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AN OVERVIEW OF PRIMARY AND EXCESS COVERAGE ISSUES FOR CLAIMS HANDLERS AND CLAIMS COUNSEL

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The focus of this paper is the nature of the relationship between the primary and the excess liability insurer and in particular the issues that may arise when the exposure to a claim may be in excess of the primary limits. This paper is a "primer" for claims handlers and claims counsel; it reviews the basic rights and duties of the primary and excess liability insurer in a variety of contexts including the broader picture of the "duty to defend" and the allocation of defence costs. Questions such as who appoints defence counsel and issues in regard to settling claims when primary and excess liability insurers are involved are addressed. The paper concentrates on disputes between primary and excess insurers in the context of general liability policies with some attention given to the newly emerging issue of whether the insured can contribute to a settlement in an effort to exhaust a policy layer and "trigger" any ensuing excess coverage. Finally, this paper reviews the IBC "Agreement of Guiding Principles between Primary and Excess Liability Insurers Respecting Claims" as the industry code-of-conduct that most Canadian liability insurers have agreed to follow.

There are relatively few Canadian cases that address the relationship between primary and excess liability insurers, but many more from the American courts. While this paper focuses on Canadian law, some American cases are reviewed to round out the discussion.

1. DEFINITIONS

What is the difference between primary and excess insurance? What is the difference between excess coverage and excess umbrella coverage? In resolving issues between liability insurers, the first thing a Court decides is whether a particular policy offers primary, excess or umbrella excess coverage to the insured. This first determination underpins the competing liability insurers' obligations to the insured, and to each other.

a. Primary Insurance:

Simply put, primary insurance is front line indemnity:

> Primary insurance coverage is insurance coverage whereby, under the terms of the policy, liability attaches immediately upon the happening of the occurrence that gives rise to the liability.[1]

b. Excess Insurance:

Excess policies are, by definition, in excess to whatever coverage is offered by another policy. Liability attaches only after whatever predetermined amount of primary coverage has been exhausted.

> An excess policy is one that provides that the insurer is liable for the excess above and beyond that which may be collected on primary insurance.[2]

The main purpose of excess insurance is to protect from any sort of loss in excess of whatever coverage was provided by the primary or underlying insurance. It seems obvious but before there can be an excess policy, there must be a primary policy in existence.[3] Normally, excess policies are less expensive for an insured to obtain because the risk of having to pay out a claim is lower, since there is already one layer of primary insurance in place. Excess policies are generally written with the expectation that the primary liability insurer will conduct the investigation, negotiation and defence of the claims until primary limits are exhausted.[4]

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[1] *St Paul Mercury Insurance Company* v. *Lexington Insurance Company,* 78 F. 3d 202 (5th Cir. 1996) at footnote 23, quoting from *Emscor Mfg. Inc*. v. *Alliance Ins. Group*, 879 S.W. (2d) 894 at 903 (Tex App. 1994, writ denied) as quoted in *Trenton Cold Storage Ltd*. v. *St. Paul Fire and Marine Insurance Co,* [2001] O.J. No. 1835 at page 7.

[2] *St Paul Mercury Insurance Company* v. *Lexington Insurance Company* (*supra*).

[3] *Beck* v. *Budget Rent-A-Car*, 669 N.E. 2d 1335, 1338 (Ill App.1996) as quoted in M. Marick & K. Dixon, "*What's Privity Got to Do with It*" (2003) Insurance Coverage and Claims Institute, at page 126.

[4] *Progressive Case. Ins. Co*. v. *Travellers Ins. Co.* 735 F. Supp. 15,19 (D.Me.1990) as quoted in M. Aylward, "*Scenes from the New Civil War: Selected Areas of Dispute between Primary and Excess Insurers*" (2001) Insurance Coverage and Claims Institute, at page 298.

There are several kinds of excess insurance:

i) Follow-Form Excess Insurance

Follow-Form excess insurance is coverage that is intended to ensure that the higher layers of coverage follow consistently the primary or lower layers of coverage. The terms or clauses in a follow-form excess policy are normally very closely based on the terms of the underlying primary policy (or a lead umbrella policy) and may incorporate by reference the terms of the underlying coverage. Endorsements may provide different wording from the primary policy.

ii) Umbrella Excess Insurance

An umbrella policy is a hybrid policy that combines aspects of both a primary policy and an excess policy. These types of policies generally provide two types of coverage: standard form excess coverage and broader coverage than the primary policy, including the duty to defend lawsuits not covered by the underlying coverage. [5]

The two functions of the umbrella excess policy are as follows:

1. To provide for a higher limit of liability for losses typically covered by liability insurance, such as general liability and comprehensive auto liability for bodily injury and property damage; and

2. To provide for some coverage for less common losses not typically covered by liability insurance, including malpractice liability, advertiser's liability and blanket contractual liability. 6

iii) "Other Insurance" Clauses

Many liability insurance policies contain an "other insurance" clause. A conflict often arises when two competing liability insurers have issued primary policies that cover the same loss, and one contains an "other insurance" clause; cases with these facts are discussed in detail below. An example of an "other insurance" clause is:

> This insurance does not cover any loss, which at the time of the happening of the loss, is insured by or would but for the existence of this Policy, be

[5] *Trenton Cold Storage Ltd*. v. *St Paul Fire and Marine Insurance,* (*supra*) at page 7.
[6] *Ridgway v. Gulf Life Insurance Co.*, 578 F.2d 1026, 1030 (5th Cir. 1978) as quoted in *Garmany v. Mission Ins. Co.* 785 F2d 941, 948 (11th Cir. 1986) at page 9.

> insured by any other existing Policy or Policies except in respect of any excess beyond the amount which would have been payable under such other Policy or Policies had this insurance not been effected.[7]

2. THE FIRST QUESTION: IS THE POLICY PRIMARY OR EXCESS?

How do the Courts allocate indemnity as between competing liability insurers? A dispute between liability insurers is very different in the eyes of the Court to a dispute between the insurer and its insured. To resolve this question, a Court will review the wording of the policies; it will not review the circumstances surrounding the making of the contract itself. The cases discussed below illustrate how the Courts address this central issue, namely the proper approach to the characterization of a policy of liability insurance.

In the case of *Family Insurance Corp. v. Lombard Canada Ltd.*[8] the Supreme Court of Canada was faced with two competing liability insurers who each relied on "other insurance" clauses as a means of raising a shield to primary indemnity. On the question of interpretation, the Court stated:

> Once the interest of the insured is no longer at stake, that is, where the contest is only between the parties, there is simply no basis for looking outside the policy. In the absence of privity of contract between the parties, the unilateral and subjective intentions of the insurers, unaware of one another at the time the contracts were made, are simply irrelevant.[9]

The two liability insurers each argued that their individual policies only provided excess coverage. The Family policy contained the following "other insurance" clause:

> If other insurance exists which applies to a loss or claim or would have applied if this policy did not exist, this policy will be considered excess insurance and the Insurer is not liable for any loss or claim until the amount of such other insurance is set up.[10]

The Lombard policy contained a different "other insurance" clause:

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[7] *Trenton Cold Storage Ltd.* v. *St Paul Fire and Marine Insurance* (*supra*) at page 4.
[8] [2002] 2 S.C.R. 695.
[9] *Family Insurance Corp v. Lombard Canada Ltd.* (*supra*) at page 707.
[10] *Family Insurance Corp. v. Lombard Canada Ltd.* (*supra*) at page 700.

> If other valid and collectible insurance is available to the Insured for a loss we cover under Coverages A, B, or D of this form, our obligations are limited as follows:
>
>> This insurance is excess over other existing insurance if any, whether such other insurance be primary, excess, contingent or on any other basis, that is liability insurance such as, but not limited to comprehensive personal liability, comprehensive general liability coverages or similar coverage for liability arising out of the activities of any insured.[11]

If the Court had accepted that both the Family and Lombard policies were excess, the insured would have been left with no primary coverage at all. In its reasons, the Supreme Court of Canada stated:

> [w]here the competing policies cannot be read in harmony, the most sensible course, and what accords with the interest and expectation of both the insured and the insurers, is to treat the conflicting clauses as mutually repugnant and inoperative.
>
> With the irreconcilable clauses rendered inoperative, the insurance policies of both the appellant and the respondent provide the insured with primary coverage. As a result, each insurer is independently liable to the insured for the full loss, as if the other insurer did not exist. Thus, what remains to be determined is the method by which the extent of each insurer's obligation to contribute is calculated. The overwhelming view in Canada is that where liability is shared among insurers covering the same risk, the loss is borne equally by each insurer until the lower policy limit is exhausted, with the policy with the higher limit contributing any remaining amounts.[12]

The *Family Insurance* case (*supra*) remains the benchmark in Canadian law to interpret primary and excess policies. The decision has acute relevance in cases between two primary insurers whose policies have similar "other insurance" clauses; facts which also limit the application of the case. The Ontario Court of Appeal in its 2007 decision in *McKenzie v. Dominion of Canada General Insurance Co.*[13] reviewed *Family* (*supra*) and

[11] *Family Insurance Corp. v. Lombard Canada Ltd.* (*supra*) at page 700.
[12] *Family Insurance Corp. v. Lombard Canada Ltd*. (*supra*) at page 716.
[13] *McKenzie v. Dominion of Canada General Insurance Co.* 2007 ONCA 480, [2007] I.L.R. I-4612 (Ont C.A.)

noted the limiting aspect. In *Family* (*supra*), the Court was faced with two primary carriers and pronounced on the validity of "other insurance" clauses between similar layers of insurance. In *McKenzie* (*supra*) the contest was between policies of insurance providing different layers of coverage. For claims handlers and claims counsel, this distinction is key.

The facts in *McKenzie* (*supra*) demonstrate the difference. A boat driver sought coverage under three separate policies; a boat owners policy, an "umbrella" liability policy and a homeowners policy. At issue was the order in which the latter two policies were required to contribute. After reviewing the wording of the policies, the Court found that the policies covered different layers of risk. An umbrella policy was not called upon to respond to claims until the limits of the second layer (in this case, the homeowners insurance) were exhausted.

The question of which policy is excess and which is primary is critical because the primary policy responds first. In the 2001 case of *Trenton Cold Storage Ltd. v. St Paul Fire and Marine Insurance Co.*[14] the Ontario Court of Appeal overturned the trial decision that the two competing liability insurers (IARW and St. Paul) were to contribute equally to the Plaintiff's loss. IARW was seeking contribution from St. Paul towards defence costs and the settlement which it paid in the underlying action.

The case turned on the wording of the respective policies. The Court of Appeal construed each policy as a whole, not by its separate provisions. First, nothing in the wording of the "deemed" primary policy of IARW showed an intent to provide anything other than primary insurance. The "other insurance" clause in that policy gave the insured permission to obtain "…other insurance being the excess of insurance". The St. Paul policy, on the other hand, expressly obligated the insured to maintain underlying insurance. The Court concluded that IARW was the primary liability insurer and it could not use an "other insurance" clause to require the umbrella excess insurer to equitably contribute to its liability. As a result, since primary coverage had not been exhausted, St. Paul was not required to contribute to the settlement of the underlying tort action. This case is significant for two reasons:

1. it shows that the Courts will review the insuring intent of the entire policy, not just the individual clauses within a policy to reach their conclusions; and

2. it illustrates a failed attempt by an admitted primary insurer, IARW, using its "Other Insurance" clause, to characterize a

[14] *Trenton Cold Storage Ltd. v. St Paul Fire and Marine Insurance Co*, [2001] O.J. No. 1835 (C.A.)

seemingly admitted excess insurer, St Paul, as a co-primary liability insurer.

This case was followed in the 2004 Ontario Court of Appeal ruling in *Lombard General Insurance Co. v. CGU Insurance Co. of Canada.*[15] At trial, Lombard sought a declaration compelling CGU to satisfy a shortfall on a judgment in the underlying lawsuit which exceeded the Lombard limit. The Court noted the different wording between the CGU and Lombard policies. The Lombard policy had a clause which referred to "underlying insurance". Similar wording was not found in the CGU policy. The Court found that the CGU policy was primary, and the Lombard policy was an umbrella policy, which obliged Lombard to respond to the claim only after the limits of the CGU policy had been exhausted. On appeal, the Court of Appeal upheld the ruling that CGU had issued a primary policy with an excess coverage clause, while the Lombard policy was excess. The Court of Appeal concluded that "…the law is clear that the primary policy with excess coverage ranks ahead of the umbrella policy"[16] which meant that in the end, Lombard only had to respond to the claim after the limits of the CGU primary policy had been exhausted. This case demonstrates a similarly unsuccessful effort, not unlike *Trenton Cold Storage* (*supra*), by a primary insurer to have an excess liability policy characterized as co-primary.

These cases are significant because they establish that when Courts are interpreting competing liability insurers' policies, the Court will:

1. review the contracts between competing liability insurers, not the circumstances surrounding the underwriting of the policies;

2. review the policies as a whole, not by specific clauses out of context to the entire policy; and

3. in examining the entirety of the policies, the presence of features traditional to excess policies, including a reference to the "schedule of underlying coverages", will largely prevent an admitted primary liability insurer from using its "Other Insurance" clause to convert an excess policy into a "co-primary" liability policy.

[15] [2003] O.J. No. 3385 (upheld on appeal to the Ontario Court of Appeal in 2004)
[16] *Lombard General Insurance Co*. v *CGU Insurance Co. of Canada* [*supra*] at page 1.

3. THE "DUTY TO DEFEND" OF EXCESS LIABILITY INSURERS

Two critical areas of dispute between primary and excess liability insurers arise when the indemnity exposure may be in excess of primary liability policy limits. First, when does the excess liability insurer have a "duty to defend" in whole or in part? Second, when does the excess liability insurer have an obligation to contribute to defence costs, and by how much? (This latter question is addressed in the following section of the paper). The two issues are inextricably linked. Ultimately the question for both claims handlers, claims counsel and before the Courts when faced with competing liability insurers is which liability insurer pays what amount and when.

The terms of the policy provide the cornerstone for the Court to determine whether the excess liability insurer has a "duty to defend". In many cases, an excess insurer's policy may contain either an express "duty to defend" clause, or, the policy may incorporate by reference or endorsement a "duty to defend" clause contained in the underlying policy. It is always open to an excess liability insurer to alter the nature of the contractual "duty to defend" by including appropriate express language in the policy. The Courts have extrapolated from the many "duty to defend" cases, decided in the context of a single policy, to determine whether there is a "duty to defend" in cases of competing liability insurers.[17]

There are several seminal decisions in Canadian law dealing with an excess liability insurers "duty to defend". These cases also address the concurrent issue of allocation of defence costs (discussed in the next section). The first is the 1990 decision of the Ontario Court of Appeal in *Broadhurst & Ball v. American Home Assurance Co.*[18] This case concerned two liability insurers; American Home issued a primary policy while Guardian Insurance Company issued an umbrella policy (described as "excess" in the reasons) to provide professional liability insurance to a law firm. Each policy provided a broad defence obligation that the liability insurer would defend the insured in any action and pay any expenses associated with the defence. The damages claimed in the underlying tort action would have exhausted the limits of the primary policy. Guardian argued that its "duty to defend" did not arise when the obligation was covered under a primary policy, especially in light of a "retention clause" in its policy which, it argued, relieved it of any defence obligation. The Court of Appeal decided that both insurers had a "duty to defend" and stated:

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[17] Among the seminal cases are *Non-Marine Underwriters, Lloyd's of London* v. *Scalera,* [2000] 1 S.C.R. 551, 185 DLR 9 (4th) 1, and *Nichols* v. *American Home Assurance Co.*, [1990] 1 S.C.R. 801 at 808-809, 678 DLR (4th) 321.

[18] (1990), 1 O.R. (3d) 225 (C.A.) leave to appeal to the Supreme Court of Canada refused (1991), 79 DLR (4th) vi, [1991] S.C.C.A.. No. 55.

> In these circumstances Guardian ought not to be entitled to excuse its non-performance of its obligations to defend by pointing to the defence being provided by another insurer and insisting that that insurer's defence relieves it of any obligation to involve itself in the defence. To conclude, as did the court below, on the one hand, that Guardian has a clear contractual duty to defend the respondents under the terms of its policy, and, on the other hand, that Guardian need do nothing in furtherance of the defence but may stand by and have the primary insurer bear the entire burden of the defence, is to render the contractual duty meaningless, and, at the same time, to confer a windfall on Guardian by permitting it to have its defence obligations discharged by another insurer.[19]

The ruling in this case is very specific to the facts: where there are concurrent and unqualified duties to defend in both the primary and excess policy, both insurers have a "duty to defend".

Additionally, one of the liability insurers in *Broadhurst & Ball v. American Home Assurance Co.* (*supra*) was not a signatory to the IBC "Agreement of Guiding Principles Between Primary and Excess Liability Insurers Respecting Claims" discussed later in this paper.[20] The IBC Agreement is not law but rather only a guideline for liability insurers. It states that any excess liability insurer who signs the agreement agrees to share equally with a primary liability insurer in legal costs, and the sharing will be adjusted following the final resolution of the claim to a pro-rated share of the indemnity for the claim.

The second leading case which addresses the "duty to defend" of the excess or umbrella liability insurer (and the concurrent issue of the allocation of defence costs when exposure is well beyond primary limits, as discussed next) is the Ontario Court of Appeal ruling in *Alie et al v. Bertrand & Frere Construction Company Limited et al; Boreal Insurance Inc et al* .[21] At trial, a concrete supplier and a producer were found liable for damages to homes negligently constructed with defective concrete foundations. Damages in the case were found to be over $20 million with legal costs estimated in the same range. Both the supplier and producer had several primary and many excess CGL policies which offered coverage over the 16 years during which the progressive or continuous property damage arose.

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[19] *Broadhurst & Ball v. American Home Assurance Co.* (*supra*) at page 13.
[20] C.B. Brown et al., *Insurance Law in Canada,* v.2 (Toronto: Thomson Carswell, 2002) at pages 18-35.
[21] (2002), 222 DLR (4th) 687, [2002] O.J. No. 4697 (Q.L.)(C.A.) (appeal to SCC denied).

Nine different appeals (and various cross-appeals) were brought by the liability insurers of the concrete supplier and the producer. Most of the excess insurers' policies contained either an express "duty to defend" clause, or, incorporated by reference a "duty to defend" clause contained in an underlying policy. In regard to the issue of the "duty to defend" of the excess liability insurers, the Court of Appeal stated:

> ...where a policy provides a duty to defend, the operation of that duty will be determined prospectively by reference to the allegations made in the claim unless the policy expressly indicates to the contrary. If the insurer is potentially liable to indemnify under the terms of the policy, the insurer will be obligated to defend...the prospective determination of a duty to defend also facilitates the expeditious resolution of claims made against the insured through the early involvement of the insurer who may eventually have to indemnify the insured.
>
> …We see no reason, however, to depart from the presumption in favour of a prospective determination of a duty to defend based on the nature of the claims made *where it is an excess insurer that has undertaken that obligation. It is always open to the excess insurer to alter the nature of the duty to defend by including the appropriate express language in the policy.*[22] (emphasis added)

Accordingly, the Court imposed a defence obligation on the excess and the umbrella liability insurers based on the clear risk of the claim exceeding primary limits, the benefit that would potentially accrue to the umbrella carriers, and the high costs of defending the action.[23] The issue of allocation of costs is addressed in the next section of this paper.

A third case addresses the question of the obligations of both the primary and excess liability insurers to defend once the primary limits of indemnity have been reached (in contrast to when a primary liability insurer whose limits are not exhausted conducts a defence of the claim that might benefit the excess liability insurer, which might call for equitable contribution.) The Ontario Superior Court considered the first question in the case of *Boreal Insurance Inc. v. LaFarge Canada Inc.*[24] a companion case arising out of the same occurrences as *Alie v. Bertrand* (*supra*). Here, the concrete supplier made an application to determine whether its primary liability insurer had a "duty to defend"

[22] *Alie et al v. Bertrand et al* (*supra*) at page 741.
[23] M.B. Snowden "Dropping Umbrellas and Following to Excess" (2004), *Canadian Institute Conference on Insurance Coverage Disputes* at page 29.
[24] [2004] O.J. No. 1571 (Q.L.)(Sup. Ct.)

despite the limits of indemnity being exhausted. Additionally, the Court was asked to decide whether the excess liability insurers were required to defend if the primary liability insurers were not.

The Court, as always, went directly to the policy wording to answer these questions. It determined that absent any clear and certain statement in the policies in question that the excess liability insurers would *not* defend against claims in these circumstances, the "duty to defend" devolved to the excess insurer once the limits were exhausted. The Court in *Boreal v. Lafarge* (*supra*) stated:

> The underlying theory behind this allocation is that because the claims exceed the primary limits, the duty to defend relates to that part of the claims for which there is a possible indemnity. I find that it follows from this theory that, where there is no possible indemnity because the limits have been exhausted, the duty to defend passes to the next insurer in the layered scheme.[25]

The Court also stated if a primary liability insurer, in the absence of any "stacked" excess insurance, simply abandoned a defence once limits are exhausted, there would be redress available to the insured to deal with any resulting unfairness.[26]

This case in regard to the "duty to defend" between a primary and excess liability insurer also establishes that:

1. A primary liability insurer is not required to defend an action once the limits in the insurance policy have been exhausted (subject to the above caveat); and

2. An excess liability insurer is required to defend an action once the policy limits of the primary insurance policy have been exhausted.

Building on this body of law is the recent ruling of *St. Mary's Cement Co. v. ACE INA Insurance,*[27] in which the Ontario Superior Court reviewed an excess policy that included an express duty to defend. The insured, a concrete powder supplier, had umbrella liability coverage through a policy which stated that it would indemnify when the "*…limits of liability of the underlying insurance are exhausted because of, inter alia, property damage*". The policy also provided that where those conditions were met, the

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[25] *Boreal Insurance Inc. v. Lafarge Canada Inc.* (*supra*) at page 11.
[26] *Boreal Insurance Inc. v. Lafarge Canada Inc.* (*supra*) at page 10.
[27] 2008 WL 2624084, 2008 CarswellOnt 3838 (Sup. Ct.)

insurer had a duty to defend. In this case, the insured was faced with 18 legal actions, with damage claims over $27 million dollars; an amount well over the limits of its primary coverage and, if the claims were proven, well within the coverage provided by the insurer. The Court stated:

> [w]here an excess insurance policy … includes a duty to defend, the insurer may be called upon to provide that defence or to contribute to that defence before it is known whether the primary policy…will be exhausted. *That is, the duty to defend is to be determined prospectively.*[28] (emphasis added)

The Court referred at length to *Alie v. Bertrand* (*supra*), particularly the reasoning that even the possibility that an excess insurer will be required to indemnify the insured if the claim is successful may be suffice to trigger a duty to defend. Put another way, it was not necessary to prove that an obligation to indemnify would in fact arise in order to trigger a duty to defend.

4. ALLOCATION OF DEFENCE COSTS BETWEEN THE PRIMARY AND EXCESS LIABILITY INSURER

As discussed earlier, a critical question for claims handlers, claims counsel and for excess liability insurers is at what point in a claim involving layers of coverage is the excess liability insurer obliged to pay defence costs? For instance, does an excess liability carrier have to pay defence costs prior to primary policy exhaustion? Another critical question, especially for claims handlers and claims counsel, is if there is a duty to contribute to defence costs by the excess liability insurer, what is the applicable formula to determine how much to contribute? These questions arise whether the allocation is in regard to defence cost funding or in regard to settlement or other indemnity obligations. The four cases below provide some guidance.

In the first leading case on the allocation of defence costs, *Broadhurst & Ball* (*supra*), the Court found that where the amount of damages that might be awarded in the underlying tort action put the excess liability insurer clearly at risk by the claim, the costs of defending the claim were to be shared equally, on a 50/50 basis, by both the primary and excess liability insurer:

> ...Since the insurers have no agreement amongst themselves with respect to the defence, their respective obligations cannot be a matter of contract. Nevertheless, their obligations should be subject to and governed by

[28] *St. Mary's Cement Co v. ACE INA Insurance* (*supra*) at para. 10.

> principles of equity and good conscience, which, in my opinion, dictate that the costs of litigation should be equitably distributed.
>
> To require a primary insurer, whose financial exposure is significantly less than that of the excess insurer, to bear the entire burden of defending an action of this nature, is, in my view, patently inconsistent with these principles....[A]s a matter of equity, the burden that these insurers assumed in insuring the same insured against the same risks should fall on both of them and the costs, accordingly be shared by them.[29]

The Court made this "50/50" finding in light of the concurrent obligation to defend, even absent a contractual nexus between the two insurers. The Court did not accept the argument that the costs in this case should be shared pro-rata in proportion to the limits of coverage. However, the Court did state that in other circumstances, a pro-rata share may be a "fitting basis" for allocation.

It is important to note that in *Broadhurst & Ball* (*supra*) the two liability insurers were arguing over the payment of defence costs, and the Court's "50/50" formula and allocation was prospective. In other words, its finding was made well before the underlying tort claim was brought to trial.

In the second leading case, *Alie v. Bertrand* (*supra*), no appeal was made against the findings of liability against the concrete producer and the supplier; instead, the appeal was focussed on which of the many liability insurers were responsible for defence costs, after the judgment. It is important to note the Court had to allocate defence costs "after the fact". The trial judge had apportioned the costs of defending the underlying action into seven equal parts representing the policy periods in issue. The costs attributable to each of the policy periods were divided equally among the liability insurers who were obligated to contribute to defence costs in that policy period. This was a "horizontal allocation" of defence costs, based on the number of years on risk of the liability insurer in question. There was also "vertical allocation"; the trial judge simply divided equally between insurers on risk in each tower or year of coverage.

The Court of Appeal upheld this finding, and stated:

> *Broadhurst & Ball* does not hold that an excess insurer with a duty to defend will be compelled to contribute to defence costs in each and every case where a claim exceeds the limit of the primary insurer. [The trial judge] recognized that the excess insurer's obligation to contribute, if any,

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[29] *Broadhurst & Ball v. American Home Assurance Co.* (*supra*) at page 13.

> was a "matter of equity" or "fairness"...[t]he determination of those equities depends on the circumstances of the particular case. Those equities include the first in line status of the primary insurer, the nature of the risk insured by each insurer, the potential windfall to an excess insurer who was not obliged to contribute to a defence which potentially benefited that insurer and the contractual obligation of the excess insurer to the insured.[30]

Ultimately in allocating defence costs between the primary and excess liability insurers, where it was likely that the claim would pierce into the layer of excess insurance, the Court of Appeal in *Alie v Bertrand* (*supra*) stated that allocation was "not an exact science" and that given the nature of the claims it would be impossible to assign defence costs to a specific policy period or an isolated event. At trial, some of the insurers had argued that costs be apportioned in accordance with the limits of coverage provided by each insurer within the seven periods. Other insurers argued that costs be apportioned in accordance with the ultimate contribution of each insurer to the judgment. The trial judge reasoned that:

> [t]here is no single formula that is applicable to all circumstances. Apportionment of these costs is obviously an exercise in the Court's equitable jurisdiction. The insurers who will have to bear the burden of these costs have no agreements among themselves. Therefore, the apportionment of defence costs is done on a basis of equitable consideration.[31]

The Court of Appeal agreed that an equal distribution of defence costs between the liability insurers was a fair and reasonable "formula" on the specific facts of the case, and particularly in light of the fact that it was impossible to determine exactly when the damage occurred. There was an equal distribution of defence costs among the seven policy periods, and an equal distribution among insurers with a duty to defence in each policy period (one insurer was found on appeal not to have a duty to defend). [32]

In May 2005 the Ontario Court of Appeal released its judgment in *ING Insurance Co. v. Federated Insurance Company*,[33] a third leading case on the allocation of costs. This case was decided after a settlement had been reached in the action and both liability insurers

[30] *Alie et al* v. *Bertrand et al* (*supra*) at page 747.
[31] *Alie et al* v. *Bertrand & Frere Construction Company Limited et al*. (1997), 30 C.C.L.I. (3d) 166, 11 C.L.R. 19, [2000] O.J. No. 1360 (Q.L.)(S.C.)at page 99.
[32] *Alie et al* v. *Bertrand et al* (*supra*) at page 756.
[33] [2004] O.J. No. 2876 (Q.L.)(Sup.Ct.), 2005 CarswellOnt 1702 (C.A.)

had contributed to the settlement. Here, ING, as the primary liability insurer, sought contribution towards its own defence costs from Federated, the excess liability insurer. Federated had been put on notice by ING only eight months before the matter settled; and at the time notice was given it was apparent that damages would exceed the primary limits. Federated argued that the lawyer retained by ING only acted for ING when he was settling the case, and that the excess insurer should only be responsible for defence costs after it was put on notice of its potential liability (well into the settlement negotiations). At trial, the Court found that the excess insurer had to contribute to the settlement according to the equities of each specific case:

> It seems obvious from *Broadhurst & Ball* that where an excess insurer has a duty to defend and is put at risk by the claim, then that excess insurer should contribute to defence costs. The exact nature of the contribution as between those insurers with a duty to defend will depend on the equities of the specific case. [34]

The trial judge apportioned defence costs proportionately to the share of damages each liability insurer paid. Since Federated, as excess liability insurer, paid 31% of the damages paid by both insurers in total to settle the case, the Court determined that it was obliged to pay 31% of ING's defence costs as primary liability insurer.

Federated appealed the trial judge's finding. The Court of Appeal allowed the appeal, and found that the trial judge had misapplied *Broadhurst & Ball* (*supra*). The Court found that an excess insurer's obligation to contribute to defence costs was premised on the existence of a duty to defend. The duty to defend only arose where notice of a claim was given; the Court reasoned that an insurer could hardly have a duty to defend a claim of which it had no notice. In summary, the Court of Appeal found:

1. The insurer's duty to defend arose on being given notice;

2. There was no obligation to contribute to defence costs absent a duty to defend; and

3. Where there is a duty to defend, an excess insurer *may* be obligated to contribute, as a matter of equity or fairness (emphasis added).

This ruling is significant to claims handlers and claims counsel for two reasons. First, the case shows that the excess insurer's obligation to contribute to defence costs does not arise until there is notice that it is at risk. Second, the case shows that the issue of

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[34] *ING Insurance Co. v. Federated Insurance Company* (*supra*) at page 2.

allocation of defence costs will only arise if there is a realistic possibility of the damages exceeding the primary limits.

The more recent ruling of the Ontario Superior Court in *St. Mary's Cement Co. v. ACE INA Insurance* (*supra*) - discussed above in the context of the duty to defend - also addresses the question of the allocation or division of defence costs. The Court considered the reasons of the Ontario Court of Appeal in *Alie v. Bertrand* (*supra*). Having decided there was a *prospectively defined duty to defend*, and that the excess policy would likely be called upon to indemnify, the Court then reasoned:

> The precise indemnity obligations (if any) of Liberty [*the primary insurer*] and ACE will not be clear until the determination of all the underlying court actions. Given the uncertainties at this point in time as to the ultimate conclusions of these underlying court actions the equitable way of dividing costs on an interim basis is to apportion them equally between Liberty and ACE. [35]

The Court ordered each insurer to share ongoing defence costs on a 50-50 basis, even though the precise indemnity obligations of the two insurers would not be clear until settlement or trial. The Court did not specifically address whether this allocation could potentially create an inordinate burden on the excess insurer, even if only on an interim basis. The excess insurer pays half of the defence costs, even though its ultimate indemnity exposure may be modest or, even just "pierce" the second layer of insurance. If the underlying cases settled at just over the primary limits, the excess insurer would still have paid half the costs to reach that point. However the Court did make clear that this equal division of costs was without prejudice to the rights of the insurers to a re-allocation of costs following a settlement or trial.

To protect the excess insurers' right to re-allocate following settlement or trial, claims handlers and counsel should ensure that the excess insurer is expressly reserving its' right of reallocation following settlement or trial.

The equitable contribution approach is followed by some American Courts when faced with the issue of payment of defence costs by excess liability insurers before the primary policy is exhausted. A vigorous defence of the action by the primary liability insurer often benefits the excess insurer even before it is called upon to indemnify. Equitable allocation has found some support in the American courts because prorating defence costs among primary and excess liability insurers based on their exposure "…provides no obstacle to an effective defence and leads to a more equitable

[35] *St. Mary's Cement Co. v. ACE INA Insurance* (*supra*) at para. 20.

distribution of the cost of litigation among the insurers".[36] However, most American courts take the view that an excess liability insurer is not obligated to participate in the defence of the insured and share in the costs as long as the primary insurer is required to defend and until the primary policy limits are exhausted.[37]

5. CARRIAGE OF THE DEFENCE OF THE UNDERLYING CLAIM

Does the excess liability insurer have a right to "step in" and defend the underlying tort case instead of the primary insurer? Liability insurers may compete for the right to control the defence of the action when both have policy limits at risk. This situation arose in *Economical Mutual Insurance Co. v. I.C.B.C.,* a 1986 decision of the Alberta Queen's Bench.[38] The issue of who was the primary and who was the excess liability insurer was uncontested. Rather the question was, with the exposure well beyond primary limits and in fact, the excess liability insurer having a risk far greater than the primary, who should have carriage of the lawsuit? The decision was made in light of the statutory obligation under the Alberta *Insurance Act* which required insurers to share the costs and expenses involved according to their respective liabilities for damages awarded against the insurer. The Court asked the question of who was the "most loss" insurer, and stated:

> Clearly the insurer who carries the first loss insurance bears the first risk of loss and therefore should be the first insurer entitled to assume, indeed required to assume, the first or primary obligation to defend to the extent of the limits of its coverage.
>
> [I]t seems reasonable that he who has the greater risk of loss is entitled to defend. In most cases that would be the first loss insurer and, ordinarily the first loss insurer would assume the obligation to defend.
>
> However in this case, based on the pleadings filed…the greater risk falls upon the excess insurer…on that basis this Court directs that ICBC is entitled to defend the insured but with full consultation with the first loss insurers and their legal representatives.[39]

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[36] *Celina Mutual Ins. Co.* v. *Citizens Ins. Co*. 349 N.W. 2d 547, 550 (Mich Ct. App 1984) as quoted in M. Marick & K. Dixon "What's Privity Got to Do with It" (2003), Insurance Coverage and Claims Institute, at page 136.

[37] M. Aylward "Scenes from the New Civil War: Selected Areas of Dispute between Primary and Excess Insurers" (2001), Insurance Coverage and Claims Institute, at page 140.

[38] (1986), 44 Alta. L.R. (2d) 242 (Q.B.)

[39] *Economical Mutual Insurance Co.* v. *I.C.B.C.* (*supra*) at page 5

The excess insurer, I.C.B.C., was entitled (note the Court did not say "obligated") to assume the defence of the insured on the basis that it was exposed to more liability under its policy with respect to the accident in question than the primary insurer.

Some excess insurance policies litigated in the United States reserve to the excess liability insurer the "option" to participate, or the right to "associate" in the defence of lawsuits against the insured. These clauses give the excess liability insurer the contractual right to become actively involved in defending lawsuits which could pierce into the excess layer. Courts in the United States have concluded that this "option" to defend clause does not obligate the excess liability insurer to defend. [40]

6. FAILURE TO SETTLE AT PRIMARY LIMITS

Does the excess liability insurer have recourse against a primary liability insurer for failure to settle a claim at primary policy limits, either through a direct cause of action or otherwise? This question (and others) about the relationship between primary and excess insurers arise because while the interests of a primary insurer are virtually unaffected by the existence of excess coverage, the interests of an excess insurer are very much affected by the actions taken by the primary carrier.[41] As well, a supplemental excess carrier can be very much affected by the actions of an underlying carrier, although there are very few cases on point that address the duties of an excess carrier to another excess carrier.[42] The "failure to settle" within the primary limits has led to frequent disputes between primary and excess liability insurers in the United States, though few to date in Canada. As a result of the litigation, two main schools of thought have emerged from the many American decisions.

Some U.S. Courts have concluded that the primary liability insurer owes an independent and direct duty to the excess insurer similar to the duty owed to its insured. For example, the New York Court of Appeals has concluded that the primary liability insurer has a duty of utmost good faith to the excess liability insurer, as well as to the insured.[43] Under this doctrine, the primary insurer may be obliged to safeguard the rights and interests of the excess insurer throughout its defence and settlement of the underlying claim. However, many jurisdictions have refused to impose such a duty, based on the reason that there is no contractual or fiduciary relationship between

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[40] "What's Privity Got to Do with It" M. Marick and K. Dixon (2003), Insurance Coverage and Claims Institute, at page 130.

[41] *F.B. Washburn Candy Corp. v. Firemans Fund* 373 Pa. Sup. 479, 485, 541 A.2d 771, 774 (1988)

[42] See the 2008 decision in *Central Illinois Public Service Company v. Agricultural Insurance Company* 378 Ill.App-3d. 728 (App.Ct.Ill., 5th Dist.)

[43] *Hartford Accident & Indemnity Co.* v. *Michigan Mutual Insurance Co*. 61 N.Y. 2d 569 (N.Y. 1984).

the primary and excess liability insurer to support a direct cause of action. [44] Some commentators have stated that the primary insurer's duty to the excess carrier should be recognized as an independent, judicially imposed duty, and not merely something derived from equitable subrogation in the name of the insured. [45]

The doctrine of equitable subrogation has found greater acceptance in the American courts in cases where the primary liability insurer fails to settle at its limits. Under this concept, an excess insurer is subrogated in the rights of its insured with respect to a bad faith action against the primary insurer.[46] In practice this means that the excess liability insurer stands in the shoes of the policyholder in pursuing an action against the primary liability insurer. But before an excess liability insurer can recover under the theory of equitable subrogation, the excess insurer has to prove that the primary insurer was negligent in fulfilling its duties to the insured under the terms of the primary policy.[47] Any claim made against the primary insurer is subject to any defence that could be asserted by the primary insurer against the insured (for example, a breach of coverage by the insured).[48]

The purpose behind the doctrine of equitable subrogation is to create an incentive for liability insurers defending a case to work to settle the case within the limits of their policies, even when it is reasonably clear that their primary policies will be consumed.[49]

7. DISPUTING THE EXHAUSTION OF THE PRIMARY LIABILITY INSURER'S POLICY

This issue has been more frequently litigated in the United States. In the Canadian context, the 2004 ruling in *Boreal v. Lafarge* (*supra*) defines exhaustion as "[e]xhaustion occurs when a judgment that results in an obligation to pay out coverage limits is rendered".[50] The Court did not address whether exhaustion was deemed to have occurred by reason of a policy buy-out or settlement.

The American caselaw on this subject offers some guidance to the excess liability insurer who disputes the primary liability insurer's exhaustion of its policy limits either

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[44] "What's Privity Got to Do with It" M. Marick & K. Dixon (2003), Insurance Coverage and Claims Institute, at page 155 and the 2006 ruling in *National Surety Corporation v. Hartford Casualty Insurance Company* 445 F. Supp. 2d 779 (U.S.D.C. – Kentucky)

[45] "Bad Faith Actions Liability & Damages" Stephen S. Ashley, Chapter 6 1., Plaintiffs (updated 2007)

[46] *Valentine* v. *Aetna Insurance Co*. 564 F. 2d, 292, 296 (9th Cir., 1977).

[47] *Employers Nat'l Ins. Co.* v. *General Accident Ins.* Co., 857 F. Supp. 549, 552 (S.D. Tex 1994)

[48] *St. Paul Mercury Ins. Co*. v. *Lexington Ins Co*. (*supra*).

[49] *Employers Nat'l Ins. Co.* v. *General Accident Ins. Co* (*supra*).

[50] *Boreal Insurance Inc. v. Lafarge Canada Inc.* (*supra*) at page 10.

through settlement, indemnification or other legal obligation.[51] The following is a summary of some of the leading cases:

- In most cases, an excess insurer is not estopped from disputing the reasonableness of a settlement affecting its policy unless it participated in the original settlement negotiations (*Commercial Union Ins. Co. v. Medical Protective Co.*, 356 N.W.2d 648, 653).

- The degree of the excess insurer's participation will be scrutinized by the Courts [*California Union Ins. Co. v. Liberty Mut. Ins. Co.*, 920 F. supp 908 (N.D. Ill 1006) but note this case has been overturned on other grounds].

- The primary insurer must actually pay its limits before the responsibility to defend or indemnify transfers to an umbrella insurer, and it cannot merely tender policy limits during the course of the lawsuit [*Utah Power & Light Co. v. Federal Ins. Co.*, 983 F.2d 1549 (10th Cir. 1993)].

- The primary insurer must prove the actual exhaustion of the underlying limits [*General Refractories Co. v. Allstate Ins. Co.* (1994) WL 246375 (E.D. Pa. June 8, 1994)].

- If the primary insurer prematurely exhausts its coverage, the excess insurer may pursue an action seeking a proper allocation of loss payments under the primary insurer's coverage. Inviting the advance agreement of the excess insurer to an overall settlement should decrease the occasions for litigation [*Kaiser Foundation Hospitals v. North Star Reinsurance Corp.*, 90 Cal. 7App. 3d 786, 153 Cal. Rptr. 678 (1979)].

8. EXCESS DIRECTORS & OFFICERS INSURANCE AND COVERAGE ISSUES

Three recent American rulings illustrate the kinds of coverage issues that arise with Directors and Officers insurance ("D & O") and how the U.S. Courts are dealing with

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[51] This discussion is largely based on "Scenes from the New Civil War – Selected Areas of Dispute between Primary and Excess Insurers" M. Aylward, (2001), Insurance Coverage and Claims Institute and on "What's Privity Got to Do with It" M. Marick & K. Dixon (2003), Insurance Coverage and Claims Institute.

disputes between excess and primary insurers in the context of D & O claims.[52] These cases raise the issue of an insured and its primary insurer taking action which, in turn, compromises the position of the excess carrier. The issue of whether an insured can pay a portion of primary limits as part of a settlement to "trigger" the inception of an excess layer is discussed in two cases; a review of all three will help avoid similar problems for claims handlers and counsel in Canada.

In *Allmerica v. Certain Underwriters at Lloyd's*[53] an insured - an insurance company itself - sued its excess liability insurer for a declaration of coverage under a "follow form" excess liability policy. The case followed a settlement of an underlying class action alleging improper practices in the sales of certain life insurance policies. The primary insurer paid policy limits to settle. The issue was whether or not a "follow form" excess carrier was bound by the primary carriers' decision to settle the claim; the "follow-form" policy had the same terms, conditions and exclusions as the primary policy and provided that "[t]*his 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)"*.[54]

Although the Underwriters were kept informed throughout the settlement, reserving their rights as to coverage, they were not direct participants in the settlement. In fact, Underwriters told the primary insurer that it lacked sufficient information to make a coverage determination before the deadline of the court imposed settlement.

In reaching its decision, the Court reiterated two critical principles. First, excess insurance policies are separate and distinct contracts from a primary policy. Second, follow-form policies do not bind various insurers to a form of joint liability should coverage fail at a prior layer. The primary insurers' argument that Underwriters intended to be bound by its interpretations of its own policy, including decisions about coverage and settlement failed. The Court concluded that:

> …absent an explicit contractual commitment to do so, an insurer is not bound by the settlement another insurer makes for the same claim, even if the language of the nonsettling policy follows the form of the settling policy.[55]

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[52] This discussion is based in part on an article "Excess D + O Insurance: Coverage Disputes and Possible Solutions" by Kevin M. LaCroix in PLUS Journal (Professional Liability Underwriting Society) – July 2008, volume XXI, Number 7 at pages 2-4.
[53] *Allmerica Financial Corp. v. Certain Underwriters at Lloyd's* 449 Mass. 621, 871 N.E. 2d 418 (Mass S.J.C.).
[54] *Allmerica Financial Corp. v. Certain Underwriters at Lloyd's,* (*supra*) at para. 1.
[55] *Allmerica Financial Corp. v. Certain Underwriters at Lloyd's* (*supra*) at para. 15.

In the second case, *Comerica Inc. v. Zurich American Ins. Co.*[56] the insured sued its excess insurer after it settled a securities fraud class action lawsuit for $21 million and recovered $14 million from its primary insurer. This did not exhaust the primary liability limit, which was $20 million, but the insured made its own payment to bridge the gap and meet the settlement amount. Akin to the last case, the excess policy was "follow form". The language of the following clauses in the "follow-form" policy was critical:

> I. Insuring Agreement
>
> *The "Insurer" shall provide the "insured(s)" with excess insurance coverage over the "Underlying Insurance" as set forth in Item 3. of the Declarations during the "Policy Period" set forth in Item 4. of the Declarations. Coverage hereunder shall attach only after all such "Underlying Insurance" has been reduced or exhausted by payments for losses* and shall then apply in conformance with the same provisions, limitations, conditions and warranties of the "Primary Policy" at inception, except for premium limit of liability and as otherwise specifically set forth in the provisions of this Policy. In no event shall coverage be broader than coverage under any "Underlying Insurance". (emphasis added)
>
> V. Depletion of Underlying Limit(s)
>
> In the event of the depletion of the limit(s) of liability of the "Underlying Insurance" solely as a result of actual payment of loss thereunder by the applicable insurers, this Policy shall…continue to apply to loss as excess over the amount of insurance remaining…In the event of the exhaustion of the limit(s) of liability of such "Underlying Insurance" solely as a result of payment of loss thereunder, the remaining limits available under this Policy shall…continue for subsequent loss as primary insurance…
>
> This Policy only provides coverage excess of the "Underlying Insurance". *This Policy does not provide coverage for any loss not covered by the "Underlying Insurance" except and to the extent that such loss is not paid under the "Underlying Insurance" solely by reason of the reduction or exhaustion of the available "Underlying Insurance" through payments of loss thereunder…* (emphasis added).

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[56] *Comerica Inc. v. Zurich American Ins. Co.* E.D. Mich. 2007, 498 F. Supp. 2d 1019 (U.S.D.C. – Mich E.D.)

At issue was whether or not the wording of the excess policy was ambiguous; the primary insurer argued that there was no requirement or instruction in the policy as to whether the primary insurer must itself pay losses. If the policy was ambiguous, or unclear, such ambiguity would be interpreted against the excess insurer. The Court determined that the insured's own "bridging" payment did not trigger the excess insurer's obligation to pay if the primary insurer itself did not pay on losses to the full extent of its policy limits; the payment was not the "functional equivalent" of exhausting the primary policy limit. In the end, the "settlement plus credit" approach to exhaustion of the primary limits *might* have had the same effect as payment of the full policy limits, but the plain language and reading of the excess policy did not allow that interpretation. The excess carrier's coverage was never implicated, and it was found not liable to the insured.

In the third case, *Qualcomm, Inc. v. Certain Underwriters At Lloyd's, London*,[57] the insured sued its excess D & O carrier under a "follow-form" policy for unpaid expenses after it settled with the primary insurer for less than policy limits. The insured argued that Underwriters was liable for losses exceeding the actual limits of the primary policy, even where that policy was not exhausted. As in the *Comerica* decision (*supra*) the insured itself had absorbed the resulting gap between the settlement amount and the primary policy limit. At issue was the following policy language in the excess policy:

> This Policy provides excess coverage only. It is a condition precedent to the coverage afforded under this Policy that [Qualcomm] maintain [the National policy] with retentions/deductibles, and limits of liability (subject to reduction or exhaustion as a result of loss payments), as set forth in items F. and G. of the Declarations. This Policy does not provide coverage for any loss not covered by the [National policy] except and to the extent that such loss is not paid under the [National policy] solely by reason of the reduction or exhaustion of the Underlying Limit of Liability through payments of loss thereunder. In the event [National] fails to pay loss in connection with any claim as a result of the insolvency, bankruptcy or liquidation of said insurer, then those insured hereunder shall be deemed self-insured for the amount of the Limit of Liability of said insurer which is not paid as a result of such insolvency, bankruptcy or liquidation.
>
> *Underwriters shall be liable only after the insurers under each of the Underlying Policies [the National policy] have paid or have been held liable to pay the full amount of the Underlying Limit of Liability.* (emphasis added)

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57 Cal .App. 4 Dist., 2008,. 161 Cal.App.4th 184, 73 Cal.Rptr.3d 770 (Cal App).

The California Appeals Court found for the excess insurer. The exhaustion clause - quoted above in the second paragraph - was held to be unambiguous and as such, precluded the excess insurers' liability. The literal policy language prevailed. If the primary insurer did not pay, or be legally obligated to pay its limits, the excess insurance was not called upon.

These three cases show the American Courts follow the same clear trend as the Canadian Courts; only the policy itself is examined, and the plain meaning prevails. The latter two cases focused on the language of the exhaustion clause, the wording of which ultimately favoured the excess carrier. For Canadian claims handlers and counsel, these cases speak loudly for the benefits of clear policy language and effective communication with all participants throughout the underlying claims process.

9. BREACH OF THE PRIMARY POLICY BY THE INSURED

What happens if there are two or more layers of insurance and an insured breaches a term of his primary policy not found in the excess policy? The Courts have decided that in these circumstances, no liability is imposed on any excess insurer absent clear contractual language to the contrary. In the case of *Insurance Corp. of British Columbia v. Swiss Reinsurance Co. Canada*[58] an impaired driver struck and killed a cyclist. The driver had two insurance policies. There was no coverage available under the primary policy because of the driver's impairment. Unlike the primary policy, there was no term in the excess liability insurer's policy excluding coverage in circumstances where the insured was impaired. The primary insurer paid its limits in the underlying claim and sought that amount from the excess liability insurer. The Court ruled that the excess insurer did not automatically cover the primary policy limits just because the insured had breached the primary policy.

10. IBC GUIDELINES: AGREEMENT OF GUIDING PRINCIPLES

The majority of primary and excess liability insurers in Canada have signed on to the "Agreement of Guiding Principles Between Primary and Excess Liability Insurers Respecting Claims", as drafted by the Insurance Bureau of Canada. The latest version is dated March 1996, with 43 Canadian liability insurers as signatories (as of July, 2006). The Agreement has no legal effect; it has not been brought before the Courts in this country as evidence or otherwise. Nonetheless it is a protocol that signatory liability insurers abide by. The Agreement is not exhaustive but it does set out the basic duties of both the primary and excess liability insurers who have signed it. In terms of its

[58] [2003] B.C.J. No. 1405 (Q.L.)(S.C.)

application, nothing in the Agreement is intended to change the rights or responsibilities of any liability insurer under its policy. It does not apply to a claim against an automobile insurer pursuant to Uninsured or Underinsured Motorist covers, nor does the Agreement apply to a claim made outside Canada.

The focus of the Agreement is co-operation and contribution between the primary and the excess liability insurer. The duties of the primary liability insurer and those of the excess liability insurer are spelled out as well as the basis for contribution between them. The full text of the IBC Guidelines and the List of Signatories as of July 2006 appear in Appendix A to this paper.

The insurance industry in the United States, led by the American Insurance Association (and other representative groups) has also published a series of guiding principles to govern the rights and obligations of primary and excess liability insurers. There is much more caselaw in the United States on the relationship between excess and primary liability insurers; the guiding principles provide a standard of conduct in an attempt to limit controversy. While these guidelines have been introduced as evidence in American courts, the same is not true in Canada; our Courts have not pronounced on the merits or otherwise of the IBC Guidelines.

11. CONCLUSION

One certainty in the relationship between the primary and excess liability insurer is that litigation between the two is expensive, time-consuming and all the more common. In order to avoid it, claims handlers and claims counsel can take pro-active steps to avoid disputes between primary and excess liability insurers. These steps include early contact and disclosure of relevant information between the two. The principal legal issues (and principal areas of dispute between liability insurers), namely, the duty to defend and allocation of defence costs, are best resolved prior to the need for the intervention of the Courts. Many other variables, like the right of the insured to control litigation due to a self-insured retention, can also be addressed early on. The policy itself, and the growing body of legal authority canvassed in this paper, can provide guidance in order to avoid coverage disputes, and ultimately, to avoid contributing to the caselaw firsthand.

APPENDIX A

IBC Agreement of Guiding Principles Between Primary and Excess Liability Insurers Respecting Claims and List of Signatories

Insurance Bureau of Canada
Bureau d'assurance du Canada

AGREEMENT OF GUIDING PRINCIPLES
BETWEEN PRIMARY AND EXCESS
LIABILITY INSURERS
RESPECTING CLAIMS

WHEREAS, It is desirable to avoid disputes between primary and excess liability insurers as defined in this agreement;

AND WHEREAS, Agreement between such insurers on their duties relating to the resolution of claims, and adherence to such agreement, would tend to avoid disputes between such insurers;

AND WHEREAS It is desirable to create a forum for the expeditious resolution of such disputes that may arise between such insurers;

THE SIGNATORIES HERETO AGREE AS FOLLOWS:

SECTION I: DEFINITIONS

In this Agreement;

1. "Appeal" means any procedure taken to seek a further determination of liability or quantum as between insurer and insured or between insured and third party;

2. "Arbitration" means arbitration according to the terms set out in Section VII;

3. "Contribution" means contribution according to the terms set out in Section V;

4. "Insurer" means a Primary or an Excess Insurer under this Agreement;

5. "Primary Insurer" means a liability insurer whose responsibility to the insured underlies, under normal circumstances, that of any Excess Insurer;

6. "Excess Insurer" means an insurer whose policy becomes exposed when a claim made is excess of a Primary Insurer's limit;

7. "Judicial Review" means any procedure taken in the Courts to review an Arbitration ruling under this Agreement;

8. "Liability Insurance" means any insurance against legal liability to pay damages on behalf of an insured;

SECTION II: APPLICATION

1. This Agreement applies to any claim in respect of which more than one Insurer who is signatory to this Agreement may be responsible to an insured.

2. This Agreement does not apply to a claim against an automobile insurer pursuant to Uninsured or Underinsured Motorist covers.

3. This Agreement only applies to signatory Insurers.

4. This Agreement is not intended to change the rights or responsibilities of any insurance policy.

5. This Agreement shall not apply to claims for which legal action has been commenced outside of Canada. Signatories affected by such a claim may nevertheless agree to be bound by this Agreement.

SECTION III: DUTIES OF A PRIMARY INSURER

1. A Primary Insurer has a duty in handling claims to act with reasonable care. This duty includes:

   (a) a duty to investigate promptly and diligently any claim in accordance with the terms of its policy;

   (b) a duty to make reasonable efforts to discover and take proper account of all facts relevant to the evaluation of the claim;

   (c) to defend any claim against an insured according to the terms of the primary policy;

   (d) to act prudently in assessing whether a claim should be settled, and where it is decided that it should, to negotiate towards settlement;

   (e) not to tender the primary policy limit to the Excess Insurer without its agreement;

   (f) not to demand contribution from the Excess Insurer to a settlement which will not exceed the primary policy limit;

(g) subject to section VI, to initiate the appeal process for any adverse decision which a reasonably prudent litigant would appeal.

2. Where a claim may exceed a policy limit, the Primary Insurer shall advise the named insured to give notice of the claim to any Excess Insurer which may become liable under the claim.

3. Upon initial notice to a Primary Insurer of the interest of an Excess Insurer, the Primary Insurer, upon written request of the Excess Insurer, will cooperate in providing information for the Excess Insurer to assess its exposure.

4. The Primary Insurer will also share additional information which it obtains which could affect the Excess Insurer's assessment of its exposure.

5. Where a trial judgment is rendered in excess of the primary policy limit, the Primary Insurer shall promptly advise the Excess Insurer.

SECTION IV: DUTIES OF AN EXCESS INSURER

1. To identify itself to the Primary or underlying Excess Insurer, and to notify that insurer of the name of its responsible claims personnel.

2. To independently investigate and assess its exposure, and to share information so acquired with other involved insurers.

3. To conduct itself in a manner so as to avoid delay in reaching settlement, and not to cause the Primary Insurer to incur unreasonable defence costs.

4. Not to demand settlement of a claim within underlying limits.

5. To cooperate with the Primary Insurer to protect the interests of the insured.

SECTION V: CONTRIBUTION

1. Where an Excess Insurer wishes to share in the investigation or defence of a claim, then it may request any or all information obtained by the Primary or underlying Excess Insurer.

2. Where such a request has been made, the Excess Insurer agrees to share equally with the Primary Insurer in the costs of investigation, including adjusting, medical, engineering, actuarial or other technical information, irrespective of the final result of the claim.

1. The Excess Insurer further agrees to share equally with the Primary Insurer in legal costs, such sharing to be adjusted following the final resolution of the claim to its pro-rated share of the indemnity for the claim.

2. The Excess Insurer retains the right to conduct its own investigation.

3. Where there are more than two Insurers participating under this Section, then any equal sharing of costs shall be equal among all participating Insurers.

4. Nothing in this section shall affect the indemnity responsibilities of any Insurer.

SECTION VI: APPEALS

1. The Primary Insurer has the responsibility to advise any known Excess Insurer of an arbitral or judicial decision on a claim which will affect the Excess Insurer.

2. Where one or more but not all participating Insurers wish to appeal an arbitral or judicial determination of the claim, then only those Insurers will be responsible for any costs of taking further action, including any further court awarded interest, and only those Insurers shall share any costs recovered by taking such further action.

3. Responsibility of an Insurer for continuing costs and interest shall end 14 days after written notice to all other involved Insurers of that Insurer's wish to discontinue participation in the appeal.

SECTION VII: ARBITRATION

1. Any dispute under this Agreement shall be resolved by binding arbitration.

2. Arbitration shall be conducted by a panel of three arbitrators selected by the Insurance Bureau of Canada.

3. Arbitration under this section may only be commenced within six months from the date on which the Insurer seeking arbitration had knowledge of the dispute.

4. The arbitration shall be held in such place as the parties to the dispute agree, and failing such agreement, in the City of Toronto, Ontario.

5. The Insurance Bureau of Canada shall present a slate of seven candidates to the parties. Each party shall choose one arbitrator, and the two so chosen shall select a third from the same slate.

6. The selected panel shall discuss with the parties whether arbitration submissions shall be oral, written or both; and any other procedures necessary to the conduct of the arbitration.

7. Costs of the arbitration shall be born equally by the parties unless there is an award of costs made under paragraph 9 below.

8. An arbitration shall be completed within ninety days of the selection of the panel.

9. Costs of the arbitration may be awarded against either party at the discretion of the arbitrators. This does not include counsel fees incurred by either party.

SECTION VIII: SIGNATURE and PARTICIPATION

1. This Agreement binds the insurers* who sign and deliver this signature and participation page to the President of Insurance Bureau of Canada.

    President,
    Insurance Bureau of Canada,
    151 Yonge Street, Suite 1800
    Toronto, Ontario, M5C 2W7

    This Agreement applies to all claims arising from events on or after March 1, 1996.

    Signatures:

    1. Name of Insurer ______________________________

       Authorized Representative ______________________________

    2. Name of Insurer ______________________________

       Authorized Representative ______________________________

    3. Name of Insurer ______________________________

       Authorized Representative ______________________________

    4. Name of Insurer ______________________________

       Authorized Representative ______________________________

    Date ______________________________

- Insurers include all active and former companies amalgamated with or taken over by the insurer signing this agreement. The insurer companies, and not their management companies, are the proper signatories.

Please return to Eve Patterson

SECTION IX: AMENDMENT OF AGREEMENT

1. No amendment to this Agreement shall be made which has not been referred to Claims (national) and Standards and Practices Committees of Insurance Bureau of Canada.

2. In order to amend this Agreement, the proposed amendment must be referred to the Claims (national) and Standards and Practices Committees, and the proposed amendment must receive the written approval of not less than 80% of the signatories. The effective date of an amendment shall be identified as part of the amendment.

3. A proposal for amendment may be made by any three current signatories, or by the Claims (national) and Standards and Practices Committees. A proposal for amendment shall be forwarded to the President of Insurance Bureau of Canada for distribution to all current signatories.

4. Signatories shall indicate their acceptance or rejection of a proposal for amendment in writing in the following form, sent by mail to the President of Insurance Bureau of Canada:

   President,
   Insurance Bureau of Canada,
   151 Yonge Street, Suite 1800
   Toronto, Ontario, M5C 2W7

   Receipt is hereby acknowledged of a copy of a proposal for Amendment Number _____ to the Agreement Between Primary and Excess Liability Insurers Respecting Claims, dated ___________________. The undersigned insurer,

   (a) agrees to adopt the aforesaid amendment [ ]
   (b) does not agree to adopt the aforesaid amendment [ ]

   Signed ____
   (Name of Insurer)

   ____
   (Authorized Representative) Date

SECTION X: WITHDRAWAL OF INDIVIDUAL SIGNATORY[59]

1. Except with the unanimous consent of all other signatories, a signatory hereto shall not withdraw from this Agreement until 60 days after written notice of intent to withdraw has been given by registered mail to the President of Insurance Bureau of Canada. Such withdrawal shall not prejudice or affect any proceeding instituted prior to either receipt by the President of the consent of all other signatories, or expiry of the 60 day notice period referred to above.

Revised Agreement effective March 1, 1996

A

Allianz Insurance Company of Canada (The Nordic Insurance Company of Canada as of April 1, 2006; *part of Intact Financial Corporation*)
Allstate Insurance Company of Canada
Atlantic Insurance Company Limited
Ascentus Insurance Ltd. (*part of RSA Group*)
Aviva Insurance Company of Canada
AXA General Insurance (*Novex Insurance Company as of May 1, 2012; part of Intact Financial Corporation*)
AXA Insurance (Canada) (*part of Intact Financial Corporation*)

C

Canadian Northern Shield Insurance Company (*part of RSA Group*)
The Citadel General Assurance Company (discontinued as of August 21, 2006)
Coachman Insurance Company
Continental Casualty Company (*part of CNA*)
The Co-operators General Insurance Company (*part of the Co-operators Group*)
Coseco Insurance Company (*part of the Co-operators Group*)

D

Dominion of Canada General Insurance Company (*part of Travelers Canada as of November 1, 2013*)

[59] List of signatories current to March 17, 2015; see http://assets.ibc.ca/Documents/Legal/Claims_Agreements/Primary_Excess_Liability_Signatories.pdf.

E

Ecclesiastical Insurance Office plc.
Echelon General Insurance (*part of the Co-operators Group*)
Economical Mutual Insurance Company (*part of The Economical Insurance Group*)
Elite Insurance Company (*part of Aviva Canada*)
Everest Insurance Company of Canada (*signed March 13, 2015*)

F

Federation Insurance Company of Canada (*part of The Economical Insurance Group*)
Federated Insurance Company of Canada (*part of Northbridge Insurance*)

G

General Insurance Corporation of New Brunswick (ceased February 26, 1998)
Grain Insurance and Guarantee Company (Wynward Insurance Group as of May 1, 2013)

H

Hartford Fire Insurance Company

I

Intact Insurance Company (*part of Intact Financial Corporation*)

K

Kent & Essex Mutual Insurance Company

L

Lanark Mutual Insurance Company
Lloyds' Underwriters (*Withdrawn from Agreement effective August 1, 2005*)
Lombard General Insurance Company of Canada (*Northbridge General Insurance Corporation as of October 7, 2011*)
Lombard Insurance Company (*Northbridge Personal Insurance Corporation as of October 7, 2011*)
Lumbermans Mutual Casualty Company (*ceased July 29, 2011*)

M

Mississiquoi Insurance Company (*part of The Economical Mutual Group*)

N

The Nordic Insurance Company Of Canada (*part of Intact Financial Corporation*)

P

Peace Hills General Insurance Company
The Perth Insurance Company (*part of The Economical Insurance Group*)
Pilot Insurance Company (*part of Aviva Canada*)
Primmum Insurance Company (*CT Direct Insurance Company as of March 10, 1998; TD General Insurance Company as of September 1, 2000 ; part of TD Insurance*)

Q

Québec Assurance Company (*part of RSA Group*)

R

Royal & Sun Alliance Insurance Company of Canada (*part of RSA Group*)

S

S & Y Insurance Company (*part of Aviva Canada*)
Saskatchewan Mutual Insurance Company
Scottish & York Insurance Co. Limited (*part of Aviva Canada*)
Security National Insurance Company (*part of TD Insurance*)
Sovereign General Insurance Company (*Withdrew from Agreement effective July 1, 2005*)

T

TD Direct Insurance Inc.
TD General Insurance Company (*part of TD Insurance*)
TD Home and Auto Insurance Company (*part of TD Insurance*)
Thompson General Insurance Inc. (*ceased*)
Tokio Marine & Nichido Fire Insurance Company (*part of Northbridge Insurance*)
Traders General Insurance Company (*part of Aviva Canada*)
Trafalgar Insurance Company of Canada (*part of Intact Financial Corporation*)

W

Waterloo Insurance Company (*part of The Economical Mutual Group*)
The Wawanesa Mutual Insurance Company
Western Assurance Company (*part of RSA Group*)

Z

Zenith Insurance Company (*part of Northbridge Insurance*)