Extrinsic Evidence Leads to Summary Judgment on Aggregate Corridor Deductible

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Some insurance programs are simple: one primary policy, one excess policy. Easy. Some insurance programs are complex and contain many layers and coverages. In the case discussed below, the court had to interpret how an Aggregate Corridor Deductible (ACD) in one policy worked and how it affected when the second policy came on risk.

In *Lexington insurance Co. v. RLI Insurance Co.*, No. 19-1496, 2020 U.S. App. LEXIS 2486 (7th Cir. Jan. 27, 2020), the policyholder, a trucking company, had a series of large personal injury settlements. The settlements were paid, but a dispute arose about the amount each of the policyholder’s insurers had to contribute to the settlement.

The policyholder’s insurance program consisted of a $3 million self-insured retention (SIR), followed by a series of excess policies. The excess layers were a $2 million first excess, followed by a $5 million excess, followed by a $25 million umbrella policy. That’s not the complicated point. The first excess policy had an ACD and the parties disputed how it applied. As the court pointed out, without the ACD endorsement, the first excess would apply immediately after exhaustion of the $3 million SIR. But the ACD complicated the simple math.
The ACD provided that the policyholder was to respond to, defend and dispose of all losses covered by the policy “for which the total claim is greater than the [$3 million SIR] until the [ACD] of [$2.5 million] has been satisfied. Once the [ACD] has been exhausted by payment for one or more losses & “costs”, the Insured is only responsible for losses and “costs” up to [the per occurrence SIR].” The endorsement also said that the ACD limit was excess of the SIR. As the court recognized, this endorsement required the policyholder to pay out an additional $2.5 million above its $3 million SIR before the first excess insurer had to pay. Also, according to the court the ACD only applied once per year.

The dispute was about whether the ACD eroded the first excess limits on any claim. In other words, as the first excess insurer argued, the ACD sat within its $2 million layer leaving it with no obligation to pay any loss until the policyholder had paid $3 million per occurrence and had exhausted the full ACD limit in any year. The upper excess insurers argued that the ACD sat below the first excess layer, which meant that those insurers’ obligations would not kick in until $7.5 million was paid on the first large occurrence.

On cross-motions for summary judgment the district court held for the first excess insurer and found that the policy unequivocally provided that payment toward the ACD eroded the first excess layer. The Seventh Circuit affirmed, but did so on the basis of undisputed extrinsic evidence because the court found the ACD ambiguous. The court found the ACD ambiguous because the policy failed to define the ACD feature or describe its mechanics with precision. In particular, nothing in the endorsement said whether the ACD eroded the policy limits.

The court first looked to custom and practice, but found that “the usages of the insurance industry” did not resolve the case and did not provide a reliable guide to industry agreement on the terms. So the court, instead, focused on extrinsic evidence—the undisputed evidence of the negotiations between the parties. The court held that summary judgment for the first excess insurer was proper because emails and underwriting files showed that the parties all intended the combined liability of the policyholder and the first excess insurer to be capped at $5 million per occurrence so that the second excess insurer’s liability would begin at $5 million per occurrence. In the court’s view, the evidence clearly indicated that the policyholder and first excess insurer intended the ACD to sit within the first excess insurer’s policy layer. The court also outlined an underwriting memo discussing reinsurance coverage where the reinsurer offered coverage assuming a $2.5 million ACD within the $2 million excess layer above the SIR. As the court said, “we can assume that [the first excess insurer] was not lying to [the reinsurer], especially given the duty of ‘utmost good faith’ that governs reinsurance transactions.”

The court concluded that although the ACD was ambiguous, the extrinsic evidence, including the dealings between the policyholder and the upper layer excess insurer, showed beyond a reasonable dispute that [the upper layer excess insurer] knew exactly what it bargained for and “that’s exactly where the district court’s judgment left it.” The extrinsic evidence compelled summary judgment in favor of the first excess insurer and the district court’s judgment was affirmed.

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