Under the Umbrella

A SINGLE LIABILITY INSURANCE POLICY OFTEN PROvides multiple coverages. For example, some policies include both umbrella and excess insurance. An umbrella policy provides primary coverage for claims that are not insured by another specified policy, while excess coverage typically applies only after another policy has been exhausted.

A recent appellate decision addressed several important aspects of an insurer's obligation to provide a defense under a policy that includes both umbrella and excess coverage. In *Legacy Vulcan Corp. v. Superior Court* (185 Cal. App. 4th 677 (2010)), the insured manufactured perchloroethylene (perc), a dry cleaning chemical. A group of plaintiffs sued the manufacturer, alleging that perc caused environmental contamination. The manufacturer tendered its defense to several of its insurers—including a carrier who had issued an "Excess Catastrophe Liability Policy" that provided both excess and umbrella coverage—but all the insurers refused to defend the case. The manufacturer paid for its own defense and eventually settled the liability dispute.

In a declaratory relief action to determine coverage, the manufacturing company contended that the umbrella/excess insurer had breached its duty to defend. The umbrella section of the policy covered personal injury, property damage, or advertising injury that was *not* covered by underlying insurance. The excess coverage section applied to the same types of claims, but only after the insured had exhausted underlying insurance. The policy did not define "underlying insurance," although it did include a schedule of underlying insurance policies.

The trial court ruled that the carrier's defense obligation was limited to that of an excess insurer: The duty to defend would arise only after all underlying insurance was exhausted. Furthermore, the court held that the term *underlying insurance* included any primary policies and self-insured retention in effect at any time during the years of alleged environmental contamination. Finally, the court decreed that the defense duty would arise only as to claims that were actually covered by the policy.

The court of appeal reversed, noting an ambiguity in the term *underlying insurance*. Consistent with long-standing precedent, the court resolved the ambiguity in favor of the policyholder: Only the specific policies listed on the schedule of insurance would qualify as underlying insurance (185 Cal. App. 4th at 691).

The court explained that the manufacturer's insurance policy expressly provided a duty to defend in connection with both the umbrella coverage and the excess coverage. To trigger the right to a defense, the insured did not have to exhaust a separate, underlying insurance policy (185 Cal. App. 4th at 692).

In the *Legacy Vulcan* case the umbrella coverage for the environmental claims was primary rather than excess, and the court therefore applied the ordinary rules regarding the duty to defend. For example, to be entitled to a defense paid by the carrier, the manufacturer had to show only that the claims were *potentially* covered, rather than actually covered. Further, the manufacturer's settlement of the claims did not retroactively absolve the insurer of its duty to defend; as long as the underlying claims were potentially covered before they were settled, the carrier was required to compensate the corporate policyholder that was left to fend for itself (185 Cal. App. 4th at 692–693).

The court also confirmed that the policy's "retained limit" provision did not crimp the insurer's duty to defend. The court pointed out that regardless of what the terms *retained limit* or *self-insured retention* mean to an insurance expert or an attorney, the duty to defend depends on what the particular policy language means to a lay policyholder. Any limitation on coverage "must be stated precisely and understandably, in words that are part of the working vocabulary of the average layperson." (185 Cal. App. 4th at 694.)

The *Legacy Vulcan* case highlights the different duties an insurer owes to its policyholder. A retained-limit provision that requires the insured to incur some amount of liability before the carrier must pay a judgment against the insured does not necessarily apply to the insurer's duty to defend. Rather, the insured is *not* required to incur a liability exceeding a policy's retained limit before an insurer is required to defend, unless the policy expressly says so (185 Cal. App. 4th at 682, 697).

The decision demonstrates that a so-called excess liability policy can provide multiple layers of protection, including umbrella coverage requiring the insurer to provide a "first dollar" defense. *Legacy Vulcan* also shows the value of carefully scrutinizing policy language when considering a client's rights and an insurer's obligations.

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