Exhaustion Requirements in the Context of True Excess Coverage and Coincidental Excess Coverage

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There are two basic types of excess insurance policies. “True” excess insurance policies and “coincidental” or “other insurance” excess insurance policies. A true excess policy exists when a single insured has two policies covering the same loss but one policy (the primary policy) is written with the clear expectation that the primary policy will defend the claim and indemnify the insured until its policy limits are exhausted. A coincidental excess policy exists when there is more than one primary policy covering the same loss but, based on the terms of the policies’ other insurance clauses, one policy is to be treated as excess.

True excess policies typically provide that coverage is not available unless and until the limits of the underlying primary policy have been “exhausted.” More often than not, the term “exhausted” is not defined in the policy. Therefore, courts are frequently called upon to answer the following question: if the underlying primary insurer settles a claim for less than its policy limits and less than the total amount of the loss, have the primary policy limits been “exhausted,” thereby requiring the excess insurer to indemnify the insured for the remainder of the loss? In answering this question, the vast majority of jurisdictions, including Michigan, have held that although the settlement with the primary insurer may “exhaust” the primary coverage thereby triggering coverage under the excess policy, the excess insurer is only obligated to pay that portion of the loss that exceeds the underlying primary policy limits.

The question of whether a primary policy has been “exhausted” in the context of a coincidental excess policy is different from the exhaustion requirements associated with a true excess policy. Pursuant to Michigan law, there are three tiers of coverage: (1) primary; (2) coincidental excess; and (3) true excess or umbrella. Coverage in each tier must be exhausted before the next tier of coverage is triggered. Thus, the coverage in the first tier (the primary policy) must be exhausted before coverage under the coincidental excess policy will apply. Likewise, coverage in the second tier (the coincidental excess policy) must be exhausted before the coverage under the true excess policy is triggered. This is true even if the true excess policy is excess to the primary policy.