**IN THE SUPERIOR COURT OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY**

THE MILLS LIMITED PARTNERSHIP, and SPG-FCM VENTURES, LLC, as successor to THE MILLS CORPORATION, Plaintiffs,	)	C.A. No.: 09C-11-174 FSS **E-FILED**
v.	)	
LIBERTY MUTUAL INSURANCE COMPANY, Defendant.	)	

Submitted: July 1, 2010
Decided: November 5, 2010

MEMORANDUM OPINION AND ORDER

Upon Plaintiffs' Motion for Partial Summary Judgment – *GRANTED*
Upon Defendant's Motion for Summary Judgment – *DENIED*

SILVERMAN, J.

Although this is a large insurance coverage case, it poses a relatively straightforward legal question about interpreting a directors' and officers' excess liability policy's exhaustion clause. It also presents a threshold choice of law question involving which state has the most significant relationship with a "D&O" policy: the state where corporate headquarters are, or the state of incorporation.

The insured had a layered insurance program covering its directors and officers, a "D&O tower." Due to the directors' and officers' misconduct, it sustained a loss, way above the tower's lower tiers, and the tower itself. In turn, the primary and lower tier excess carriers settled for less than policy limits. When Plaintiffs reached the defendant carrier's coverage level, it refused to pay. Now, the carrier claims that by settling with the lower tier carriers, the insured did not exhaust those policies and, therefore, under its policy's terms the carrier is not obligated. The denial of coverage prompted the insured to file here.

There are two conflicting lines of authority on the coverage question. One holds, in essence, that as long as the actual loss reaches a policy's attachment point, it does not matter how the lower tiers settled. The other requires all lower tiers' exhaustion by full payment before the higher-level policy is triggered. And so, the court must consider which line of authority Delaware follows. As discussed below, this is the second time this court is addressing this question.

More specifically, Plaintiffs are The Mills Limited Partnership, and SPG-FCM Ventures, LLC, as successor to The Mills Corporation, both of which were Delaware entities with principal executive offices in Arlington, Virginia. Defendant, Liberty Mutual, which appears to be headquartered in Georgia, issued Mills an excess liability insurance policy, which is Mills's sixth layer of insurance.

Plaintiffs contend that when they settled with the five underlying insurers, Plaintiffs "functionally exhausted" the underlying policies. Defendant claims that its policy does not attach because settling with the underlying carriers for less than their policy limits means Plaintiffs did not actually exhaust the underlying policies. According to Defendant, full payment by the underlying carriers is expressly required by its policy. That is so, even if, like here, the insured's loss reaches and exceeds Defendant's policy no matter what, and, like here, Defendant offers no reason why it relies on the exhaustion clause except to deny benefits.

The parties have filed cross motions for partial summary judgment. First, the court must decide which state's law controls here, Virginia's or Delaware's. Then, the court must revisit the core question about whether actual exhaustion is a prerequisite to triggering the Liberty Mutual policy.

I.

A. The Policy

On September 6, 2005, Liberty Mutual issued Mills an excess directors' and officers' liability insurance policy, with a policy period from May 27, 2005, to May 27, 2006. The policy period was later extended to November 30, 2006. The Liberty Mutual policy is an excess, following-form policy for $10 million, sitting on top of a primary policy and five excess liability insurance policies, each with a liability limit of $10 million. Thus, the Liberty Mutual policy attaches at $60 million.

As a following-form policy, the Liberty Mutual policy adopts the terms and conditions of the primary policy except where the Liberty Mutual policy says otherwise. Liberty Mutual's policy provides that it "will pay all of loss in excess of both the Underlying Limit of Liability, plus the applicable retention or deductible under the Primary Policy" up to $10 million. The policy also states that it "only provides coverage when the Underlying Limit of Liability is exhausted by reason of the insurers of the Underlying Policies paying or being held liable to pay in legal currency the full amount of the Underlying Limit of Liability as loss." [1]

[1] In pertinent part, the Liberty Mutual policy provides:

> 3. Limit of Liability: The Insurer will pay all of loss in excess of both the Underlying Limit of Liability plus the

B. The D&O Tower

American International Specialty Lines Insurance Company issued the primary policy for May 27, 2005, to May 27, 2006. As mentioned, the primary's limit of liability is $10 million.

Plaintiffs also purchased six excess directors' and officers' liability insurance policies, each with a liability limit of $10 million, that followed the primary policy's form. Nutmeg Insurance Company issued the first excess layer of insurance at $10 million excess of $10 million. Arch Specialty Insurance

> applicable retention or deductible under the Primary Policy, up to the Limit of Liability stated in Item 3 of the Declarations[, $10 million]. The Insurer's maximum liability under this Policy for loss shall be the amount shown in Item 3 of the Declarations. In the event the Limit of Liability stated in Item 3 of the Declarations is exhausted by payment of loss, any and all obligations of the Insurer hereunder shall be deemed to be completely fulfilled and extinguished.
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> 4. Maintenance of Underlying Policies: It is a condition precedent to the coverage afforded under this Policy that the insureds maintain the Underlying Policies with retention/deductibles, participation/co-insurance and limits of liability (subject to reduction or exhaustion as a result of loss payments), as set forth in Items 4.(A) and 4.(B) of the Declarations. Except as provided in paragraph 4.1., this Policy only provides coverage when the Underlying Limit of Liability is exhausted by reason of the insurers of the Underlying Policies paying or being held liable to pay in legal currency the full amount of the Underlying Limit of Liability as loss.

Company issued the second excess layer at $10 million excess of $20 million. Houston Casualty Company issued the third layer at $10 million excess of $30 million. Zurich American Insurance Company issued the fourth layer at $10 million excess of $40 million. Allied World Assurance Company issued the fifth layer at $10 million excess of $50 million. As mentioned, Liberty Mutual issued the sixth layer of insurance at $10 million excess of $60 million. According to Plaintiffs, there is another policy on top of Liberty Mutual's.

C. The Loss

In October 2005, someone blew the whistle. The SEC was informed that Mills was committing massive fraud. In the following months, as the SEC bored-in, Mills began reissuing its financial statements and its stock plummeted.

On January 20, 2006, investors brought four securities class actions against Mills and several former directors and officers.[2] Some defendants were charged with misconduct as both directors and officers. Some were named only as directors. As to the defendant directors/officers, they were charged with using their positions to defraud investors in various ways, mostly by lying about Mills's financial picture. As to the directors-only, they were charged with signing fraudulent federal securities filings.

[2] *See In re The Mills Corp. Sec. Litig.*, 265 F.R.D. 246 (E.D. Va. 2009).

In August 2006, Mills announced that it was issuing a restatement slashing its income and value by hundreds of millions of dollars, and increasing a key project's budget by $800 million. In the process, Mills also admitted massive fraudulent overstatements of income, shareholders' equity and partners' capital for twenty-three consecutive quarters.

The class actions were consolidated in July 2007. In November 2008, through mediation, Mills settled for $165 million. Its total loss was around $190 million. The settlement was approved by the United State District Court for the Eastern District of Virginia on December 23, 2009. [3]

Meanwhile, the suits and demands were tendered to and accepted by the insurers under the primary and excess policies, including Liberty Mutual's, as claims made within the policy period. In April 2008, Liberty Mutual denied coverage, asserting that Plaintiffs materially misrepresented themselves in warranty statements. As mentioned, in December 2009, the litigation ended with Mills having suffered a $190 million loss.

Plaintiffs then settled all coverage disputes with the primary and excess carriers below Defendant, receiving approximately eighty-two percent of the total liability limits of the underlying excess policies. Again, despite the record's size,

[3] *Id.*

the court does not know why Mills settled with the lower tier carriers for less than policy limits. Liberty Mutual suggests in conclusory fashion and without elaborating, "Plaintiffs entered into its settlements with the underlying excess insurers to avoid the risk of an adverse judgment in litigation[.] . . ."

To be clear for present purposes: Even if the underlying carriers had paid their policies' limits, Defendant's attachment point and coverage would have been exceeded. Moreover, as discussed in Section IV, Liberty Mutual does not explain how the underlying settlements were prejudicial to Liberty Mutual. Notions of collateral estoppel might be involved, but the parties are satisfied with the record and that is not part of it. Liberty Mutual says its policy is clear, and on that it stands.

D. Location

The parties agree that during the time on-risk, Mills was headquartered in Virginia. Despite expansive briefing, however, the parties have not told the court where the insured officers and directors were based, nor where their misconduct occurred. For example, the court knows neither where the Board met nor where the directors were when they signed the actionable federal securities filings. Presumably, the filings were made in the District of Columbia, which means that wherever the scheme was fabricated the lies were first told in Washington.

It appears that Mills, a REIT, developed, owned and managed a diversified international portfolio of real estate properties. For example, the unfinished project that was then $800 million over budget, mentioned above, is in New Jersey. (Perhaps with poetic irony, it was called "Xanadu.")

Furthermore, the court infers that at least two defendants who signed registration statements and did other challenged acts were German nationals, with direct ties to Frankfurt. Mills had a large joint venture with a German group. Along with the officer/director and director-only defendants, Mills's accountants and underwriters, who also were named for their parts in the fraud, were mostly New York-based. One underwriter appears to have been based in Minnesota.

Otherwise, the lead plaintiffs in the securities litigation were institutional investors and individuals located throughout the United States. Presumably, they were defrauded all over the country, or at least in New York, where Mills was publicly traded on the NYSE. As discussed next, these facts potentially have a bearing on where the insured risk was located, and that relates to whether Virginia's or Delaware's insurance law controls this case.

II.

The parties agree that one or the other, either Virginia's or Delaware's law, governs whether Mills was contractually required to exhaust the underlying insurance layers fully, or whether it could settle with each underlying carrier for less than the full coverage amount and still trigger Defendant's policy. Mills relies on Delaware's law as Delaware was Mills's place of incorporation, while Liberty Mutual relies on Virginia's law because Virginia was where Mills was headquartered.

The court will apply Delaware law. As discussed below, there is no conflict between Virginia and Delaware law. Further, the parties probably expected Delaware law would apply. Alternatively, Delaware has the most significant relationship to the insured risk – the misconduct of Mills's officers and directors.

A. No Conflict of Law

A court has to first "compare the laws of the competing jurisdictions to determine whether the laws actually conflict."[4] If applying Delaware's and Virginia's laws would produce different results, a "true conflict" exists, and the

[4] *Penn. Employee, Benefit Trust Fund v. Zeneca, Inc.*, 710 F.Supp.2d 458, 466 (D. Del. 2010) (predicting Delaware courts, like other state and federal courts, would require an actual conflict exist before engaging in a complete conflict of laws analysis).

court then conducts a choice of law analysis.[5] But, "if the laws would produce the same decision . . . there is no real conflict and a choice of law analysis would be superfluous."[6] Thus, a conflict of laws analysis begins with two laws. Here, however, Liberty Mutual has neither presented a competing law nor explained why Virginia would reject Delaware's law.

Liberty Mutual acknowledges that Virginia has not decided which approach to exhaustion clauses Virginia would follow. So, Liberty Mutual asks the court to predict that Virginia will reject Delaware's approach. Then, Liberty Mutual expects this court to follow that approach, rather than Delaware's. As discussed in Section III, because Delaware's approach to exhaustion clauses is in the mainstream and correct, this court holds that Virginia would adopt the same approach.

B. Parties' Expectations

A fundamental policy of contract law is protecting the parties'

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[5] *Travelers Indem. Co. v. Lake*, 594 A.2d 38, 46-7 (Del. 1991).

[6] *Great Am. Opportunities, Inc. v. Cherrydale Fundraising, LLC*, 2010 WL 338219 at *8 (Del. Ch. Jan. 29, 2010) (Parsons, V.C.). *But see Am. States Ins. Co. v. Mankato Iron & Metal, Inc.*, 848 F.Supp 1436, 1443 (D. Minn. 1993) (holding a federal court sitting in diversity has to determine the state law by conducting a choice of law analysis) *citing Potomac Elec. Power Co. v. Hartford Fire Ins. Co.*, 777 F.Supp. 968, 972 (D.D.C. 1991).

expectations.[7] Here, the policy does not specifically address the law governing litigation under the policy. Thus, the policy might be found ambiguous as to choice of law.[8] Of course, if that is so and there is no extrinsic evidence as to the parties' intent, *contra preferentum* favors the non-drafting party, Mills's choice of law.[9]

There is, however, further reason to find that the parties expected Delaware law to apply here. The primary insurance policy, which Liberty Mutual followed, provided that "all disputes or differences which may arise under or in connection with this policy . . . shall be submitted to the alternate dispute resolution process ("ADR") set forth in this clause." ADR may be commenced in Georgia, Illinois, New York, Colorado, or Virginia, but "arbitrators shall . . . give due consideration to the general principles of the law of the state" where Plaintiffs are incorporated.

Plaintiffs contend, therefore, that the mandatory alternate dispute

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[7] Restatement (Second) of Conflict of Laws § 188 (1971) ("Protection of the justified expectations of the parties is the basic policy underlying the field of contracts.").

[8] *See e.g. Cincinnati SMSA Ltd. P'ship v. Cincinnati Bell Cellular Sys. Co.*, 708 A.2d 989, 992 (Del. 1998) (noting "In cases where obligations can be understood from the text of a written agreement but have nevertheless been omitted in the literal sense, a court's inquiry should focus on 'what the parties likely would have done if they had considered the issue involved.") *citing E.I. DuPont de Nemours and Co. v. Pressman*, 679 A.2d 436, 443 (Del. 1996).

[9] *See Viking Pump, Inc. v. Century Indem. Co*, 2 A.3d 76, 90 (Del. Ch. 2009); *see also Winn v. Aleda Constr. Co.*, 315 S.E.2d 193, 195 (Va. 1984).

resolution clause adopted by Liberty Mutual, which in effect chooses Delaware law, implies that the parties expected Delaware law to apply to coverage disputes. It can be argued that the policies' silence on which law governs actual litigation favors Virginia law by negative implication. Nonetheless, the policy affirmatively chooses Delaware law for arbitration, even if ADR could not have been commenced in Delaware. The distinction drawn by Liberty Mutual between ADR and litigation lacks substance. Thus, based on the contract and the absence of extrinsic evidence to the contrary, it appears that the parties probably expected Delaware law to apply.

C. Choice of Law

In a choice of law analysis, "Delaware has adopted the Restatement's 'most significant relationship test' for determining which state's law to apply."[10] For insurance contracts, "disputes are resolved by an analysis of the contacts set forth in Restatement (Second) Conflict of Laws Section 188 and Section 193."[11] The analysis is an "issue-by-issue approach to determining choice of law." [12]

Section 193 favors "the local law of the state which the parties

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[10] *Liggett Group, Inc. v. Affiliated FM Ins. Co.*, 788 A.2d 134, 137 (Del. Super. 2001).

[11] *Id.*

[12] *Id. citing* Restatement (Second) of Conflict of Laws § 188 (1971).

understood was to be the principle location of the insured risk[.]" [13] But, when another state "has a more significant relationship under the principles stated in §6[,]" the court should apply that state's law. [14] Comment *b* explains: "And where the honesty and the fidelity of a particular person is the subject of the insurance, the parties will usually know beforehand where he will spend most of his time during the life of the policy."[15]

So, to the extent it suggests that headquarters is the location of the risk covered by D&O insurance, the Restatement relies superficially on quaint presumptions.[16] When Comment *b* was adopted forty years ago, it probably was safe to assume that men ran their businesses from their desks and that is where everyone expected them to be insured.

Comment *b* does recognize:

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[13] Restatement (Second) of Conflict of Laws § 193 (1971).

[14] *Id.*

[15] *Id.*

[16] *See In re Enron Corp. Sec., Derivative & "ERISA" Litig.,* 391 F. Supp. 2d 541, 585 (S.D. Tex. 2005) (applying the law where headquarters was when the policy "insures the honesty and fidelity of employees at a particular place of business"), citing Restatement (Second) of Conflict of Laws §193 cmt. *b-c* (1971).

> The location of the insured risk will be given greater weight than any other single contact in determining the state of the applicable law provided that the risk can be located, at least principally, in a single state. Situations where this cannot be done, and where the location of the risk has less significance, include (1) where the insured object will be more or less constantly on the move from state to state during the term of the policy and (2) where the policy covers a group of risks that are scattered throughout two or more states. [17]

In a case like this, where the insured risk is the conduct of directors and officers located in states throughout the world, Comment *b* and § 193 itself, are less pertinent than § 188. Section 188(2) provides several contacts to consider when the parties omit a choice of law provision. Those contacts include:

> (a) the place of contracting,
> (b) the place of negotiation of the contract,
> (c) the place of performance,
> (d) the location of the subject matter of the contract, and
> (e) the domicil, residence, nationality, place of incorporation and place of business of the parties.

"These contacts are to be evaluated according to their relative importance with respect to the particular issue."[18] This means "that such importance may attach to

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[17] Restatement (Second) of Conflict of Laws §193 cmt. *b* (1971).

[18] *Id.*

one or more of the contacts . . . to make the contact[] especially determinative of the outcome of the choice of law issue under § 188(2).”[19]

These contacts are considered in light of the principles set out in § 6(2) including:

> (a) the needs of the interstate and international systems,
> (b) the relevant policies of the forum,
> (c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue,
> (d) the protection of justified expectations,
> (e) the basic policies underlying the particular field of law,
> (f) certainty, predictability and uniformity of result, and
> (g) ease in the determination and application of the law to be applied.[20]

When the insured risk is the directors' and officers' "honesty and fidelity" to the corporation, and the choice of law is between headquarters or the state of incorporation, the state of incorporation has the most significant relationship. Liberty Mutual's argument that "the only connection . . . is that

[19] *Nat'l Acceptance Co. of Cal. v. Hurm*, 1989 WL 70953 at *3 (Del. Super. June 16, 1989) (Gebelein, J.).

[20] Restatement (Second) of Conflict of Laws § 6(2) (1971).

Plaintiffs are . . . Delaware corporations" minimizes the importance of that connection. Calling it the *only* connection begs the question of the state of incorporation's importance in this situation.

First, Liberty Mutual insured Mills's directors and officer under Delaware law.[21] Second, Delaware's law ultimately determines whether a director or officer of a Delaware corporation has misbehaved *vis a vis* the corporation, its shareholders, and its investors.[22] Again, this is not a products liability, consumer fraud, or embezzlement situation. When the conduct of a corporation's directors and officers is centrally implicated, the place of incorporation is important.

Although Virginia also allows its corporations to insure themselves and their directors and officers, Virginia has, at best, an indirect interest in whether Delaware corporations insure their directors and officers. Again, the point is that Liberty Mutual insured Mills's directors and officers under Delaware law. Those directors and officers caused a Delaware corporation to defraud its investors, which

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[21] 8 *Del. C.* § 145(g).

[22] *See e.g. Malone v. Brincat*, 722 A.2d 5, 9 (Del. 1998) (holding that "directors who knowingly disseminate false information that results in corporate injury or damage to an individual stockholder violate their fiduciary duty, and may be held accountable in a manner appropriate to the circumstances").

made the corporation liable and triggered the corporation's D&O policy. In a case like this, what difference does headquarters' location make to the company or the people involved?

III.

Mills correctly contends that "the majority of courts, including courts applying Delaware law, hold that settlement with an underlying carrier functionally exhausts that carrier's coverage." Mills primarily relies on *Zeig v. Massachusetts Bonding & Insurance Co.*,[23] *Stargatt v. Fidelity & Casualty of New York*,[24] and *HLTH Corp. v. Agricultural Excess & Surplus Insurance Co.*[25] Mills concludes that "[t]he majority rule, strictly followed by courts applying Delaware law for more than 30 years, requires that Liberty's interpretation of the Policy's exhaustion provision be rejected."

Mills also asserts that "Delaware has a clear public policy favoring settlements[,]" and that "[e]ven if the Liberty exhaustion provision could bar

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[23] 23 F.2d 665 (2d Cir. 1928).

[24] 67 F.R.D. 689 (D. Del. 1975), *aff'd*, 578 F.2d 1375 (3d Cir. 1978).

[25] 2008 WL 3413327 (Del. Super. July 31, 2008) (Cooch, J.).

coverage based on settlements with underlying carriers, Liberty may not rely on this provision in this case, since it has repudiated the insurance contract by wrongfully denying coverage on other grounds." "In the alternative, Plaintiffs contend that Liberty Mutual's exhaustion provision is ambiguous and must be construed in favor of coverage."

Defendant contends that "[t]he lower excess carriers' failure to pay their full policy limits bars Plaintiffs' claims against Liberty Mutual in this action." Defendant asserts that "because the Liberty Mutual Excess Policy requires full exhaustion of the underlying insurance as a condition precedent to coverage, the fact that the underlying insurers have not paid their full limits, precludes coverage under the Liberty Mutual Excess Policy." Defendant claims that Plaintiffs "could have bargained for a contract under which Liberty Mutual agreed to pay liabilities over $60 million, even if the underlying excess carriers did not actually pay the entire settlement." Defendant further contends that "[a]s written, however, the . . . Policy only provides for coverage when the Underlying Limit of Liability is exhausted by reason of the insurers of the Underlying Policies paying or being held liable to pay in legal currency the full amount of the Underlying Limit of Liability as loss."

Defendant further asserts that,

> *Zeig* does not hold as a general proposition that exhaustion of the underlying coverage is not required in order to trigger the excess policies, but rather, the decision in *Zeig* was based upon a perceived ambiguity in the specific policy language before the court.

Defendant also contends that "[p]utting aside for the moment that *HLTH* is an unreported decision . . . and, as such, is not binding upon this Court, Liberty Mutual respectfully submits that *HLTH* was wrongly decided." Defendant claims that "[b]ecause the Liberty Mutual Excess Policy's exhaustion provision clearly and unambiguously provides that coverage thereunder is not triggered unless and until the full limits of the underlying insurance have been exhausted by actual payment by the underlying insurers in connection with claims, the Policy language should be enforced as written[.]"

Finally, Defendant asserts that "[l]eading cases across the country require that underlying policies' limits of liability be exhausted before excess insurers are liable under their higher level excess policies." These "leading cases" are an unreported Illinois case,[26] an Indiana case that was vacated and remanded,[27]

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[26]*Premcor USA, Inc. v. Am. Home Assurance Co.*, 2004 WL 1152847 (N.D. Ill. May 21, 2004), *aff'd*, 400 F.3d 523 (7th Cir. 2005).

[27]*Ind. Gas Co., Inc. v. Aetna Cas. & Sur. Co.*, 951 F. Supp. 811 (N.D. Ind. 1996), *remanded and vacated*, 141 F.3d 314 (7th Cir. 1998).

and a Missouri case.[28] Defendant also relies on *Comerica Inc. v. Zurich American Insurance Co.*,[29] and *Qualcomm, Inc. v. Certain Underwriters At Lloyd's, London*,[30] cases that this court has explicitly declined to follow. [31]

In *Zeig*, plaintiff was required to exhaust three policies totaling $15,000 before the insured could collect from defendant, the fourth insurance company in line.[32] Plaintiff settled his claims with the three underlying insurance companies for $6,000, instead of collecting the full $15,000. Much like Liberty Mutual here, the "defendant argue[d] that it was necessary for the plaintiff actually to collect the full amount of the policies for $15,000, in order to 'exhaust' that insurance[,]" *Zeig* held that "[s]uch a construction of the policy sued on seems unnecessarily stringent." [33] *Zeig* held:

> [D]efendant had no rational interest in whether the insured collected the full amount of the primary policies,

[28]*Wright v. Newman*, 598 F. Supp. 1178 (D.C. Mo. 1984), *aff'd*, 767 F.2d 460 (8th Cir. 1985).

[29]498 F. Supp. 2d 1019 (E.D. Mich. 2007).

[30]73 Cal. Rptr. 3d 770 (Cal. Ct. App. 2008).

[31]*HLTH Corp.*, 2008 WL 3413327, at *15.

[32]*Zeig*, 23 F.2d at 665 (Defendant's policy was issued "[a]s excess and not contributing insurance, and shall apply and cover only after all other insurance herein referred to shall have been exhausted in the payment of claims to the full amount of the expressed limits of such other insurance.").

[33]*Id.* at 666.

> so long as it was only called upon to pay such portion of the loss as was in excess of the limits of those policies. To require an absolute collection of the primary insurance to its full limit would in many, if not most, cases involve delay, promote litigation, and prevent an adjustment of disputes which is both convenient and commendable. A result harmful to the insured, and of no rational advantage to the insurer, ought only to be reached when the terms of the contract demand it.
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> We can see no reason for a construction so burdensome to the insured. Nothing is said about the 'collection' of the full amount of the primary insurance. The clause provides only that it be 'exhausted in the payment of claims to the full amount of the expressed limits.' The claims are paid to the full amount of the policies, if they are settled and discharged, and the primary insurance is thereby exhausted. . . . Only such portion of the loss as exceeded, not the cash settlement, but the limits of these policies, is covered by the excess policy.
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> . . . .
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> The plaintiff should have been allowed to prove the amount of his loss, and, if that loss was greater than the amount of the expressed limits of the primary insurance, he was entitled to recover the excess to the extent of the policy in suit.[34]

In *Stargatt*, the District Court for the District of Delaware analyzed the same issue: "whether the benefits of an excess insurance policy are collectible when claims equal to the limits of the primary policy have been settled, or only when the

[34]*Id.*

primary policy limits have actually been paid."[35] Observing that "[n]either of the parties, nor the Court, has found any Delaware authority" on the issue, *Stargatt* adopted *Zeig*'s reasoning and the federal court was "confident that the Delaware courts would reach the same result. . . ."[36] *Stargatt*'s confidence was justified.

In *HLTH Corp.*, the insurance policy provided:

> Only in the event of exhaustion of the Underlying Limit by reason of the insurers of the Underlying Insurance . . .paying in legal currency loss which, except for the amount thereof, would have been covered hereunder, this policy shall continue in force as primary insurance, subject to its terms and conditions and any retention applicable to the Primary Policy, which retention shall be applied to any subsequent loss in the same manner as specified in the Primary Policy.[37]

HLTH held that "the decisions in . . . Delaware are clear on the issue of exhaustion of underlying limits' position, i.e., that Defendants' liability is completely unchanged whether Plaintiffs have received all of the underlying payments or not."[38]

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[35] *Stargatt*, 67 F.R.D. at 690 (Defendant's insurance policy provided: "The Insurers shall not be liable to indemnify the Assured hereunder to any greater extent than $750,000 . . ., and then only when the Primary Policy in the amount of $250,000 . . . has been exhausted.").

[36] *Id.* at 691.

[37] *HLTH Corp.*, 2008 WL 3413327, at *4.

[38] *Id.* at *15; *see also Tenneco Auto. Inc. v. El Paso Corp.*, 2001 WL 1641744, at *9-10 (Del. Ch. Nov. 29, 2001) (rejecting the argument that policyholder could not settle its claims with its insurer for less than its policy limit as "inconsistent with our general policies favoring and

Furthermore, *HLTH* "decline[d] to accept the reasoning set forth in *Qualcomm, Inc. v. Certain Underwriters at Lloyd's, London*, 2008 WL 736483 (Cal. App. Mar. 25, 2008) or in *Comerica Inc. v. Zurich American Insurance Co.*, 498 F. Supp. 2d 1019 (E.D. Mich. 2007)."[39] *HLTH* held that "the opinions in both of these cases are contrary to that of *Zeig* and its progeny, including *Stargatt*, and are therefore contrary to the established case law of . . . Delaware." [40]

Here, the court will follow *Zeig, Stargatt, HLTH Corp.,* and *Zeig*'s other progeny. Liberty Mutual's policy is substantially similar to the *HLTH* policy. As set-out above, the Liberty Mutual policy provides that Defendant is responsible for paying "all of loss in excess of both the Underlying Limit of Liability plus the applicable retention or deductible under the Primary Policy, up to the Limit of Liability[,]" which is $10 million. The policy also states that it "only provides coverage when the Underlying Limit of Liability is exhausted by reason of the insurers of the Underlying Policies paying or being held liable to pay in legal currency the full amount of the Underlying Limit of Liability as loss."

The federal court's approval of the $190 million settlement in effect,

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encouraging settlement[]"); *Westinghouse Elec. Corp. v. Am. Home Assurance Co.*, 2004 WL 1878764 (N.J. Super. Ct. July 8, 2004).

[39] *Id.*

[40] *Id.*

if not for purposes of *res judicata*, then for *Zeig's* purposes, held the underlying insurers liable to pay the full amount of their liability. That triggered the insurance policies. The fact that the amount that the insured collected was less than the full amount of liability does not offend the Liberty Mutual policy.

Most importantly, echoing *Zeig*, there is no business reason offered to explain why it should make a difference to Liberty Mutual if Mills settled with the underlying carriers, so long as the Liberty Mutual policy was going to be reached even if Mills had collected every cent under its underlying policies. Presumably, like the underlying carriers did, Liberty Mutual will now ask Mills to compromise its claim, and Liberty Mutual will be relieved that Mills does not have to insist on full payment by Liberty Mutual for fear of sacrificing its claim against the next excess carrier. Anyway, the court holds that Mills's settling with the underlying insurance companies, under the circumstances presented, exhausted the underlying policies as a matter of law. [41]

IV.

The parties have not specifically argued it and the court will not dwell on it, but there is another, slightly different way to look at the coverage question.

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[41] *See id.*

The alternative view bears mention, perhaps, because *Zeig* hints at it and it underscores *Zeig*'s point.

Had Mills asked Liberty Mutual for consent to settle with the lower tier carriers, Liberty Mutual has not offered a reason to justify refusing. Thus, although its facts are distinguishable, *Dunlap v. State Farm Fire & Casualty Co.'s*[42] reasoning would apply. Under *Dunlap*, an insurance company has a duty of good faith and fair dealing to its insured. *Dunlap* holds that "an insurer may not rely on an exhaustion provision absent a realistic risk of prejudice." [43]

Liberty Mutual contends that it "possesses a strong rational interest in requiring that the underlying limits of liability be exhausted before the Liberty Mutual excess policy is triggered." Liberty Mutual asserts:

> By requiring that all underlying insurance be exhausted through actual payments by the underlying insurers, Liberty Mutual should have been entitled to rely on the underlying insurers to raise and, *if necessary*, expend effort and expense to litigate all appropriate coverage issues and defenses. (Emphasis added).

Liberty Mutual had a full opportunity to demonstrate how the underlying settlements could reasonably be viewed as a problem for Liberty Mutual. Liberty

[42]878 A.2d 434, 445 (Del. 2005).

[43]*Id.* at 445.

Mutual, however, does not identify an expense to which the underlying settlements have actually put Liberty Mutual, or a coverage issue or defense that an underlying carrier might have used to reduce Liberty Mutual's exposure, even as to defense costs. Thus, Liberty Mutual's justification for relying on the exhaustion clause is hollow. It is unsupported by the record, even when viewed in the light most favorable to Liberty Mutual.

This dispute arises out of a business deal controlled by a contract and basic notions of good faith, fair dealing and reasonableness. The court is not interested in scrutinizing a business deal in a vacuum simply to vindicate a theoretical right, as if this coverage question were a game of "Gotcha." If Liberty Mutual had offered a real business reason why actual exhaustion was in Liberty Mutual's interest, that would be one thing: Liberty Mutual is entitled to every legitimate benefit of its bargain. It appears here, however, the insurance company is only relying on the exhaustion clause because it could defeat coverage, thereby allowing the insurance company to avoid paying benefits that it otherwise owes to its customer for a covered loss.

V.

For the foregoing reasons, Plaintiffs' Motion for Partial Summary Judgment is **GRANTED**, and Defendant's Motion for Partial Summary Judgment is **DENIED**.

IT IS SO ORDERED.

/s/ Fred S. Silverman
Judge

cc: Prothonotary (Civil)
Kathleen A. Murphy, Esquire
Brian L. Kasprzak, Esquire