

Mo' Coverage Mo' Problems:
Allocation and Related Complications When
Multiple Types of Liability Insurance Apply to a Single Lawsuit

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I. Introduction

Oftentimes a single lawsuit may implicate coverage under two or more liability insurance policies, each policy providing a separate type of coverage that is ostensibly mutually exclusive of the coverage under the other. A common example is a lawsuit against a general contractor based on property damage associated with a design/build project. Such a lawsuit may implicate the general contractor's coverage under both a general Commercial General Liability ("CGL") insurance policy and a Professional Liability ("PL") insurance policy.¹ The CGL policy would generally cover damages attributable to property damage but exclude damages arising from professional services, while the PL policy's insuring agreement would only encompass losses arising from professional services. Another example is a class action lawsuit against an employer alleging an illegal modification or termination of retiree benefits. This lawsuit may involve allegations of violation of the Employee Retirement Income Security Act ("ERISA") and of age discrimination prohibited by the Age Discrimination in Employment Act ("ADEA").² The employer's Fiduciary Liability insurance policy would address allegations of ERISA violations, but exclude coverage for claims of age discrimination, while the employer's Employment Practices Liability insurance ("EPL") policy would do the opposite.

An insurer is only obligated to provide coverage with respect to those parts of loss caused by a lawsuit that are insured under the insurance contract.³ Courts apply different methodologies (discussed below) to determine an appropriate allocation of insured versus non-insured parts of loss. When a lawsuit implicates more than one type of coverage, the task is the same, only doubled: the allocation of insured versus non-insured parts of loss must occur separately under each type of coverage. Ideally, the result of the combined exercise of allocating parts of loss under each coverage type will yield an aggregate result that is internally consistent. That is, each insurer will agree with the policyholder and the other insurer to accept responsibility for a distinct part of the insured loss under its own policy. The sum of the distinct parts of loss accepted as insured (when added to any agreed uninsured amounts, if applicable) will total the entire amount of the loss. In the hypothetical retiree benefits class action described above, the application of an appropriate allocation methodology may yield a determination that 10% of loss is attributable to covered exposures under an EPL policy (e.g., age discrimination) and 90% of loss is attributable to covered exposures under a Fiduciary policy (e.g., ERISA breach of fiduciary duty). So the EPL carrier would be responsible for \$0.10 of every dollar of loss and the Fiduciary carrier would be responsible for the other \$0.90 of every dollar of loss.

Allocation between the policyholder and insurers is a good thing, at least in the abstract; losses are spread among multiple parties in a manner that preserves the benefit of the bargains struck between the

¹ See, e.g., *Prisco v. Serena Sturm Architects, Ltd. v. Liberty Mut. Ins. Co.*, 126 F.3d 886 (7th Cir. 1997); *1325 N. Van Buren, LLC v. T-3 Grp., Ltd.*, 716 N.W.2d 822 (Wis. 2006); *N.Y. State Thruway Authority v. KTA-Tator Eng'g Servs., P.C.*, 78 A.D.3d 1566 (N.Y. App. Div. 2010).

² See, e.g., *Fulghum v. Embarq Corp.*, 785 F. 3d. 395 (10th Cir. 2015) (involving claims of breach of fiduciary duty under ERISA and age discrimination under ADEA all based on the employer's reduction of retiree welfare benefits).

³ Of course, the insurer's "duty to defend," when applicable, is broad enough to strain the limits of this proposition. But even in that context, an insurer's obligation depends on the potential of covered loss. See discussion *infra*, including note 5.

policyholder and its insurers. It is easy to explain the necessity for allocation and to express the results of allocation after the fact. But the work involved in achieving an appropriate allocation is complicated. Allocation depends on the application of the language of the insurance contract and legal doctrines, influenced by the allegations, facts and circumstances of the lawsuit, the nature and viability of the particular claims asserted, the nature and magnitude of the types of relief sought, and other factors. Allocation may be required early on in a lawsuit before the facts and legal theories are well-developed, for example when required for the advancement of defense costs or in early mediation. Allocation can be subjective, and, in the event of a settlement, may depend on counter-factual assumptions about what might have happened had a trial actually occurred. In light of all of these variables, in many or most cases, allocation may not generate a result that can be characterized as objectively correct, but, at best, only "fair" in some sense.⁴

In any event, allocation issues provide fertile ground from which disputes may spring and thrive, even in the best of circumstances. In the case of a lawsuit requiring allocation with respect to multiple types of coverage, the potential for disputes may be even greater. The maintenance of multiple coverages is beneficial and a given, and the categorical elimination of allocation disputes arising from multiple coverages would seem to be impossible. But it may be possible to decrease or mitigate those disputes by understanding allocation methodologies and the contexts in which they apply. In the following, we attempt to provide to provide a summary that might help with that understanding.

II. DISCUSSION

A. Given the relevance of multiple types of differing coverages, allocation may be required in a few different contexts.

There are various contexts in which different allocation rules may apply, given the application of two or more mutually exclusive coverages to loss arising from a single lawsuit:

- when multiple insurers are obligated to defend a lawsuit under "duty to defend" policies;
- when multiple insurers are responsible for components of loss (both defense costs and settlements/judgments) on an indemnity basis;
- when multiple insurers provide coverage subject to retentions of differing levels.

Allocation in the last context borrows from principles applied in the former two contexts. Within each of the three contexts, different allocation rules may apply depending on the jurisdiction and other circumstances.

1. Allocation of defense costs among multiple insurers in the "duty to defend" context.

Allocating responsibility for defense costs between covered and non-covered matters is not a complicated matter from the policyholder's perspective under a "duty to defend" policy. An insurer with that obligation

⁴ Perhaps as a reaction, many D&O liability policies contain language addressing various aspects of allocation, including providing that defense costs shall not be allocated (*i.e.*, all are insured), dictating the type allocation methodology, and/or imposing various ADR methods as a means for resolving allocation disputes.

must defend the entirety of a lawsuit if there is merely the possibility that any potential liability under the lawsuit would be insured.⁵ If multiple insurers owe a duty to defend, they must allocate defense costs between themselves. Such allocation may occur voluntarily or in the context of a contribution action brought by the defending insurer against a non-defending insurer. Allocation of defense costs under these circumstances would typically be resolved based on the "other insurance" clauses of the respective insurers' policies, which apply when two or more insurance policies cover the same risk for the benefit of the same insured.⁶ These clauses are sometimes reconcilable, and in that case, the clauses typically would dictate clearly that all primary insurers will be obligated to share in providing coverage pro rata based on limits (a "pro rata clause"), provide that one of the insurers will only provide excess coverage (an "excess clause") or provide that one of the insurers will be relieved from the responsibility altogether ("an escape clause").⁷ On other occasions, those clauses will be mutually repugnant, in which case, state law would provide the rule for allocation, which also may be pro rata based on limits.⁸ Whether "other insurance" clauses are reconcilable or mutually repugnant is a common source of disputes.

2. Allocation of defense costs in the indemnity (non-duty to defend) context.

When multiple insurers are obligated to provide coverage for defense costs, but none has a "duty to defend," it is typically the case that all defense costs "reasonably related to the defense of a covered claim" are insured.⁹ Importantly, the fact that defense costs may be reasonably related to non-covered as well as covered matters does not eliminate coverage.¹⁰ Of course, at least at the margins, "reasonably related" is in the eye of the beholder and, accordingly, can give rise to disputes.

⁵ See, e.g., *Va. Elec. & Power Co. v. Northbrook Prop. & Cas. Ins. Co.*, 475 S.E.2d 264, 265 (Va. 1996); *McCormack Baron Mgmt. Servs., Inc. v. Am. Guar. & Liab. Ins. Co.*, 989 S.W.2d 168, 170 (Mo. 1999); *Montrose Chem. Corp. v. Sup. Ct. of L.A. Cnty.*, 6 Cal. 4th 287, 300 (Cal. 1993); *Hartford Fire Ins. Co. v. Thermos LLC*, 146 F. Supp. 3d 1005, 1012 (N.D. Ill. 2015); *Navigators Ins. Co. v. Hamlin*, 96 F. Supp. 3d 1181, 1190 (D. Or. 2015); *Upper Deck Co., LLC v. Fed. Ins. Co.*, 298 F. Supp. 2d 994, 998 (S.D. Cal. 2002).

⁶ See Barry R. Ostrager & Thomas R. Newman, *Handbook on Insurance Coverage Disputes* § 11.01 (18th ed. 2017).

⁷ See *id.* § 11.02. See also, e.g., *Med. Protective Co. v. Nat'l Union Fire Ins. Co.*, 25 Fed. Appx. 145, 147-48, 2002 WL 13037, at **2-3 (4th Cir. Jan. 4, 2002) (holding that "other insurance" clauses were reconcilable: plaintiff insurer's policy provided primary coverage, and defendant insurer's coverage provided excess coverage; because primary policy was not exhausted, defendant insurer's policy was not implicated by the loss); *Nat'l Liab. Ins. Co. v. State Farm Fire and Cas. Ins. Co.*, 276 F. Supp. 3d 517, 526-27 (E. D. Va. 2017).

⁸ See, e.g., *Am. Cas. Co. v. Health Care Indem., Inc.*, 520 F.3d 1131, 1136-37 (10th Cir. 2008); *Equity Mut. Ins. Co. v. Spring Valley Wholesale Nursery*, 747 P.2d 947, 954 (Okla. 1987).

⁹ See, e.g., *Cont'l Cas. Co. v. Bd. of Educ. of Charles Cnty.*, 489 A.2d 536, 544 (Md. 1985); *Safeway Stores, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 64 F.3d 1282, 1289 (9th Cir. 1995); *Piper Jaffray Cos., Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh*, 38 F. Supp. 2d 771, 780 (D. Minn. 1999); *Raychem Corp. v. Fed. Ins. Co.*, 853 F. Supp. 1170, 1182 (N.D. Cal. 1994); *Fed. Realty Inv. Trust v. Pac. Ins. Co.*, 760 F. Supp. 533, 537 (D. Md. 1991).

¹⁰ See *Potomac Elec. Power Co. v. Cal. Union Ins. Co.*, 777 F. Supp. 980, 984 (D.D.C. 1991) (holding that "if fees and expenses were incurred in connection with a covered claim, but were also involved in an uncovered claim, then if the fees and expenses of the uncovered claim are reasonably related to the defense of a covered claim they may ordinarily be allocated wholly to the covered claim" (internal quotations and citations omitted)); *Nodaway Valley Bank v. Cont'l Cas. Co.*, 715 F. Supp. 1458, 1465 (W.D. Mo. 1989), *aff'd*, 916 F.2d 1362 (8th Cir. 1990); *Health-Chem. Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh*, 559 N.Y.S.2d 435, 438 (N.Y. Sup. Ct. 1990) (allowing apportionment of fees devoted to the non-covered parties or claims "alone").

3. Allocation of indemnity coverage

When multiple insurers are responsible for components of loss arising from settlements/judgments, the components of loss are typically allocated according to two competing allocation frameworks, the "relative legal exposure" analysis and the "greater settlement rule."¹¹ Sometimes courts also apply these allocation frameworks in allocating defense costs as well as settlements/judgments.¹² As the following discussion suggests, these frameworks can be based on a substantial number of variables that may be subject to reasonable dispute, and often result in controversy.

Under a "relative legal exposure" analysis, loss is allocated according to the relative exposure created by covered and non-covered matters.¹³ Relative legal exposure is "neither comparative fault nor relative liability, but is potential liability of the parties at the time of settlement."¹⁴ The allocation inquiry examines how a reasonable party in the insured's position would have valued the covered and non-covered claims at the time of the settlement, considering the circumstances and events leading up to the settlement, including a review of the settlement negotiations and internal memoranda to determine whether the settlement included non-covered damages.¹⁵

In contrast, under the "greater settlement rule," the insurer is obligated to pay for the entire amount of any settlement or judgment (or when applicable, defense costs), except for the higher increment, if any, attributable to non-covered matters.¹⁶ The focus of the analysis is the liability for the insured claims or

¹¹ These rules are variously known by other, similar names, including "relative exposure" or "measure of proportional fault," and the "larger settlement rule," respectively.

¹² See, e.g., *Safeway Stores, Inc.*, 64 F.3d at 1287 ("Allocation is appropriate only if, and to the extent that, the defense or settlement costs of the litigation were, by virtue of the wrongful acts of the *uninsured* parties, higher than they would have been had only the insured parties been defended or settled." (internal quotations and citations omitted)); *Perini Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, CIV. A. No. 86-3522-S, 1988 WL 192453, **2-3 (D. Mass. June 2, 1988) (applying relative legal exposure rule to allocate defense costs).

¹³ See *Stauth v. Nat'l Union Fire Ins. Co. of Pittsburgh*, Nos. 97-6437, 97-6438, 185 F.3d 875 (Table), 1999 WL 420401, at *11 (10th Cir. June 24, 1999); *Owens Corning v. Nat'l Fire Ins. Co. of Pittsburgh, Pa.*, 257 F.3d 484, 492 (6th Cir. 2001); *Piper Jaffray*, 38 F. Supp. 2d at 774. "Determining relative exposure and weighing the relative benefits of the settlement and costs incurred requires a fact based analysis." *Clifford Chance Ltd. Liab. P'ship v. Indian*, 836 N.Y.S. 2d 484 (N.Y. Sup. 2006); see also *Caterpillar, Inc. v. Great Am. Ins. Co.*, 62 F.3d 955, 961 (7th Cir. 1995) (explaining relative legal exposure rule).

¹⁴ *Safeway Stores, Inc. v. Nat'l Union Fire Ins. Co.*, No. C-88-3440-DLJ, 1993 WL 739643, *5 (N.D. Cal. Feb. 4, 1993). Courts may consider a multitude of factors to determine "relative legal exposure," including the following: (1) the legal merits of the claims; (2) the ability to pay a judgment; (3) the burdens of the litigation, including the defense; (4) the effect of any "deep pocket factor"; (5) the motivations and intentions of those who negotiated the settlement, as shown by the settlement documents and any other relevant evidence; (6) the benefits sought to be, and actually, accomplished by the settlement, as shown by the settlement documents and any other relevant evidence; and (7) such other and similar matters peculiar to the particular litigation and settlement. *Id.* at *5-6.

¹⁵ *UnitedHealth Grp. Inc. v. Exec. Risk Specialty Ins. Co.*, 870 F.3d 856, 863-64 (8th Cir. 2017). See also *Nodaway Valley Bank*, 715 F. Supp. at 1461 (holding that a realistic and fair appraisal at time of settlement would allocate most of the legal exposure to insured individual directors and not to uninsured corporate holding company); *aff'd*, 916 F.2d at 1365 (noting that an allocation analysis "concerns the evaluation of the comparative responsibilities of the particular parties and of their exposure to an award of damages in the underlying suit.").

¹⁶ *Harbor Ins. Co. v. Cont'l Bank Corp.*, 922 F.2d 357, 368 (7th Cir. 1990). See also *Owens Corning*, 257 F.3d at 491-92; *Caterpillar, Inc. v. Great Am. Ins. Co.*, 62 F.3d 955, 962 (7th Cir. 1995); *Safeway Stores, Inc.*, 64 F.3d at 1287;

parties in the lawsuit, and to the extent that the loss exceeds the liability for the insured claims or parties, the excess amount is not insured.¹⁷

4. Allocation of defense costs (non-duty to defend) and indemnity within a retention.

Many liability insurance policies provide coverage in excess of a retention. The amount of such retention may vary, depending on the insurance contract. In cases in which a lawsuit implicates multiple types of coverage, the amounts of the retentions under those different types of coverage often vary. The question then arises whether payments by the policyholder to satisfy a retention under one type of coverage, and/or payments by an insurer under that type of coverage, will apply to exhaust the retention under another type of coverage. For example, in the retiree benefits class action lawsuit example used above, the Fiduciary Liability policy may have a \$500,000 retention, and the EPL policy may have a \$2,000,000 retention. If the policyholder has incurred \$2,000,000 of defense costs, of which the first \$500,000 satisfied the retention under the Fiduciary Liability policy, and the next \$1,500,000 was reimbursed by the Fiduciary liability carrier, is the retention under the EPL policy exhausted? Of course, the answer depends on the retention exhaustion-related language of the EPL policy.

The exhaustion language might be no more restrictive than to apply to payments made in respect of loss associated with the lawsuit.¹⁸ Or the language might be more restrictive, only permitting exhaustion by payments in respect of lawsuit-related loss that otherwise would be insured.¹⁹ While a different conceptual issue, some policies also provide that a retention may not be exhausted by third-party (*e.g.*, other insurer) payments, but only by an insured's payments.²⁰

It would seem that allocation should be required when policy language dictates that the retention may only be exhausted by loss that otherwise would be insured, otherwise an insurer might be compelled to provide coverage for uninsured matters. And there is authority for the proposition that allocation is

Nordstrom, Inc. v. Chubb & Son, Inc., 54 F.3d 1424, 1432 (9th Cir. 1995); *Piper Jaffray Cos. Inc.*, 38 F. Supp. 2d at 774; *See also Raychem Corp.*, 853 F Supp. at 1180.

¹⁷ *See Caterpillar, Inc.*, 62 F.3d at 962 ("The question at issue is whether the insurance policy covered certain claims, not the metaphysical underpinnings of why a corporation or its directors and officers might have acted as they did."); *Nordstrom, Inc.*, 54 F.3d at 1433 n.2 ("We reject Federal's contention that allocation in this case should also depend on an analysis of factors other than liability, such as negative publicity, that might have had a practical effect on the amount of the settlement.").

¹⁸ *See, e.g., State Nat'l Ins. Co. v. White*, No. 8:10-cv-894-T-27TBM, 2011 WL 5826569, at *4 (M.D. Fla. 2011) ("At best, the SIR Endorsement is ambiguous as to whether the SIR Retention can be satisfied only by the payment of costs and expenses incurred in connection with the covered claims and, therefore, must be liberally construed in favor of the insured."); *see also Taco Bell Corp. v. Cont'l Cas. Co.*, No. 01 C 0428, 2003 WL 1475035, at *14 (N.D. Ill. Mar. 17, 2003) (holding that the SIR could be exhausted by any commercially reasonable "defense costs" regardless of whether those costs were attributable to covered claims).

¹⁹ *In re Feature Realty Litig.*, 634 F. Supp. 2d 1163, 1170 (E. D. Wash. 2007) (addressing exhaustion under policy language providing that "self-insured retention is not exhausted or diminished by payment of any loss, claim or 'suit' that is not covered by this policy.").

²⁰ *See, e.g., Cont'l Cas. Co. v. N. Am. Capacity Ins. Co.*, 683 F.3d 79, 90 (5th Cir. 2012) (explaining that, had the subject insurance policy "explicitly require[d]" that the insured itself pay the SIR amount itself, the defense costs expended by other insurers would not have satisfied the insured's SIR).

required within a retention.²¹ Presumably, allocation of amounts applied to exhaust a retention would be accomplished pursuant to some recognized allocation methodology, such as the relative legal exposure or the greater settlement rules discussed above. To the extent that allocation is not possible or results in no allocation toward non-covered matters, however, then the entire amount of payments by the insured or another insurer would apply toward exhausting the retention.²²

The three different types of exhaustion-related language described generate different results in the retiree benefits class action example. First, if the policy language permits exhaustion by any lawsuit-related loss, then the \$2,000,000 retention of the EPL policy is exhausted by virtue of the \$2,000,000 in defense costs, paid by both the policyholder and the insured, in respect of all losses whether or not otherwise covered under the Fiduciary policy or the EPL policy. Second, if the policy language only permits exhaustion by otherwise covered losses, only such portion of the \$2,000,000 in defense costs attributable to defense of the EPL-covered claims would exhaust the retention. So, if we assumed that 10% of loss is attributable to covered exposures under an EPL policy (*e.g.*, age discrimination) and 90% of loss is attributable to covered exposures under a Fiduciary policy (*e.g.*, ERISA breach of fiduciary duty), then only \$200,000 (or 10% of the \$2,000,000 in defense costs) would apply to exhaust the EPL policy retention. Third, if the policy language only permits exhaustion by policyholder payments, the maximum amount of exhaustion would be the \$500,000 paid by the policyholder (to exhaust the retention under the Fiduciary policy), and that \$500,000 might further be reduced to \$50,000 if only 10% of the \$500,000 were attributable to the defense of claims covered under the EPL policy.

Obviously, the variance in language and alternatives for exhaustion of the retention can be advantageous or disadvantageous to the policyholder or to one or another of the insurers, depending on the circumstances. Thus, even on the rare occasion that the parties agree (or it has been established) that coverage exists under each of the different policies, the method for apportionment of the different coverages to the same lawsuit or claim is bound to give rise to disputes.

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²¹ See *In re Feature Realty Litig.*, 634 F. Supp. 2d at 1171 (holding that addressing allocation would be appropriate in the context of determining whether a retention was exhausted by payments made by another insured and the policyholder, given that policy only insured one claim among many, but sums paid were not susceptible to allocation between insured/uninsured amounts).

²² *Id.* at 1173 ("As it has not been demonstrated that any element of damage is solely attributable to the non-covered cause of action, there is no reasonable basis for allocation.").