \$6 million gap in coverage.¹¹²

The district court in *Comerica* also rejected the policyholder's argument that the clause should be voided as violating public policy.¹¹³ In rejecting this argument, the court found solace in *Zeig* itself, agreeing with the Second Circuit's observation that "[i]t is

¹⁰² *Comerica Inc. v. Zurich Am. Ins. Co.*, 498 F. Supp. 2d 1019 (E.D. Mich. 2007).

¹⁰³ *Id.* at 1034.

¹⁰⁴ *See id.* at 1020, 1025–26.

¹⁰⁵ *Id.* at 1020.

¹⁰⁶ *See id.* at 1025, 1029.

¹⁰⁷ *Id.* at 1029 (citing *Zeig v. Mass. Bonding & Ins. Co.*, 23 F.2d 665, 666 (2d Cir. 1928)).

¹⁰⁸ *Comerica*, 498 F. Supp. 2d at 1032.

¹⁰⁹ *Id.* at 1030.

¹¹⁰ *Id.*

¹¹¹ *Id.* at 1022 (emphasis added).

¹¹² *Id.* at 1020, 1032.

¹¹³ *See id.* at 1032.

doubtless true that the parties could impose such a condition precedent to liability upon the policy, if they chose to do so.”¹¹⁴

Comerica proved to be no outlier. One year later, the California Court of Appeal reached the same result in *Qualcomm, Inc. v. Certain Underwriters at Lloyd's, London*.¹¹⁵ In *Qualcomm*, the primary insurer paid \$16 million of its \$20 million limit in connection with a stock option lawsuit filed against the policyholder.¹¹⁶ Qualcomm then sued its excess insurers, seeking a declaration that the excess insurers were liable for losses exceeding \$20 million so long as Qualcomm or some third party paid the \$4 million gap in coverage.¹¹⁷ The trial court held that the excess coverage had not been triggered because the excess policy required payment of the full \$20 million by the primary insurer.¹¹⁸ The California Court of Appeal affirmed, holding that the excess policy explicitly required that the primary insurer pay its full limits, or be held liable to pay its full limits, before the excess insurers had any obligation under the excess policy.¹¹⁹ In particular, the *Qualcomm* court relied on the excess insurers' policy language providing that the excess insurers “shall be liable only after the insurers under [the primary policy] have paid or have been held liable to pay the full amount of the Underlying Limit of Liability.”¹²⁰

The *Qualcomm* court acknowledged *Zeig* and some of the cases following *Zeig*, but concluded that *Zeig* was both poorly reasoned and distinguishable.¹²¹ The court rejected *Zeig*'s reasoning because it viewed *Zeig* as “plac[ing] policy considerations . . . above the plain meaning of the terms of the excess policy,” and because it viewed as “strained” the *Zeig* court's conclusion that “payment” might include something other than actually paying.¹²² The court also distinguished *Zeig* because the excess policy before the *Qualcomm*

¹¹⁴ *Id.* (alteration in original) (quoting *Zeig v. Mass. Bonding & Ins. Co.*, 23 F.2d 665, 666 (2d Cir. 1928)).

¹¹⁵ *Qualcomm, Inc. v. Certain Underwriters at Lloyd's, London*, 73 Cal. Rptr. 3d 770, 786 (Cal. Ct. App. 2008).

¹¹⁶ *Id.* at 773, 774.

¹¹⁷ *See id.* at 774.

¹¹⁸ *Id.* at 774–75.

¹¹⁹ *Id.* at 778, 779, 786. Although there was only one excess policy at issue in *Qualcomm*, there were multiple excess insurers because the excess policy was a subscription policy sold on the London market, where a number of persons or entities agreed to insure a portion of the risk covered by the excess policy. *See How to Place a Risk at Lloyd's*, LLOYD'S, <https://www.lloyds.com/lloyds/offices/americas/us-homepage/placing-risk/how-to-access-lloyds> (last visited Oct. 10, 2015); *What is Lloyd's?*, LLOYD'S, <https://www.lloyds.com/lloyds/about-us/what-is-lloyds> (last visited Oct. 10, 2015).

¹²⁰ *Qualcomm*, 73 Cal. Rptr. 3d at 774, 779.

¹²¹ *Id.* at 780.

¹²² *Id.*

court was much more specific in requiring actual payment *by the primary insurer* of its full limit before the excess insurers had a duty to provide coverage.¹²³

Following *Comerica* and *Qualcomm*, several other courts reached the same result. These courts have held *Zeig* and its progeny inapplicable because of the specific language in the excess policies before them.¹²⁴ For example, in *Citigroup Inc. v. Federal Insurance Co.*, the Fifth Circuit had four excess policies before it.¹²⁵ One of the excess policies provided that coverage attached only after “all Underlying Insurance carriers have paid in cash the full amount of their respective liabilities.”¹²⁶ Another policy provided that “[t]he [excess] [i]nsurer 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.”¹²⁷ A third excess policy provided that the coverage attached “only after any Insurer subscribing to any Underlying Policy shall have agreed to pay or have been held liable to pay the full amount of its respective limits of liability.”¹²⁸ The fourth excess policy provided that coverage attached “[i]n the event of the exhaustion of all of the limit(s) of liability . . . solely as a result of payment of loss thereunder.”¹²⁹ The Fifth Circuit concluded that all four policies unambiguously required that all lower-layer insurers pay, or be held liable to pay, their full limits before the excess insurer had any coverage obligation.¹³⁰ Because the primary insurer had settled in return for a payment of only \$15 million of its \$50 million limit, the court held that the requirements for coverage under the excess insurers’ policies had not been met.¹³¹ The other recent cases declining to permit gap filling in the face of a below-limits settlement involved similarly explicit policy language.¹³²

¹²³ *Id.*

¹²⁴ *See, e.g.*, *Citigroup Inc. v. Fed. Ins. Co.*, 649 F.3d 367, 373 (5th Cir. 2011); *Great Am. Ins. Co. v. Bally Total Fitness Holding Corp.*, No. 06 C 4554, 2010 U.S. Dist. LEXIS 61553, at *17, *18 (N.D. Ill. June 22, 2010); *JP Morgan Chase & Co. v. Indian Harbor Ins. Co.*, 947 N.Y.S.2d 17, 22, 22–23 (N.Y. App. Div. 2012); *Forest Labs., Inc. v. Arch Ins. Co.*, 953 N.Y.S.2d 460, 465–66 (N.Y. Sup. Ct. 2012); *Quellos Grp., LLC v. Fed. Ins. Co.*, 312 P.3d 734, 735 (Wash. Ct. App. 2013).

¹²⁵ *Citigroup*, 649 F.3d at 372.

¹²⁶ *Id.*

¹²⁷ *Id.*

¹²⁸ *Id.*

¹²⁹ *Id.* at 373 (alteration in original).

¹³⁰ *See id.* at 370, 371.

¹³¹ *Id.* at 370, 373.

¹³² *See, e.g.*, *Great Am. Ins. Co. v. Bally Total Fitness Holding Corp.*, No. 06 C 4554, 2010 U.S. Dist. LEXIS 61553, at *7, *8 (N.D. Ill. June 22, 2010) (“[O]nly after the insurers of the

At the same time, several courts in the past few years have applied the *Zeig* gap-filling rule where the excess insurer's policy does not explicitly require that payments of underlying limits be made in full by the underlying insurer.¹³³ In these cases, courts held that the policyholder could settle with its primary or lower-layer excess insurers for less than policy limits, and continue to pursue excess coverage, so long as the policyholder was responsible for any gap in coverage caused by its settlements.¹³⁴

Thus, the current state of the law appears to be that courts will enforce provisions in excess policies explicitly requiring the payment of full limits by any lower-layer insurers.¹³⁵ In cases where the excess policies contain explicit language along these lines, the policyholder very likely imperils its ability to pursue excess coverage if it settles with one or more lower-layer insurers for less than their full policy limits, even if the policyholder is willing to cover the gap in coverage.¹³⁶

On the other hand, the *Zeig* gap-filling rule continues to be applied by courts where the excess insurer's policy does not explicitly state that underlying limits must be paid in full and by the underlying

Underlying Policies shall have paid, in the applicable legal currency, the full amount of the Underlying Limit Similarly, [another] excess insurance policy [provided coverage] [i]n the event of exhaustion of all of the limits of insurance of the Underlying Insurance solely as a result of actual payment of loss or losses thereunder.”); *JP Morgan Chase & Co. v. Indian Harbor Ins. Co.*, 947 N.Y.S.2d 17, 22 (N.Y. App. Div. 2012) (“[L]iability for any loss shall attach to [the excess insurer] only after the Primary and Underlying Excess Insurers shall have duly admitted liability and shall have paid the full amount of their respective liability.”); *Forest Labs., Inc. v. Arch Ins. Co.*, 953 N.Y.S.2d 460, 463 (N.Y. Sup. Ct. 2012) (“[O]nly in the event of a reduction or exhaustion of the Underlying Limits of Liability, solely as a result of *actual payment of a Covered Claim pursuant to the terms and conditions of the Underlying Insurance thereunder* [will excess insurance coverage be provided].”); *Quellos Grp., LLC v. Fed. Ins. Co.*, 312 P.3d 734, 735 (Wash. Ct. App. 2013) (“The [first excess insurance] policy states coverage ‘shall attach only after the insurers of the Underlying Insurance shall have paid in legal currency the full amount of the Underlying Limit.’ The [second excess insurance] policy states coverage ‘will attach only after all of the Underlying Insurance ha[ve] been exhausted by the actual payment of loss by the applicable insurers.’”).

¹³³ *See, e.g.*, *Pac. Emp’rs Ins. Co. v. Clean Harbors Env’tl. Servs. Inc.*, No. 08 C 2180, 2011 U.S. Dist. LEXIS 20000, at *8–9 (N.D. Ill. Feb. 24, 2011). (“[T]he [excess] [p]olicy does not provide that the sole method of exhaustion is payment *by the underlying insurer.*”); *Maximus, Inc. v. Twin City Fire Ins. Co.*, 856 F. Supp. 2d 797, 801 (E.D. Va. 2012) (“[The excess policy] neither states that actual payment requires payment of the full limit of an underlying policy by the lower-tier carriers, nor does it expressly preclude the insured from filling the gap to exhaust the underlying policy.”); *Schmitz v. Great Am. Assurance Co.*, 337 S.W.3d 700, 707 (Mo. 2011) (holding that partial settlement by primary insurer exhausted primary insurance and triggered excess coverage where excess policy provided that excess insurer would not pay loss within underlying limits that the policyholder agreed to be responsible for).

¹³⁴ *See, e.g.*, *Maximus*, 865 F. Supp. 2d at 804.

¹³⁵ *See supra* notes 130–33 and accompanying text.

¹³⁶ *See supra* notes 102–33 and accompanying text.

insurers.¹³⁷ Where excess policy language does not expressly require payment of the full amount of underlying limits by the lower-layer insurer, the law regarding partial settlements—where *nobody* fills the gap in coverage caused by a below-limits settlement—appears to be unchanged, with some jurisdictions allowing partial settlements and others refusing to do so.¹³⁸ Where excess policy language explicitly requires payment of full limits by the lower-layer insurers, it is difficult to imagine a partial settlement being sanctioned by a court, at least where the primary insurer is not paying full limits, without that court simply ignoring or refusing to enforce the excess policy language before it.

C. The Revolution That Wasn't —The Rise of Zeig's "Other" Rule

From the Second Circuit's 1928 decision in *Zeig* until the latter part of the past decade, a policyholder had good reason to be confident that it could settle with some of its insurers for less than full limits without prejudicing its pursuit of excess coverage.¹³⁹ All the policyholder needed was a willingness to fill any gap in coverage caused by its settlement.¹⁴⁰ Today, however, a policyholder's ability to settle with a primary insurer for less than full limits and then pursue excess insurers is less secure.¹⁴¹

But this change in the legal landscape is not the result of a change in the law. The holding of *Zeig* was not that a policyholder can always settle with lower-layer insurers, fill the gap in coverage caused thereby, and then pursue excess insurers.¹⁴² That was the result in *Zeig*, but not the case's holding.¹⁴³ The enduring holding in *Zeig* is

¹³⁷ See *supra* note 133 and accompanying text. It is worth noting that the California Court of Appeal not only distinguished *Zeig*, but also rejected its reasoning. *Qualcomm, Inc., v. Certain Underwriters at Lloyd's, London*, 73 Cal. Rptr. 3d 770, 780 (Cal. Ct. App. 2008). It remains to be seen whether courts will reject *Zeig* in cases where the excess insurer's policy does not expressly require payment of full limits by the lower-layer insurer. Thus far, however, courts rejecting the gap-filling rule have done so where there is in fact specific language compelling that result. See cases cited *supra* note 133.

¹³⁸ See *Brewer & Ewing, supra* note 74, at 227–28.

¹³⁹ See, e.g., *HLTH Corp. v. Agric. Excess & Surplus Ins. Co., No. 07C-09-102 RRC*, 2008 Del. Super. LEXIS 280 *46–47 (Del. Super. Ct. July 31, 2008).

¹⁴⁰ See, e.g., *Quellos Grp., LLC v. Fed. Ins. Co.*, 312 P.3d 734, 743, 744 (Wash. Ct. App. 2013).

¹⁴¹ See *Brewer & Ewing, supra* note 74, at 214 (“[R]ecent decisions show a clear trend to allow the language of the insurance policy to trump the public policy concerns that influenced the *Zeig* court Most courts are interpreting these different [policy] provisions so that below-limits settlement of claims against the underlying policies will not trigger excess coverage.”).

¹⁴² See O'Connor, *supra* note 4, at 51.

¹⁴³ See *Zeig v. Mass. Bonding & Ins. Co.*, 23 F.2d 665, 666 (2d Cir. 1928); O'Connor, *supra* note 4 at 51.

that if an excess insurer desires to condition its coverage on the actual payment of full limits by any lower-layer insurers, the excess insurer must state it clearly in its policy.¹⁴⁴ As the Second Circuit put it in *Zeig*, “[i]t is doubtless true that the parties could impose such a condition precedent to liability upon the policy, if they chose to do so.”¹⁴⁵ Having failed over a period of decades to change the law, some excess insurers simply changed their contracts instead, and courts generally have applied the excess insurers’ policy language as written.¹⁴⁶ Indeed, courts rejecting the gap-filling rule based on clear policy language are completely faithful to *Zeig*, as these courts have simply enforced the clear language in the excess policies before them, language the Second Circuit intimated in *Zeig* was a permissible term if clearly stated.¹⁴⁷ By the same token, modern court decisions are equally faithful to *Zeig* when they allow gap-filling by the policyholder in cases where the excess policies do not clearly require actual payment of full limits by the lower-layer insurers.¹⁴⁸

Indeed, the evolving judicial treatment of below-limits settlements highlights a fundamental truth about contract law: precedent construing contract language is only good until the contract language changes.¹⁴⁹ At that point, courts need to consider the contract language before them and determine whether the new language requires a new result. Courts have done just that. Modern courts have decided cases involving below-limits settlements based on the policy language to which the parties agreed rather than blindly following precedent from cases involving entirely different policy language.¹⁵⁰

Courts are, of course, not the only ones that need to pay close attention to the policy language. Policyholders would be wise to

¹⁴⁴ See *Zeig*, 23 F.2d at 666.

¹⁴⁵ *Id.*

¹⁴⁶ Brewer & Ewing, *supra* note 74, at 214.

¹⁴⁷ See Brewer & Ewing, *supra* note 74, at 215–22 (describing the holdings of the four leading cases as enforcing unambiguous language freely included in exhaustion provisions).

¹⁴⁸ See cases cited *supra* note 133.

¹⁴⁹ See Brewer & Ewing, *supra* note 74, at 214.

¹⁵⁰ *But see* *HLTH Corp. v. Agric. Excess & Surplus Ins. Co.*, No. 07C-09-102 RRC, 2008 Del. Super. LEXIS 280, at *43 (Del. Super. Ct. July 31, 2008). In *HLTH Corp.*, the excess insurer’s policy provided coverage “[o]nly in the event of exhaustion of the Underlying Limit by reason of the insurers of the Underlying Insurance . . . paying in legal currency loss which, except for the amount thereof, would have been covered hereunder.” *Id.* The court in *HLTH Corp.* simply stated its agreement with *Zeig*, noting that Delaware and New Jersey courts had applied the *Zeig* gap-filling rule in prior cases, and thus, below-limits settlement did not preclude coverage under the excess policy. *Id.* at *44–45, *46. Other than quoting the excess insurer’s policy language, the court simply ignored the policy language and held that precedent supported the gap-filling rule. *Id.* at *43, *47.

examine the conditions precedent to coverage in their excess policies at least twice—once when procuring the policy, and once before entering into a settlement with a lower-layer insurer. If a policyholder does not want its excess insurance contingent on payment of full limits by lower-layer insurers, the policyholder should not procure policies providing to the contrary.¹⁵¹ If the policyholder's excess policies require payment of full limits by the lower-layer insurer, the policyholder should not enter into a below-limits settlement with a lower-layer insurer unless it is willing to live without excess coverage for the loss.

While the modern treatment of below-limits settlements is not the result of any substantial change in the law, the change in settlement dynamics has been profound.¹⁵² As excess policies have more frequently required actual payment of full limits by the lower-layer insurers, it has become considerably more difficult for policyholders to settle large-scale, multi-insurer coverage disputes.¹⁵³ If the policyholder's excess policies require payment of full limits by the lower-layer insurers, a policyholder and its lower-layer insurers cannot settle their own differences without entering into a global settlement that includes the excess insurers, or else the policyholder likely will lose any ability to continue pursuing the excess insurers.¹⁵⁴ The only alternative is for a policyholder to settle with its lower-layer insurers for full policy limits, which the lower-layer insured has no incentive to do if they believe they have potential defenses to coverage.¹⁵⁵ This can force parties to continue litigating against each other when they have no desire to litigate, all because of the risk that

¹⁵¹ See, e.g., *Quellos Grp. LLC v. Fed. Ins. Co.*, 312 P.3d 734, 743–44 (Wash. Ct. App. 2013) (noting that some of the excess policies in the case permitted the policyholder to cover gaps in coverage from below-limits settlements, and that one of the non-settling insurers had a policy amendment available, which *Quellos* had not requested, that would permit gap-filling by the policyholder).

¹⁵² See *supra* notes 124–34 and accompanying text.

¹⁵³ See, e.g., *Qualcomm, Inc. v. Certain Underwriters at Lloyd's, London*, 73 Cal. Rptr. 3d 770, 785–86 (Cal. Ct. App. 2008) (rejecting public policy considerations of promoting settlements and requiring payment of full limits by lower-layer to attach excess insurer based on the unambiguous language of the excess insurance policy).

¹⁵⁴ See, e.g., *Trinity Homes, LLC v. Ohio Cas. Ins. Co.*, 629 F.3d 653, 659 (“Rather than agree to a lower payout by a [commercial general liability] provider as part of a settlement, an insured with an excess policy would be forced to fully litigate each and every of its [commercial general liability] policy claims before seeking recourse from its umbrella insurer.”).

¹⁵⁵ *Liberty Mut. Fire Ins. Co. v. J.T. Walker Indus.*, No. 2:08-2043-MBS, 2012 U.S. Dist. LEXIS 112427, at *8 (S.D.N.Y. Aug. 10, 2012); Jacki L. Anderson, *Excess Insurance Triggered Despite Policyholder's Settlement with Primary Insurers for Less than Policy Limits*, NAT'L L. REV. (Sept. 22, 2014), <http://www.natlawreview.com/article/excess-insurance-triggered-despite-policyholder-s-settlement-primary-insurers-less-p>.

a voluntary settlement could prejudice the policyholder's pursuit of other insurers.

Virtually every state recognizes a public policy in favor of the voluntary settlement of disputes,¹⁵⁶ and cases enforcing excess policy clauses requiring payment of full limits by lower-layer insurers make settlement harder, not easier.¹⁵⁷ Indeed, the practical ability to prevent a policyholder from settling with others can provide excess insurers with considerable leverage in settlement negotiations.¹⁵⁸

However, courts have shown no appetite for using notions of public policy to cast aside clear policy language regarding conditions precedent to excess coverage.¹⁵⁹ Public policy considerations favoring settlement arguably motivated the Second Circuit to create the gap-filling rule in *Zeig*, but that was a rule to be applied in the face of policy language the court viewed as ambiguous.¹⁶⁰ Where private

¹⁵⁶ See, e.g., *Largo v. Hayes*, 534 So. 2d 1101, 1105 (Ala. 1988); *Colton v. Colton*, 244 P.3d 1121, 1127 (Alaska 2010); *Miller v. Kelly* 130 P.3d 982, 986 (Ariz. Ct. App. 2006); *Stromwell v. Van Hoose*, 265 S.W.3d 93, 104 (Ark. 2007); *Poster v. S. Cal. Rapid Transit Dist.*, 801 P.2d 1072, 1074 (Cal. 1990); *Davis v. Flatiron Materials Co.*, 511 P.2d 28, 32 (Colo. 1973); *DiLieto v. Cty. Obstetrics & Gynecology Grp., P.C.*, 998 A.2d 730, 760 (Conn. 2010); *Sammons v. Doctors for Emergency Servs., P.A.*, 913 A.2d 519, 533 (Del. 2006); *Makins v. District of Columbia*, 861 A.2d 590, 597 (D.C. 2004); *Robbie v. City of Miami*, 469 So. 2d 1384, 1385 (Fla. 1985); *Ruskin v. AAF-McQuay, Inc.*, 670 S.E.2d 517, 520 (Ga. Ct. App. 2008); *Amantiad v. Odum*, 977 P.2d 160, 169–70 (Haw. 1999).

¹⁵⁷ See *Danbeck v. Am. Family Mut. Ins. Co.*, 2001 WI 99, ¶ 36, 245 Wis. 2d 186, 203, 629 N.W.2d 150, 159 (Bradley, J., dissenting) (“[I]nvoicing the supposed lack of ambiguity to avoid consideration of the policy of encouraging settlement, the majority not only fails to promote that policy, but indeed frustrates it.”).

¹⁵⁸ See *Pereira v. Cogan*, No. 04 Civ. 1134 (LTS), 2006 U.S. Dist. LEXIS 49263, *26 (S.D.N.Y. July 12, 2006) (“Interpreting the policy to excuse the excess insurers from providing coverage within their respective layers on account of the unrelated insolvency of an intermediary insurer would work a similar hardship on the insureds, who have already been deprived of a layer of coverage by the insolvency, and provide a windfall to the excess insurers.”); *HLTH Corp. v. Agric. Excess & Surplus Ins. Co.*, No. 07C-09-102 RRC, 2008 Del. Super. LEXIS 280, at *47 (Del. Super. Ct. July 31, 2008) (“The Court sees unfairness in allowing the excess insurance companies in the instant case to avoid payment on an otherwise undisputedly legitimate claim.”).

¹⁵⁹ See *Comerica Inc. v. Zurich Am. Ins. Co.*, 498 F. Supp. 2d 1019, 1031 (E.D. Mich. 2007) (“[T]he public policy favoring settlement . . . ‘cannot supersede unambiguous policy language or impose obligations under the contract which otherwise do not exist. The generalized public policy favoring settlements is insufficient to justify voiding or refusing to enforce the clear language of the policy in this case.’” (quoting *Danbeck*, 2001 WI 99, ¶ 21, 245 Wis. 2d at 197–98, 629 N.W.2d at 156)); *Qualcomm, Inc. v. Certain Underwriters at Lloyd’s, London*, 73 Cal. Rptr. 3d 770, 785 (Cal. Ct. App. 2008) (refusing to disregard unambiguous policy language in furtherance of public policy); *Quellos Grp. LLC v. Fed. Ins. Co.*, 312 P.3d 734, 744 (Wash. Ct. App. 2013) (holding that public policy did not permit the court to rewrite an unambiguous contract term).

¹⁶⁰ See generally *Zeig v. Mass. Bonding & Ins. Co.*, 23 F.2d 665, 666 (2d Cir. 1928) (“A result harmful to the insured, and of no rational advantage to the insurer, ought only to be reached when the terms of the contract demand it.”); see also *Stargatt v. Fid. & Cas. Co. of N.Y.*, 67 F.R.D. 689, 691 (D. Del. 1975) (favoring explicit contractual language over policy considerations

parties agreed on unambiguous language in their insurance contract, courts have not viewed public policy as a sound basis for rewriting the contract.¹⁶¹ As the California Court of Appeal explained in *Qualcomm*: “Whatever merit there may be to conflicting social and economic considerations, they have nothing whatsoever to do with our interpretation of the unambiguous contractual terms. If the contractual language in an insurance contract is clear and unambiguous, it governs, and we do not rewrite it for any purpose.”¹⁶²

Indeed, there are good reasons why public policies favoring the orderly settlement of disputes should not be used to rewrite unambiguous policy language, even if the policy language admittedly makes settlement more difficult. The issue of below-limits settlements only comes into play where the policyholder has sufficient operations as to make it advisable to have both primary and excess insurance coverage.¹⁶³ Thus, it is not surprising that the policyholders in these cases have been sophisticated business entities, including two large banks (Comerica and Bank One—the predecessor-in-interest to JP Morgan Chase & Co.); a large telecommunications company (Qualcomm); a nationwide consumer lender (the predecessor-in-interest to Citigroup); and a nationwide fitness center company (Bally Total Fitness).¹⁶⁴ Such sophisticated business entities hardly have a compelling argument that courts should rewrite their excess insurance contracts so they can keep the benefits of such contracts but be relieved of unambiguous terms to which they regret agreeing.

Beyond the notion that unambiguous contracts should be enforced as they are written, excess insurers have valid reasons, which courts should respect, for insisting on payment of full limits by lower-layer insurers. Excess insurance is less expensive than primary insurance because the insurer only has a duty to pay once the policyholder’s loss reaches a stated attachment point.¹⁶⁵ Thus, if litigation is resolved

favoring settlements), *aff’d*, 578 F.2d 1375 (3d Cir. 1978) (mem.).

¹⁶¹ See *Qualcomm*, 73 Cal. Rptr. 3d at 772 (“We decline to reach a broad holding based on public policy considerations, and instead conclude that the literal policy language in this case governs.”).

¹⁶² *Id.* at 786 (quoting *Aerojet-General Corp. v. Commercial Union Ins. Co.*, 65 Cal. Rptr. 3d 803, 813 (Cal. Ct. App. 2007)).

¹⁶³ See *Brewer & Ewing*, *supra* note 74, at 208–09 (describing a situation where it would be advisable to have such coverage).

¹⁶⁴ See *supra* notes 102–31 and accompanying text.

¹⁶⁵ See *Medhi Ali v. Fed. Ins. Co.*, 719 F.3d 83, 91 (2d Cir. 2013) (“Because [excess] coverage is only triggered after the primary insurance limit has been exhausted, excess insurance is generally available at a lesser cost than the primary policy since the risk of loss is less than for the primary insurer.” (quoting *Gabarick v. Laurin Mar. (Am.) Inc.*, 649 F.3d 417, 422 (5th Cir.

for less than the excess insurer's policy limit, the excess insurer pays nothing.¹⁶⁶ Yet sometimes policyholders try to coerce excess insurers into contributing to settlements below their attachment points by threatening to structure a settlement that protects the policyholder and lower-layer insurers but leaves the excess insurer exposed to an adverse judgment if the excess insurer refuses to contribute to the settlement.¹⁶⁷

The most obvious example of this phenomenon is the partial settlement, whereby the policyholder and primary insurer shift the defense obligation from the primary insurer to the excess insurer.¹⁶⁸ They do this without the primary insurer having paid its full limits, and leave the excess insurer exposed to a tort lawsuit against the policyholder where the policyholder has no economic interest at all in how it turns out.¹⁶⁹

This is what the policyholder attempted in *Federal Insurance Co. v. Srivastava*.¹⁷⁰ In *Srivastava*, the policyholder told an excess insurer that it would structure a securities settlement to protect the policyholder and all the insurers, other than the excess insurer, if the excess insurer did not contribute to a settlement that did not reach the excess insurer's attachment point.¹⁷¹ While not all courts

2011)); *Fed. Ins. Co. v. Srivastava*, 2 F.3d 98, 101 (5th Cir. 1993) ("Excess liability insurers contract to provide inexpensive insurance with high policy limits by requiring the insured to contract for primary insurance with another carrier." (quoting *Harville v. Twin City Fire Ins. Co.*, 885 F.2d 276, 278 (5th Cir. 1989))); *Brewer & Ewing*, *supra* note 74, at 209 ("As you climb the tower of coverage from A to E, each layer should cost less than the previous one, as the chance that it will ever be needed becomes more and more remote."); James M. Fredericks, Comment, *Excess Insurer's Duty to Defend After Primary Insurer Settles Within Policy Limits: Wisconsin After Loy and Teigen*, 70 MARQ. L. REV. 285, 294 (1987) ("Taking into consideration the existence and underlying limits of the primary policy, the excess policy is written at a lower premium than that of the primary policy.").

¹⁶⁶ See *Horace Mann Ins. Co. v. Gen. Star Nat'l Ins. Co.*, 514 F.3d 327, 334 (4th Cir. 2008) ("[T]he general rule is that as between a true excess policy and a primary liability policy with an other-insurance clause, the limits of the policy that provides primary insurance must *always* be exhausted before coverage under the excess policy is triggered."); see also *Rhone-Poulenc, Inc. v. Int'l Ins. Co.*, 877 F. Supp. 1170, 1176 (N.D. Ill. 1995) ("The protections of excess insurance do not begin until those of the primary policy end When an excess clause is given effect, the insurer is not liable for any part of the loss or damage covered by other insurance except for the amount of loss or damage in excess of the coverage provided by the other policy.").

¹⁶⁷ See e.g., *Srivastava*, 2 F.3d 98 at 100–01.

¹⁶⁸ See *Unger*, *supra* note 77, at 22 ("The advantage [of a partial settlement] to a primary carrier is that it is permitted to pay its limits and shift the duty to defend to an excess carrier."); *supra* notes 77–79 and accompanying text.

¹⁶⁹ See *Unger* *supra* note 77, at 22 ("[T]he plaintiff expressly reserves the right to pursue claims against an excess insurer for damages in excess of the primary insurance coverage limit.").

¹⁷⁰ *Fed. Ins. Co. v. Srivastava*, 2 F.3d 98 (5th Cir. 1993).

¹⁷¹ See *id.* at 100–01.

permitted partial settlements even when the *Zeig* gap-filling rule was universally followed,¹⁷² it is not difficult to see why an excess insurer might want to explicitly contract its way out of a partial settlement scenario—at least where the primary insurer is paying less than its full limits.

Similarly, the *Zeig* gap-filling rule permits other types of settlement chicanery where policyholders can collude with their tort adversary or lower-layer insurers to protect themselves, but leave the excess insurer hanging out to dry. One way is through an inflated settlement that purports to reach the excess insurer's limits but where, in reality, the policyholder is covering a gap in insurance through a promissory note that will never be paid, or will fraudulently claim that it is actually paying the gap in coverage.¹⁷³ As the Second Circuit correctly observed, excess insurers have “good reason to require actual payment up to the attachment points of the relevant policies, thus deterring the possibility of settlement manipulation.”¹⁷⁴

Excess insurance is priced based on its attachment point, and efforts to coerce an excess insurer to pay a portion of a global settlement that functionally is less than the insurer's attachment point upsets the balance between premium structure and coverage.¹⁷⁵ While excess insurance clauses conditioning coverage on payment of full limits by lower-layer insurers can sometimes give excess insurers leverage in settlement negotiations, the *Zeig* gap-filling regime gives just as much leverage in settlement to policyholders and lower-layer insurers.

IV. CONCLUSION

Two decades ago, before excess insurers began winning disputes over below-limits settlements with any regularity, the New Mexico Supreme Court allowed *Zeig*-style gap-filling by the policyholder in a case before it, and in the course of doing so, made a prescient observation: “The resolution of this issue turns on the language of the excess insurer's policy. As such, though we may find guidance in other similar cases, this issue must be resolved on the facts of this

¹⁷² See *supra* notes 90–92 and accompanying text.

¹⁷³ See *Mehdi Ali v. Fed. Ins. Co.*, 719 F.3d 83, 94 (2d Cir. 2013) (quoting *Fed. Ins. Co. v. Estate of Irving Gould*, No. 10 Civ. 1160 (RJS), 2011 U.S. Dist. LEXIS 114000, at *22–23 (S.D.N.Y. Sept. 28, 2011)).

¹⁷⁴ *Mehdi Ali*, 719 F.3d at 94.

¹⁷⁵ See *Fredericks*, *supra* note 165, at 312, 313 (“The excess insurer's rate structure does not envision a rule which permits another party to expand the excess insurer's potential liability.”).

particular case and on the language of the individual insurance contract.”¹⁷⁶

This is exactly what has happened over the past decade. Judicial precedent on issues of contract construction is only as good as the contract language the courts had before them. When the contract language changes substantively, so do the results in court. Thus, the series of cases holding that excess insurers had no duty when lower-layer insurers paid less than full policy limits is not a departure from settled law, but is instead settled law on an entirely different type of contract language. Where excess policies address exhaustion of underlying limits in the passive voice, without identifying *who* must pay the full underlying limits, the excess insurers issuing those policies run the risk that a court will find ambiguity and permit the same gap-filling allowed in *Zeig* and its progeny. Where the excess insurer’s policy explicitly states that coverage under the policy requires payment of full limits by the lower-layer insurers, courts can be counted on to enforce that provision, and a policyholder entering into a below-limits settlement with an insurer risks losing any ability to access coverage excess to that of the settling insurer. Enforcing contracts based on what they actually say is hardly a radical concept.

Requiring payment of full limits by underlying insurers complicates the settlement of complex insurance disputes immeasurably, and makes piecemeal settlements virtually impossible. But this change in the settlement landscape simply takes leverage in settlement negotiations once held, and sometimes wielded coercively, by policyholders, and shifts that leverage to excess insurers that are being asked to contribute to a settlement. If this is an undesirable state of affairs for policyholders, it is a prison for which they hold the key, as courts are only enforcing the terms of excess policies to which both the excess insurer and the policyholder agreed.

¹⁷⁶ *Rummel v. Lexington Ins. Co.*, 1997-NMSC-041, ¶ 25, 123 N.M. 752, 759, 945 P.2d 970, 977 (N.M. 1997).