

CLIENT ADVISORY

COMMERCIAL UMBRELLA – STAND ALONE OR FOLLOW FORM?

A commercial umbrella policy is a bit like third base – we only pay attention to it when we are hurrying home. That's because we usually have to wait until the primary casualty terms are in place before we can begin focusing on the umbrella – and by then time is quickly running out!

Anecdotal evidence of this tendency can be found in the typical answer to any questions as to the coverage found in a commercial umbrella – it follows form. Unfortunately, this answer is too often not accurate – a fact that you would rather not discover after your client has a large claim denied by the umbrella insurer even though it is covered by an underlying policy.

A Rose by Any Other Name

The confusion begins with what we name the form – alternately excess liability policy or umbrella liability policy. An umbrella policy may be described as a specific type of excess liability policy – a policy whose value may be measured by comparing that particular form to the three objectives an umbrella is generally designed to achieve for your client – more on that later.

As you cannot determine the substance of a book solely by examining its title, similarly the title of the policy form – excess or umbrella – does not reveal the terms of coverage. Titles such as “Excess Liability Protection,” “Commercial Umbrella,” “Commercial Excess Liability Policy,” and “Commercial Umbrella Liability Coverage Form” are commonly used, but reveal little about what is covered by the umbrella policy.

And herein lies a point that is difficult to overstate – it is critical to read fully the umbrella policy (including all endorsements) to determine the terms and conditions that apply to your client. Recognize there is no “standard” umbrella policy – while there are undoubtedly similarities among the forms, the differences are also marked. Given this understanding, the question of what is important for your client naturally arises. This article is to look at the issues to consider in answering that question.

Three Objectives of an Umbrella Policy

It has been generally understood that an umbrella policy has three purposes. First, and arguably the most obvious purpose, is to provide greater limits of liability to your client for any one accident or occurrence. In other words, when one large liability claim exceeds the limits of the underlying policy, the umbrella is to provide coverage (subject to the umbrella limits) to pay damages that exceed the underlying limit. However, as mentioned above, if the umbrella excludes claims that are covered by an underlying policy, this most basic of purposes is unfulfilled.

Second, the umbrella policy is to provide coverage that is broader than your client's underlying policies. However, underlying

policies, particularly the Commercial General Liability, provide considerably broader coverage than was provided in the past. Therefore, this purpose or objective may not be realized in many instances. In addition, the pricing of umbrella policies does not contemplate known, uninsured exposures. So to expect an umbrella insurer to provide coverage over known uninsured exposures seems unreasonable. Yet, umbrella policies, in certain circumstances, still provide broader coverage than underlying policies. For example, many umbrella policies' coverage territory is worldwide – most underlying policies provide more limited coverage territories.

Third, the umbrella policy is to drop down and provide coverage over an underlying policy aggregate limit that is reduced or exhausted by payment of damages. To a large extent, most umbrella policies satisfy this purpose – albeit with some important caveats.

Stand Alone versus Follow Form – A Description

Umbrella policies can be loosely categorized as either a “stand-alone” policy or a “follow-form” policy.

connection with the general supervision of such operations.” Owners and/or general contractors retain certain non-delegable duties. One, among others, is proper supervision of the work methods employed by sub-contractors on the job site. Another is a duty to maintain the site to keep it free of hazards or protect the public against hazards that cannot be avoided (putting a barrier around an open hole).

If the owner or general contractor fails to properly supervise the activities of the specifically-listed “contractor,” and “bodily injury” or “property damage” occurs as a result, the OCP responds. Coverage is not extended to protect against any and all charges of negligent supervision; the OCP covers the “you” against liability. A “stand-alone” umbrella policy is characterized by having all of its own terms, conditions, limitations, and exclusions. In other words, the coverage provided by the underlying policies does not affect the umbrella policy – coverage is determined solely by the wording found in the umbrella policy. While certainly not

conclusive, a “stand-alone” umbrella may be indicated by a multi-page policy form – ten, fifteen or even twenty pages not including endorsements.

A “follow-form” umbrella policy is characterized by incorporating into the umbrella the terms, conditions, limitations, and exclusions found in the listed underlying policies. While a “follow-form” umbrella policy does have its own limit and a few of its own conditions, such as the requirement to maintain the listed underlying insurance, coverage is determined by the extent of coverage provided in the underlying policies. A clue that an umbrella may be “follow-form” is that policy consists of only a couple of pages.

Stand Alone versus Follow Form – Which is Better for Your Client?

Is a “stand-alone” umbrella better than a “follow-form” umbrella? Ideally, you would like the umbrella form to meet all three umbrella objectives – in which instance it would not matter how the umbrella form was categorized.

However, it is often not feasible to accomplish all three goals. In which case the answer depends upon what goals are most important to you and your client. And there are clearly trade-offs.

For example, finding a pure “follow-form” umbrella policy would accomplish the first goal – providing limits that are excess of the underlying policies and avoid an umbrella coverage denial for a claim covered by the underlying insurance. The trade-off is that your client would not have broader coverage in the umbrella and may not have adequate drop down coverage over an exhausted aggregate limit.

On the other hand, the “stand-alone” umbrella coverage may look to be as broad as the underlying policies and provide adequate drop down coverage over an exhausted aggregate limit and provide coverage in a few areas not included in the underlying policies.

The problem with this approach is rooted in the very nature of the “stand-alone” umbrella. It may be difficult if not impossible to determine if the umbrella actually is as broad as all underlying insurance – each insurer makes its own determination as to how and when coverage applies. This uncertainty regarding “broad as primary” coverage may be offset by your client’s concern with drop down coverage as well as the few situations in which the “stand-alone” umbrella is broader than the underlying policies. This may be a trade-off that is important to your client. In either case, one fact is inescapable – until you have read and

understand the umbrella coverage that is being offered to or purchased by your client, you are not able to discuss tradeoffs.

Conclusion

In actuality, most umbrella policies have the characteristics of both “stand-alone” and “follow-form.” In other words, the policies do not fit neatly into either category. The result is that the umbrella may be broader in some instances but more restrictive in other instances than the underlying policy – possibly leaving your client short of both objectives one and two mentioned above.

For example, what may initially look like a “follow-form” policy (the insuring agreement incorporates by reference the terms and conditions of the underlying policy) may contain so many of its own terms, conditions and exclusions (often by endorsement), that the benefit of “follow-form” is completely lost or substantially reduced.

Further, while most umbrella policies drop down over a reduced or exhausted aggregate limit – an umbrella may provide less coverage when dropping down than would the underlying policy. For example, some umbrella insurers will drop down over an exhausted aggregate limit, but expressly state they do not have a duty to defend any additional claims. Some insurers take the opposite approach – they expressly assume the duty to defend any additional claim that is covered by the umbrella once it has dropped down over an exhausted aggregate. As the duty to defend is a very important aspect of any liability policy, this difference is significant when evaluating the value of the drop down provision of an umbrella policy.

In sum, understanding the terms and conditions of the umbrella policy as well as the needs of your client are fundamental if you wish to assist your client in selecting an umbrella policy that fits their needs.

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