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Alerts

Excess Carrier Obligated to Provide Coverage Notwithstanding Bankrupt Insured's Inability to Pay Underlying Retained Limit

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Insights for Insurers

Rosciti v. Insurance Company of the State of Pennsylvania, 659 F.3d 92 (1st Cir. 2011)

Buyers purchased a mobile home manufactured by plaintiff insured. Contending that the home was defective, the buyers later sued the insured, seeking to recover for the alleged defects. Thereafter, the insured filed for Chapter 11 bankruptcy protection, thereby effectively staying the buyers' lawsuit. The buyers added the excess carrier as a defendant, seeking to recover directly from it pursuant to a Rhode Island direct action statute (R.I. Gen. Laws § 27-7-2.4), which allows tort victims to recover damages from liability insurers of a bankrupt tortfeasor to the extent of the existing coverage.

Pursuant to the "Retained Limit Provision" of the insured's excess policy, the excess carrier's obligation to provide coverage only arose "after there has been a complete expenditure of [the insured's $500,000] retained limit(s) by means of payment for judgments, settlements, or defense costs." Because the insured had not yet paid the initial $500,000 due to its insolvency, the excess carrier claimed that it had no obligation to pay the buyers.

The U.S. Court of Appeals for the First Circuit agreed that the excess carrier's obligation to afford coverage was only triggered if the insured exhausted the $500,000 self-insured limit. But it concluded that enforcement of this limiting provision would violate Rhode Island public policy embodied in the direct action statute, as it would permit an insurer to avoid its obligation to provide any liability coverage whenever a bankrupt insured could not pay its self-insured retention. As such, there would be very few scenarios when a carrier would have to make any payments on behalf of a bankrupt insured.

Importantly, however, the court clarified the excess carrier would only be liable for the amount of any judgment that exceeded the insured's self-insured limit of $500,000. Thus, if the buyers were to receive a judgment less than $500,000, the excess carrier would not be liable for any portion of that judgment. Further, the court noted that any award against the excess carrier would be capped at the limit of the operative excess policy. In sum, the court reasoned that the excess carrier "faces the same amount of potential exposure it would have faced if [the insured] had not gone bankrupt."

The excess carrier also argued that this interpretation would require the excess carrier to defend against the buyers' lawsuit whereas it would otherwise not have had to do so, and that the excess carrier did not account for this in establishing its premium charge. The court opined that there was no record evidence of how the premium was calculated and, in any event, the policy allowed the excess carrier to assume the defense of any lawsuit. Moreover, Rhode Island public policy does not forbid an excess carrier from having to *defend* claims when its insured is bankrupt. Rather, the statute only limits the *indemnity* to whatever is due under the policy. According to the court, because the buyers' claims were in excess of the self-insured retention, the excess carrier would merely be defending a claim within its layer, with its total exposure capped at the excess policy limits.

Practice Note

Going forward, excess carriers should be mindful that the insolvency and/or bankruptcy of an underlying self-insured may force the carrier to defend against liability claims brought against an insured. Accordingly, excess carriers must closely scrutinize the financial stability of insureds, and in instances where an insured faces potential fiscal instability, excess

carriers are advised to adjust premiums accordingly.

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