

**The Excess Insurer Lament: When Is The Primary Layer Exhausted? The Fourth Circuit Weighs In Against The Excess Insurer - *ABT Building Products Corp. v. National Union Fire Ins. Co. of Pittsburgh*, 472 F.3d 99 (4<sup>th</sup> Cir. 2006).**

**By James W. Bryan**

How would you like to be the excess insurer on the losing end of a coverage/bad faith lawsuit and have to pay over \$11 million in extra-contractual damages when the dissenting opinion reads as follows: “The majority rewrites [the excess insurer’s] policy to require it to participate in defense and settlement discussions on the slim possibility that *claims in the future* could exhaust the primary limits of [the primary insurer’s] insurance coverage.” *ABT Building Products Corp. v. National Union Fire Ins. Co. of Pittsburgh*, 472 F.3d 99, 129 (4<sup>th</sup> Cir. 2006) (dissenting opinion) (emphasis in original). A tale of woe for the excess insurer follows and provides good reason for insurers to take note of the Fourth Circuit Court of Appeals.

As stated in *ABT*, the insured ABT Building Products Corp. is a manufacturer of hardboard siding, a wood-based product that is sold and affixed to the exteriors of homes. ABT has a plant in North Carolina. In 1995, homeowners began filing lawsuits against ABT. They alleged that the siding, when exposed to moisture, humidity, and other normal climatic conditions, absorbed moisture and prematurely rotted and deteriorated. Many of the plaintiffs also claimed that those problems had, in turn, resulted in consequential damages to other parts of their homes. Primary and excess insurers over several years were on the risk for these claims. *Id.* at 100.

In 1997 and 1999, ABT and the homeowner plaintiffs had settlement discussions, culminating in an agreement that a national class action pending in an Alabama state court was the appropriate vehicle by which to resolve their disputes. ABT and their insurers were advised by a defense expert that the damages to manufactured homes alone would be \$87.7 million. In Sept. 2000, the Alabama state court approved the following settlement of the underlying actions: ABT’s primary insurer, Employers Insurance of Wausau, agreed to pay ABT the sum of \$1.5 million in compromise of disputed claims and to continue to pay its share of defense costs through July 31, 1999. ABT agreed to pay Wausau's share of defense costs incurred after July 31, 1999. Of the \$1.5 million settlement, \$1.1 million was allocated to a Wausau primary policy. The settlement released all claims against ABT in the underlying actions for homeowner class members who did not opt out, including claims for consequential damages, in exchange for payments to be made by ABT to class members through an agreed-upon twenty-five claims program. The program required the submission of claims by homeowners and the calculation of the appropriate damage payment by a formula. *Id.* at 108-109.

ABT’s excess insurer National Union Fire Ins. Co. of Pittsburgh did not participate in the defense or settlement with ABT and homeowners. Under the terms of the umbrella policy, National Union agreed to cover only “those sums in excess of the retained limit that the Insured becomes legally obligated to pay by reason of liability imposed by law ... because of Bodily Injury, Property Damage, ... that takes place during the Policy Period

and is caused by an Occurrence.” *Id.* at 131. In addition, National Union shall have the “duty to defend any claim or suit seeking damages covered by the terms and conditions of this policy when: The applicable limits of Insurance of the underlying policies in the Schedule of Underlying Insurance and the Limits of Insurance of any other underlying insurance providing coverage to the Insured have been exhausted by *payment of claims* to which this policy applies.” *Id.* at 132.

National Union contended among other things that the \$1 million primary limit had not been exhausted and National Union had no duty to defend because (a) ABT had not exhausted the primary limits before the class settlement and (b) the \$1.5 million settlement did not constitute a “payment of claims” within the meaning of the umbrella policy. *Id.* at 128.

In 2001, ABT filed a bad faith action against National Union alleging improper claim handling relating to the actions brought by the homeowners and alleging underwriting irregularities relating to the issuance of one of the umbrella policies in question. In 2004, a jury rendered a verdict for the insured and the judgment was entered in part as follows: \$2.5 million for breach of duty to defend, \$3.9 million for unfair and deceptive trade practices, trebled to \$11.7 million, and \$2 million in attorneys fees. *Id.* at 128-129.

On appeal, one of the main issues was whether the excess policy language imposed a defense obligation upon National Union when the primary limits have been exhausted by payment of claims to the insured, but not by payment of claims to the 469 third party claimants, whose paid claims at the time of trial had only added up to \$275,000. *Id.* at 128-129. This dollar amount of “*Foster claims paid to date*” was submitted to the trial court shortly before the jury returned its verdict. *Id.* at 133.

The general rule is that an excess insurer's duty to defend is triggered only when the limits of primary insurance have been exhausted. *Id.* at 135; *see, e.g., Fieldcrest Cannon v. Fireman's Fund Ins. Co.*, 127 N.C.App. 729, 493 S.E.2d 658, 660 (1997) (holding that the insurer was “an umbrella” excess coverage carrier and, as such, its duty to defend could not be triggered unless and until the primary insurers' coverage limits were paid); *Atlantic Wood Industries, Inc. v. Lumbermen's Underwriting Alliance*, 196 Ga. App. 503, 396 S.E.2d 541 (1990); *Phoenix Ins. Co. v. United States Fire Ins. Co.*, 189 Cal. App. 3d 1511, 235 Cal. Rptr. 185 (2d Dist. 1987); *Schultheis v. Centennial Ins. Co.*, 108 Misc. 2d 725, 438 N.Y. S.2d 687 (Sup. Ct. 1981); *Signal Companies, Inc. v. Harbor Ins. Co.*, 27 Cal. 3d 359, 165 Cal. Rptr. 799, 612 P.2d 889 (1980); *Schneider Nat. Transport v. Ford Motor Co.*, 280 F.3d 532 (5th Cir. 2002); *Farmington Cas. Co. v. United Educators Ins. Risk Retention Group, Inc.*, 36 Fed. Appx. 408 (10th Cir. 2002); *see also* Barry R. Ostrager & Thomas R. Newman, *Handbook on Insurance Coverage Disputes* 188 (5th ed. 1992) (“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.”).

According to the Fourth Circuit, National Union argued that the term *payment of claims* should be “narrowly construed,” excluding all payments other than those made directly to third-party claimants against ABT to satisfy judgments or secure the release of claims,

and since Wausau paid ABT in order for ABT to make future payments to third-party claimants, Wausau's settlement with ABT was not a "payment of claims" under the umbrella policy. *Id.* at 115.

In its opinion issued on December 19, 2006, the Fourth Circuit held that "because the term 'payment of claims' clearly does not exclude payments of the kind involved here, we are unable to accept National Union's proffered interpretation." *Id.* at 116. Key to the court was that the term *payment of claims* "does not restrict the recipient or timing of the payment in question." *Id.* "National Union, of course, could have sought a more restrictive formulation - such as 'payment of claims to third parties' or 'payment of judgments or settlement agreements enforceable by third parties' - but it did not do so." *Id.* The court was critical of the insurer's "narrow construction," which "effectively would assign it a defense duty that would arise in only one circumstance: when its insured has faced multiple actions, resolved enough of them to exhaust its underlying coverage, and continued to defend the rest." *Id.* at 117.

Judge Niemeyer wrote a forceful dissent. His dissenting opinion took the majority to task for being "baffled ... that the excess insurer does not need to 'get in the game' until after the primary limits are exhausted. Yet that is ubiquitously understood in the insurance industry and even by the adverse litigants in this case." *Id.* at 142. The dissent observed that certain provisions in the excess policy employ the word "claim" five different times and in each instance it could not be more clear that "claim" is the claim of a third party against the insured and not a claim by the insured against its insurance carrier. *Id.* at 138.

Judge Niemeyer explained: "Overall, it is the primary insurer's duty to assume all defense costs. A true excess insurer is specifically intended to come into play only when the limits of underlying primary coverage are exhausted." *Id.* at 142 (quoting Eric Mills Holmes, *Holmes' Appleman on Insurance* § 145.4[B]). Until that happens, the excess insurer is entitled to stand by, because none of its contractual obligations have been implicated. Once the dust has settled, the excess insurer may of course be required to repay the primary insurer for defense costs incurred on its behalf, just as the primary insurer may sometimes have to pay the insured for defense costs expended. Judge Niemeyer noted that this is not an anomaly, but the appropriate division of labor between different layers of insurance. 472 F.3d at 143.

Judge Niemeyer stated his views succinctly: "[T]he majority has done violence to the policy language; directly assaulted the longstanding expectations of the insurance industry in issuing excess policies; and erected a new, indecipherable standard for future conduct by excess insurers. I roundly dissent." *Id.* at 129.

Unfortunately, as any losing party knows, the majority has the last word. The outcome of a nine-day jury trial, with a bad result for the excess insurer, has been upheld on appeal by the Fourth Circuit. Of course, other separate and distinct issues in the case clouded the picture, such as trigger issues, "occurrence" issues and allegations of misrepresentation by the insurer in the underwriting process. But nonetheless, when the homeowner suits started popping up in 1997, who would have thought that in 2006 the

excess insurer of ABT would be told by a federal appellate court to pay over \$11 million of extra-contractual damages? No word yet on an appeal to the U.S. Supreme Court.

James W. Bryan  
Nexsen Pruet Adams Kleemeier, P.L.L.C.  
Greensboro, North Carolina  
jbryan@npaklaw.com