

By Robert J. Prah, CPCU

NEW COMMERCIAL UMBRELLA PROGRAM

A unique, standard umbrella and excess liability coverage for commercial accounts is now available

Until recently, commercial umbrella liability insurance was classified as a specialty or nonstandard line. That has changed with the introduction of AAIS's new commercial umbrella/excess liability coverage program. This program offers the first standard commercial form and manual for providing excess and umbrella liability coverage, taking its place among two other umbrella programs developed by AAIS, the farm umbrella and personal umbrella programs.

Advisory organizations such as AAIS ordinarily have not offered umbrella products in the past, as this was traditionally the domain of reinsurers. Reinsurers play an influential role in the overall implementation of a commercial umbrella liability program. Reinsurers, however, are also interested in a standardized product with all the necessary state amendments and filing actions to which they can direct their clients. The AAIS program offers companies a product that is standardized from state to state. Forms and endorsements have been filed (in states that require filing) and approved by regulators. The manual is offered as a prototype.

Key advantages of the AAIS umbrella policy include:

- distinct provisions for excess and umbrella liability coverages
- an excess follow form feature that allows it to be used over underlying *claims-made* or *occurrence* forms
- an umbrella feature that provides drop-down coverage
- the flexibility of having a large number of optional endorsements available to tailor coverage to the particular needs of an insured

It also may be the most cost-effective alternative available to insurers.

With premium growth generally flat for several years now, writing an umbrella policy on top of existing business gives companies (and agents) an opportunity to produce additional premium, as well as meet a serious exposure facing many commercial accounts. In addition,

offering a commercial umbrella can help retain profitable accounts that otherwise might look elsewhere for this coverage and, in the process, move their primary insurance to a competitor.

The need for umbrella/excess protection

It comes as no surprise to experienced insurance practitioners that the nature and extent of lawsuits, and the media attention that often follows, are key factors in the increasing need for commercial umbrella liability insurance. Expressed simply, an aggressive civil justice system and the litigious nature of American society, which often result in staggering liability awards, compel businesses to purchase additional liability protection, often in the form of an excess or umbrella policy. Multi-million dollar verdicts, virtually unheard of years ago, are commonplace today.

Whether it involves a grain elevator explosion with severe burn injuries (Ohio), a mislabeled contaminant that was mistakenly used as a feed supplement, resulting in the destruction of thousands of livestock (Michigan), or a truck accident resulting in several fatalities (Florida), commercial insureds need to consider umbrella/excess coverage to protect their businesses against catastrophic liability claims.

Recall also that not long ago a fatal auto accident in Washington state caused a fire that burned 200,000 acres of land, destroyed buildings and at least a dozen homes in its path, and was finally extinguished only a few miles from one of the largest nuclear waste facilities in the United States. Consider the claims generated from that one auto accident!

Bear in mind that commercial liability (CGL) policies contain an *aggregate limit* provision, meaning that once the limit is exhausted by the payment of claims, no coverage remains under the policy. This is an additional factor

The AAIS commercial umbrella/excess liability policy can be written over any underlying commercial liability or businessowners policy, AAIS or non-AAIS.

Excess and umbrella coverage under the AAIS Commercial Umbrella/Excess Liability form

Exposure	Underlying coverage	Coverage E (excess)	Coverage U (umbrella)
Auto liability	Commercial auto policy	Triggered by claims in excess of required underlying limits*	Excluded
Premises and operations	CGL policy	Triggered ...	"Drops down" to cover losses not addressed and not excluded in the CGL
Products and completed works	CGL policy	Triggered ...	"Drops down" ...
Contractual liability	CGL policy	Triggered ...	Excluded, with an exception for BI/PD liability assumed under an insured contract
Professional liability	Provided by separate form or CGL endorsement	Triggered ...	Excluded
Aircraft/watercraft	Separate policy	Triggered ...	Excluded
Employment practices liability	Provided by separate form or CGL endorsement	Triggered ...	Excluded
Employers liability	Employers liability policy	Triggered ...	Excluded
Employee benefits liability	Provided by endorsement	Triggered ...	Excluded, because it is not BI, PD, PI, or AI
Workers Compensation	Workers Compensation Policy	Excluded	Excluded

*Excess coverage is provided only if an applicable underlying policy is in force and declared on the schedule of underlying insurance. If the underlying limit is less than the required limits stated on the dec page, the insured will have a coverage gap for the difference between the required limit and the limit in force. If the insured is required to have a \$500,000 per-accident auto limit but has only \$300,000 in coverage, Coverage E will pay amounts in excess of \$500,000 but the insured is responsible for the \$200,000 shortfall.

contributing to the need for commercial umbrella/excess liability insurance.

In response, AAIS has introduced the first standard program for writing umbrella and excess liability coverage for commercial accounts. An *excess* policy provides coverage on the same terms, but at higher limits than underlying policies. An *umbrella* policy provides coverage that "drops down" to respond to claims not covered by underlying insurance that are not expressly excluded in the umbrella form. The AAIS approach includes both an excess coverage provision, Coverage E, and an umbrella coverage provision, Coverage U.

Coverage E applies only to losses covered by primary policies that are identified on a "schedule of underlying insurance." Coverage E applies only after losses covered by underlying policies exceed the required limits entered on the schedule. If no primary or underlying insurance is in effect for a particular exposure (such as aircraft or watercraft), there is no coverage under Coverage E.

Coverage U provides drop-down coverage above a "retained limit" or other insurance for premises/operations and products/completed work claims that are not insured or are excluded by the scheduled underlying commercial liability policy. The auto, watercraft, and professional liability exposures are all expressly excluded under Coverage U.

The AAIS Commercial Umbrella/Excess Liability Program offers a base policy with 35 endorsements filed countrywide on an advisory basis, along with sample rules and rating information.

It is important to emphasize that the policy can be written over *any* underlying commercial liability or businessowners policy, AAIS or non-AAIS.

Purpose of an umbrella policy

Umbrella forms are designed to protect the insured against large or catastrophic liability claims that can cause severe financial difficulties or bankruptcy. Traditionally, an

umbrella policy functions in three ways to meet this purpose.

1. Excess of limits coverage: provides coverage for damages and defense costs that exceed the each-occurrence limit of the underlying insurance.

2. Drop-down coverage: applies in situations that are not covered by the underlying policy, but are not expressly excluded in the umbrella policy, e.g., unanticipated or unforeseen exposures that still come within the scope of the umbrella insuring agreement and are not subject to any exclusions.

This coverage is subject to a self-insured retention (SIR), also referred to as a retained limit, a provision that functions much like a deductible. The insured retains, or is personally responsible for, losses up to this self-insured retention. (The retained limit applies only in this kind of situation, not in cases where the umbrella policy applies in excess of the underlying limits as described in 1. above.)

3. The umbrella/excess policy also applies to claims where the

applicable aggregate limit of the underlying commercial liability policy has been exhausted by payment of claims. For example, there may be only a few thousand dollars left in an underlying policy's aggregate limit when a fairly small claim occurs and exhausts that limit. In such situations, the umbrella/excess policy will pick up where the underlying policy leaves off.

Basic coverages—Form UM 0200

The terms of Coverage E are governed by the coverages, terms, definitions, conditions, and exclusions of underlying insurance, with few exceptions. As a result, it can be said that Coverage E "follows the form" of scheduled underlying policies. This means that Coverage E will always provide coverage at least as broad as any of the underlying policies, unless the loss is excluded by one of the Coverage E exclusions or by endorsement. Coverage E may be used to provide excess liability coverage over commercial liability, commercial auto liability, employers liability, watercraft liability, professional liability, or other miscellaneous liability policy forms.

The excess follow-form features of Coverage E allow it to be used over underlying claims-made coverages or policies as well. Certain underlying coverages, such as employee benefits liability and employment practices liability, are generally written on a claims-made basis. The follow form trigger in Coverage E allows this form to be used to provide excess insurance above these claims-made coverages.

Coverage U (umbrella) provides drop-down coverage over a self-insured retention where there is no underlying insurance, or over other insurance that is available to an insured but not scheduled as underlying insurance.

Coverage U responds on an occurrence basis to claims for bodily injury, property damage, personal injury, and advertising injury. Unlike Coverage E, the coverages, terms, conditions, etc., with respect to Coverage U are contained in the Commercial Umbrella/Excess Liability Coverage Form itself. Note also that Coverage U provides no auto liability coverage.

Defense coverage

The defense coverage provisions apply to defending claims and suits under both Coverage E and

Coverage U. The defense provision states up front that defense costs are payable *in addition to* the policy limit.

The umbrella/excess insurer has the option of participating with the insured or underlying insurer in the defense or handling of claims or suits under Coverage E when it believes the underlying policy limits may be exhausted.

Exclusions/conditions

The exclusions are divided into two sections: Coverage E exclusions and Coverage U exclusions. The Coverage E exclusions eliminate coverage for claims not covered by underlying insurance, ERISA liability, workers compensation benefits, vehicles used in racing or stunting activities, pollution, and medical payments.

Regardless of the terms of underlying insurance, the umbrella/excess policy does not provide automobile no-fault, uninsured or underinsured motorists coverage, or any similar coverage. If a particular state requires that any of these coverages be included in an umbrella policy, however, appropriate state endorsements are available.

Coverage U contains exclusions such as contractual liability, professional services, and intentional acts. Additional exclusions apply to ERISA, auto, and recreational vehicles.

Under both Coverage E and U, liability arising out of lead is excluded, as is coverage for cleanup and other costs related to lead.

Coverage E applies on an excess basis over either occurrence or claims-made underlying policies, and is subject to a general aggregate limit and a products/completed work hazard aggregate limit, as well as an each-occurrence limit.

Coverage U applies on an occurrence basis, excess of a retained limit or other insurance, and is also subject to a general aggregate limit and a products/completed work hazard aggregate limit, as well as an each-occurrence limit. The retained limit (the manual calls for a retained limit of \$10,000, but companies may modify this as they see fit) must be shown on the declarations.

Neither coverage will replace underlying insurance in the event an underlying insurer becomes bankrupt but, rather, will respond as though the underlying insurance were valid and collectible.

The maintenance of underlying

insurance condition (with respect to Coverage E) requires that the insured notify the company in the event that any underlying insurance is canceled or not renewed and not replaced, or if the underlying insurance is materially changed. If the insured fails to comply with this provision, the insurer will not be responsible for more than it would have been responsible for if the underlying insurance had not been terminated or had been kept at its original limits or coverages. In other words, if the insured's \$500,000 underlying commercial liability policy were canceled and not replaced, the umbrella/excess insurer would be responsible only for an amount in excess of the \$500,000 underlying limit, up to the limits of the umbrella/excess policy. ■

The author

Robert J. Prah, CPCU, is director of education for the American Association of Insurance Services. For more information about AAIS insurance programs, contact: Robert Schnoll, Marketing Manager, by phone at (800) 564-AAIS (2247), ext. 222, or by e-mail (bobs@AAISonline.com).