Umbrella Coverage Must Step In To Defend Immediately

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Justice Walter Croskey has often written leading opinions on key questions of insurance coverage. He has done it again!

In *Legacy Vulcan Corp. v. Superior Court*, _____ Cal.App.4th_____; 2010 DJDAR 6409 (April 30, 2010) Justice Croskey summarized and developed the law on defense duties of umbrella insurers.

Thoughtful individuals and thoughtful businesses often buy umbrella insurance because it serves the dual function of being excess to first layer insurance, such as automobile insurance and primary comprehensive general liability insurance, and importantly, it acts as primary insurance for risks which it covers which for whatever reason the underlying insurance does not cover. That doesn't happen too often because umbrella underwriters generally try to make sure that their policyholders have appropriate underlying coverage.

The umbrella policy in the *Legacy Vulcan* case covered personal injury, property damage or advertising injury claims "in excess of the retained limit" under two separate provisions. The first provision concerned such claims "not within the terms of the coverage of underlying insurance but within the terms of coverage of this insurance." (This is called umbrella coverage.) The other provision made the policy apply "if limits of liability of the underlying insurance are exhausted" because of claims (this is standard excess coverage).

The court ruled that where claims are not covered by the underlying primary insurance, the umbrella insurer "drops down" to provide primary coverage, as held in several earlier Supreme Court cases. If a policy – such as this one – provides both excess and umbrella insurance, it then follows that the policy provides both excess and primary coverage, the latter for claims not covered by other primary insurance.

The policy defined the insurer's liability as the "ultimate net loss in excess of" either of two different formulas, one of them being in excess of the coverage limits of any underlying insurance (excess coverage),

and the other being in excess of any "retained limit . . . not within the terms of the coverage" of any scheduled underlying insurance (umbrella coverage).

The court held that the principles of the duty to defend, which generally require a defense promptly upon notice of a claim to the primary insurer, "are fully applicable to the umbrella coverage" under this policy, and that the duty to defend sets in where a claim is potentially covered by the policy and "not within the terms of coverage of 'underlying insurance.'" In other words, if no primary insurer must defend but the umbrella policy potentially covers the risk, the umbrella insurer's duty to defend is immediate.

The court further found that the term "underlying insurance" is a generic term and that, "absent an explicit qualification [it] is neither limited to the underlying insurance listed in [the attached schedule] nor encompasses all underlying insurance."

The phrase is therefore ambiguous; and since ambiguities must be resolved in accordance with the objectively reasonable expectations of the policyholder, the duty to defend applies forthwith to all claims for which the umbrella policy contains an indemnity obligation and which no primary insurance must defend.

Next, the court addressed the interaction between the duty to defend and the policy's requirement that the insured must maintain a sizeable self-insured retention. It ruled that a self-insured retention (SIR) is not the same as a deductible, but (citing the Supreme Court's 1997 *Aerojet -General Corp. v. Transport Indemnity Co.* case, 17 Cal.4th 38, 72), noted that "self-insurance is no insurance and affords the insured no protection at all." Thus, despite the presence of a self-insured retention, a reasonable policyholder would expect that the umbrella insurer's defense duty for claims not covered by primary insurance but potentially covered by the umbrella insurance will begin immediately upon the umbrella insurer's receipt of the claim. Absent clear policy language to the contrary, that defense duty does not wait for exhaustion of the self-insured retention.

The court found no provision in the policy which would limit the defense duty to any specific point subsequent to the time when the claim had set in – such as the point when the SIR had been exhausted. Therefore, the insurer had a duty to defend immediately, without regard to exhaustion of horizontal coverages or self-insured retentions.

It was a great day for policyholders!

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