Client Alert: Allmerica Primary/Excess

On August 7, 2007, in a case of first impression in Massachusetts, the Supreme Judicial Court (SJC) decided that an excess insurer's obligations under a follow form policy are not governed by the primary's actions. *Allmerica Financial Corporation, and others v. Certain Underwriters at Lloyd's, London*, 449 Mass. 621 (2007).

After the plaintiff, Allmerica Financial Corporation, settled a class action lawsuit[1] alleging improper practices in the sale of its life insurance policies, it sought indemnification coverage for the $39.4 million settlement from its insurers. Allmerica's primary insurer, Columbia Casualty Company (Columbia Casualty), defended the action under a reservation of rights. During settlement negotiations, Columbia Casualty agreed to pay its policy's $20 million limit into a settlement fund. Allmerica also held an excess "follow form" insurance policy written by the defendant, Lloyd's, London (Lloyd's). Lloyd's similarly reserved its rights. When Allmerica sought indemnification for the settlement beyond the primary policy's limits, Lloyd's denied coverage. Allmerica then filed a declaratory judgment action and unsuccessfully moved for summary judgment in the Superior Court. On appeal, the SJC*sua sponte* transferred the case from the Appeals Court. The SJC concurred with the trial court that an excess insurer is not bound by settlement decisions made by a primary insurer.

Lloyd's follow form policy provided that "this Policy is subject to the same conditions, limitations, and other terms… as are contained in or may be added to the Policy(ies) of the Primary Insurer(s)." Lloyd's policy would only attach "when the Underlying Insurer shall have paid or have been held liable to pay, the full amount of the underlying limit(s)."

On August 27, 2001, Allmerica and Columbia Casualty executed a "settlement agreement and release" in which Columbia Casualty agreed to pay its policy limit towards the underlying settlement. The settlement contained a carve-out for "any rights or claims for coverage under any excess insurance policies," including Lloyd's policy.

In November 1998, when settlement talks in the underlying action were drawing to a close, Lloyd's informed Allmerica that it lacked sufficient information to make a coverage determination before the court-imposed settlement deadline. Lloyd's agreed not to assert the voluntary payment/lack of cooperation coverage defense to help expedite the settlement.

Subsequently, Lloyd's disclaimed coverage for any loss encompassed by the settlement, citing particularly the policy's exclusion for prior wrongful acts and its exclusion for claims based upon promises of future performance.

On September 30, 2002, Allmerica filed suit in Superior Court, asserting claims for declaratory judgment and breach of contract against Lloyd's. After cross-motions for summary judgment, the judge granted Lloyd's summary judgment on the basis, *inter alia*, that Lloyd's was not bound by Columbia Casualty's coverage decision with respect to the underlying settlement.

On appeal, the SJC first considered whether Lloyd's, as excess follow form insurer, was bound by the primary insurer's decision to settle Allmerica's claim. The SJC cited the "drop down" cases in the primary and excess context to demonstrate a basic point about excess insurance policies, i.e., that they are separate and distinct contracts from the primary policy:

> Use of a follow form clause is advantageous in grafting such an insurance program because it makes an excess policy a carbon copy of the primary policy, with the only differences being the names of the parties and the coverage limitations. Follow form language thus allows an insured to have coverage for the same set of potential losses (and with the same set of exceptions) in each layer of the insurance program. The language does not, however, bind the various insurers to a form of joint liability should coverage at a prior layer fail. The layer of risk each insurer covers is defined and distinct. *Id*. at 630.

The SJC explained that requiring an excess insurer's coverage to "drop down" would, as a practical matter, "make it a party to the prior layer's contract. "This is not what an excess insurer agrees to even when it uses a follow form clause." *Id* . The SJC also cited disputes involving an excess insurer's objections to a settlement reached by a primary or prior excess insurer to illustrate the dynamics of the relationship. The SJC concluded that this line of cases was "consonant with our conclusion in the 'drop down' cases, all of which respect the right of an insurer to make coverage and settlement decisions independent of third parties, including other insurers." *Id*. at 632.

The court rejected Allmerica's argument that the effect of Lloyd's "follow form" clause adopted not only the language used by Columbia Casualty to describe the coverage and exclusion in the contract but also the "intent of the parties to the primary policy." Consequently, Allmerica argued that Lloyd's intended to be bound by the primary's interpretation of the policy, including any decisions the primary might make about coverage or settlement:

> This conclusion does not follow from the same premise. An excess carrier's intent to incorporate the same words used in a separate agreement between the primary insurer and the insured does not imply an intent by the excess carrier to accept decisions made by the primary carrier about the extent of its obligations under its own agreement. By adopting the form of words used by Columbia Casualty, the

> Lloyd's did not also cede to it the right to make decisions about the Lloyd's obligation to perform in various circumstances. To conclude otherwise would undermine the distinct and separate nature of each insurer's contract with Allmerica.

The SJC concluded that, in the absence of specific policy language to the contrary, Lloyd's use of the same words as the primary insurer did not eviscerate its right to make a separate coverage determination as to the applicability of its policy.

The SJC noted that its conclusion should not be construed to limit the settlement responsibility of insurers articulated in *Hartford Casualty Insurance Company v. New Hampshire Ins. Co*., 417 Mass. 115 (1994) (enunciating the obligation of an insurer is to act in good faith. "Good faith requires that any settlement decision be made without regard to the policy limits and that the insurer exercise common prudence to discover the facts as to liability and damages upon which an intelligent decision may be based." *Id*. at 119).

1 The underlying action alleged that Allmerica engaged in improper practices by making misleading sales presentations using the "vanishing premium" concept by improperly marketing its policies as a saving or investment vehicle.

For more information, please contact Barbara O'Donnell (bodonnell@rc.com) at (617) 557-5945 or Catherine O'Donnell (codonnell@rc.com) at (617) 557-5903.