

**BLOGS**

Policyholder

Ninth Circuit Says Excess Insurers Must Participate in Early Settlement Negotiations

Excess insurance plays a vital role in mitigating the risk of large losses, but excess insurers often contend they have no obligations and are entitled to sit on the sidelines of a lawsuit against their policyholder until underlying insurers have fully paid their limits. This position harms policyholders, particularly when settlement of a lawsuit requires contribution from these excess insurers.

While courts universally acknowledge the value of pre-trial resolution and settlement, some jurisdictions have discouraged settlement of large losses by holding that excess insurers have no duty to the policyholder until primary policies have completely exhausted their limits. When excess insurers refuse to come to the settlement table, settlements often fall through, exposing policyholders to high risk verdicts.

Fortunately, some courts do acknowledge that excess insurers have pre-exhaustion obligations. The recent decision by the Ninth Circuit in *Teleflex Med. Inc. v. Nat'l Union Fire Ins. Co.*, 851 F.3d 976 (9th Cir. 2017) is the leading case in holding that excess insurers must participate in settlement negotiations, even prior to exhaustion of underlying layers.

In *Teleflex*, the policyholder agreed to mediate an IP infringement lawsuit early in discovery, but excess insurer National Union refused to attend. The parties reached a proposed settlement, contingent on contributions from National Union. However, National Union refused to consent to the settlement despite the fact that policyholder risked exposure from a verdict well in excess of the underlying carrier's \$1m limit. The policyholder finalized the settlement anyway and proceeded to sue National Union for breach of contract and bad faith for the amount of its settlement contribution, and was successfully awarded over \$6m by the United States District Court for the Southern District of California.

On appeal to the Ninth Circuit, the critical issue raised by National Union was the continued applicability of the so-called "*Diamond Heights* rule," taken from a 1991 California Court of Appeals case. The *Diamond Heights* rule says that where an excess insurer is presented with a proposed settlement of a covered claim approved by policyholder and primary carrier, the excess insurer has three options:

1. approve the proposed settlement;
2. reject the proposed settlement and take over the defense; or
3. reject both proposed settlement and defense, but face a potential lawsuit by the policyholder seeking contribution toward the settlement.

After finding the *Diamond Heights* rule was still good law, the Ninth Circuit rejected National Union's attempts to distinguish that case based on the fact that the *Teleflex* litigation was still in relatively early stages. The Ninth Circuit countered that there are good reasons to settle during discovery rather than on the eve of trial. The Ninth Circuit



proceeded to criticize National Union for months-long “foot-dragging” rather than expediently settling, and ultimately upheld the District Court’s award for breach of contract and bad faith.

Policyholders should take note. While the *Diamond Heights* holding may be decades-old, it takes on new force in light of the *Teleflex* decision. In particular, it clarifies that foot-dragging by an excess carrier, delaying the execution of a proposed settlement, is not appropriate at any stage of litigation. Where a good-faith proposed settlement is on the clock, excess insurers must either approve, agree to defend, or face a potential lawsuit for contribution.