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## COMMENTS

### EXCESS INSURER'S DUTY TO DEFEND AFTER PRIMARY INSURER SETTLES WITHIN POLICY LIMITS: WISCONSIN AFTER *LOY AND TEIGEN*

#### INTRODUCTION

Excess insurance is a policy covering the insured against certain hazards applying to loss or damage in excess of a stated amount. Its purpose is "to protect the insured in the event of a genuinely catastrophic loss."<sup>1</sup> The risk of initial loss or damage may be carried by the insured, or by another policy known as primary protection. The primary insurer bears the initial burden of defending the lawsuit. An excess insurer's duty to defend normally arises after the primary insurer's policy limit has been exhausted.

There is a lack of uniformity among decisions regarding the obligation to defend and the allocation of defense costs between primary and excess insurance carriers.<sup>2</sup> The Wisconsin Supreme Court considered the relationship between primary and excess insurers in *Loy v. Bunderson*<sup>3</sup> and *Teigen v. Jelco of Wisconsin, Inc.*<sup>4</sup> These cases are unique from others in that the primary insurers settled for amounts within their policy limits, while the insureds reserved their claims against the excess insurers.

This Comment focuses on "true" excess insurers, though reference is made to "coincidental" excess insurers. As a preliminary matter, a distinction must be made between excess insurers whose policy limits do not ordinarily come into play

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1. Gallagher & German, *Resolution of Settlement Conflicts Among Insureds, Primary Insurers, and Excess Insurers: Analysis of the Current State of the Law and Suggested Guidelines for the Future*, 61 NEB. L. REV. 284, 352 (1982) [hereinafter Gallagher & German, *Settlement Conflicts*].

2. *Compare* Aetna Casualty & Sur. Co. v. Certain Underwriters at Lloyds, 56 Cal. App. 3d 791, 805-08, 129 Cal. Rptr. 47, 56-57 (1976), *with* Travelers Ins. Co. v. American Fidelity & Casualty Co., 164 F. Supp. 393, 402 (D. Minn. 1958).

3. 107 Wis. 2d 400, 320 N.W.2d 175 (1982).

4. 124 Wis. 2d 1, 367 N.W.2d 806 (1985).

until the primary insurers' limits are exceeded, otherwise known as "true" excess or excess "by design," and secondary insurers whose limits are excess only because of the policy provisions, otherwise known as "unintended" or "coincidence" coverage arising from "other insurance" clauses in the policies.<sup>5</sup> In "true" excess situations, as with cases involving only one primary insurer, the initial focus is on the language of the various policies involved, since the language is much more likely to be tailored to meet the needs of the insured. The "true" excess policy is a separate policy written only with the excess liability situation in mind. An "umbrella" policy is the most common form of "true" excess insurance, insuring against more types of risks than are covered by the insured's primary policy. The vast majority of "coincidence" coverages, in contrast, are merely form policies. The "coincidence" policy is simply a primary policy with the same duty to defend obligations as if there were no excess coverage problem presented.

Nevertheless, despite the fact that different types of excess coverage exist, courts often ignore the distinctions between the various forms. For purposes of this Comment, unless otherwise noted, the term "excess" will be used to connote the "true" excess situation.

This Comment reviews in Part I the general nature of the duty to defend. Part II discusses the obligations the primary insurer and excess insurer owe to their insured. Part III focuses upon whether any obligation runs from the primary insurer to the excess insurer. It demonstrates that a relationship does exist between the two companies. Part IV then summarizes the current law in Wisconsin on the issue of whether an excess insurer must defend the insured after the primary insurer has settled out of the action for an amount within the primary policy limits. Part V compares the various ap-

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5. See P. MAGARICK, *EXCESS LIABILITY* 19 (2d ed. 1982); Alleman, *Resolving the "Other Insurance" Dilemma: Ordering Disputes Among Primary and Excess Policies*, 30 KAN. L. REV. 75 (1981-82); German & Gallagher, *Allocation of the Duties of Defense Between Carriers Providing Coverage to the Same Insured*, 47 INS. COUNS. J. 224 (1980) [hereinafter German & Gallagher, *Duties of Defense*]; Comment, *Liability of Excess and Primary Automobile Insurance Companies for Defense Costs*, 52 MARQ. L. REV. 367 (1968-69).

proaches to the issue and suggests that an excess insurer should not be forced to defend the insured in such a situation.

## I. THE DUTY OF DEFENSE

In deciding whether any insurance company is obligated to defend its insured, the insurance policy provisions must be examined to determine whether the allegations fall within coverage.<sup>6</sup> Generally speaking, the allegations in the complaint determine the duty to defend.<sup>7</sup> The duty arises if policy coverage "is merely alleged or if it appears that there *may* be coverage, even though subsequent developments and the evidence prove that there was, in fact, no actual coverage"<sup>8</sup> under the policy. In *Grieb v. Citizens Casualty Co.*,<sup>9</sup> the Wisconsin Supreme Court stated:

It is the nature of the claim alleged against the insured which is controlling even though the suit may be groundless, false or fraudulent . . . . Conversely stated, "the insurer is under an obligation to defend only if it could be held bound to indemnify the insured, assuming that the injured person

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6. For a thorough discussion on the duty to defend in general, see Sharpe & Shaffer, *The Parameters of an Insurer's Duty to Defend*, 19 FORUM 555 (1983-84).

7. See P. MAGARICK, *supra* note 5, at 25 n.1.

8. *Id.* at 10; 7C J. APPLEMAN, *INSURANCE LAW AND PRACTICE* § 4682, at 20-21 (1979). The duty to defend continues even if there are allegations in the complaint that are outside of the coverage. See, e.g., *St. Paul Fire & Marine Ins. Co. v. Sears, Roebuck & Co.*, 603 F.2d 780 (9th Cir. 1979); *United States Fidelity & Guar. Co. v. Louis A. Roser Co.*, 585 F.2d 932 (8th Cir. 1978); *Oliver B. Cannon & Son v. Fidelity & Casualty Co.*, 484 F. Supp. 1375 (D. Del. 1980); *C. Raymond Davis & Sons v. Liberty Mut. Ins. Co.*, 467 F. Supp. 17 (E.D. Pa. 1979); *Steyer v. Westvaco Corp.*, 450 F. Supp. 384 (D. Md. 1978); *Tropical Park, Inc. v. United States Fidelity & Guar. Co.*, 357 So. 2d 253 (Fla. Dist. Ct. App. 1978); *Lerner v. General Ins. Co. of Am.*, 245 S.E.2d 249 (Va. 1978). Often, however, the duty is based solely on the allegations of the complaint and not on outside facts. See, e.g., *Klaesen Bros. v. Harbor Ins. Co.*, 410 So. 2d 611 (Fla. Dist. Ct. App. 1982); *Illinois Casualty Co. v. Turpen*, 84 Ill. App. 3d 288, 405 N.E.2d 4 (1980); *American Policyholders' Ins. Co. v. Cumberland Cold Storage Co.*, 373 A.2d 247 (Me. 1977); *Dochod v. Central Mut. Ins. Co.*, 81 Mich. App. 63, 264 N.W.2d 122 (1978); *Applegren v. Milbank Mut. Ins. Co.*, 268 N.W.2d 114 (N.D. 1978); *Flori v. Allstate Ins. Co.*, 120 R.I. 511, 388 A.2d 25 (1978). *Contra* *Texaco, Inc. v. Hartford Accident and Indem. Co.*, 453 F. Supp. 1109 (E.D. Okla. 1978); *C.A. Fielland, Inc. v. Fidelity & Casualty Co.*, 297 So. 2d 122 (Fla. Dist. Ct. App. 1974); *Lanoue v. Fireman's Fund Am. Ins. Cos.*, 278 N.W.2d 49 (Minn. 1979).

9. 33 Wis. 2d 552, 148 N.W.2d 103 (1967).

proved the allegations of the complaint, regardless of the actual outcome of the case."<sup>10</sup>

The duty of an insurer to provide a defense for claims asserted against its insured is contractual in nature. Courts examine policy language to determine defense obligations.<sup>11</sup> The duty to defend provision of any insurance policy is an agreement by which the insurer, in consideration of a premium paid by the insured, assumes the obligation to arrange for and pay the expenses of certain lawsuits brought against the insured.<sup>12</sup>

An insurer owes a duty of good faith and fair dealing<sup>13</sup> to the insured and, more particularly, a duty of due care in de-

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10. *Id.* at 558, 148 N.W.2d at 106 (citing 29A AM. JUR. *Insurance* § 1452, at 565 (1960)); see *Sola Basic Indus. v. United States Fidelity & Guar. Co.*, 90 Wis. 2d 641, 280 N.W.2d 211 (1979); *Gerrard Realty Corp. v. American States Ins. Co.*, 89 Wis. 2d 130, 277 N.W.2d 863 (1979); see also 7C J. APPLEMAN, *supra* note 8, at 16 (insurer bound to defend insured against suits alleging facts and circumstances covered by the policy, even though such suits are groundless, false or fraudulent).

11. The majority of states do not require an insurer to defend unless the obligation is expressed in the terms of the policy. See, e.g., *Previews, Inc. v. California Union Ins. Co.*, 640 F.2d 1026 (9th Cir. 1981); *Outboard Marine Corp. v. Liberty Mut. Ins. Co.*, 536 F.2d 730 (7th Cir. 1976); *Healy Tibbitts Constr. Co. v. Foremost Ins. Co.*, 482 F. Supp. 830 (N.D. Cal. 1979); *Mattocks v. Daylin, Inc.*, 452 F. Supp. 512 (W.D. Pa. 1978), *aff'd*, 614 F.2d 770 (3d Cir. 1979); *Haines v. St. Paul Fire & Marine Ins. Co.*, 428 F. Supp. 435 (D. Md. 1977); *All-Star Ins. Corp. v. Steel Bar, Inc.*, 324 F. Supp. 160 (N.D. Ind. 1971); *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966); *Brown Mfg. Co. v. Crouse*, 251 Iowa 594, 102 N.W.2d 154 (1960); *Ruder & Finn, Inc. v. Seaboard Sur. Co.*, 52 N.Y.2d 663, 422 N.E.2d 518, 439 N.Y.S.2d 858 (1981); *Westchester Fire Ins. Co. v. Rhoades*, 405 S.W.2d 812 (Tex. Civ. App. 1966); *Stanhope v. Brown County*, 90 Wis. 2d 823, 280 N.W.2d 711 (1979); *RTE Corp. v. Maryland Casualty Co.*, 74 Wis. 2d 614, 247 N.W.2d 171 (1976).

12. *C. Raymond Davis*, 467 F. Supp. 17; *Kincaid v. Simmons*, 66 A.D.2d 428, 414 N.Y.S.2d 407 (1979).

13. In every policy of insurance, there is an implied covenant of good faith and fair dealing by which each party agrees to refrain from preventing the other from receiving the benefits of the agreement. See, e.g., *Chavers v. National Sec. Fire & Casualty Co.*, 405 So. 2d 1 (Ala. 1981); *Guin v. Ha*, 591 P.2d 1281 (Alaska 1979); *Noble v. National Am. Life Ins. Co.*, 128 Ariz. 188, 624 P.2d 866 (1981); *Grand Sheet Metal Prods. Co. v. Protection Mut. Ins. Co.*, 34 Conn. Supp. 46, 375 A.2d 428 (1977); *Farmers Ins. Exch. v. Schropp*, 222 Kan. 612, 567 P.2d 1359 (1977); *Corwin Chrysler-Plymouth v. Westchester Fire Ins. Co.*, 279 N.W.2d 638 (N.D. 1979); *Hoskins v. Aetna Life Ins. Co.*, 6 Ohio St. 3d 272, 452 N.E.2d 1315 (1983); *Christian v. American Home Assurance Co.*, 577 P.2d 899 (Okla. 1978); *Bibeault v. Hanover Ins. Co.*, 417 A.2d 313 (R.I. 1980).

fending and settling claims.<sup>14</sup> Good faith and fair dealing require, for instance, that the insurer effect reasonable settlements of claims within the policy limits when there is a substantial likelihood of recovery in excess of those limits.<sup>15</sup> Such a duty is reflected in the company's premiums.<sup>16</sup> A breach of the duty of good faith, as with the breach of any duty, gives rise to a cause of action by the insured.<sup>17</sup>

Furthermore, an insurer has the duty to indemnify the insured. While the obligation to defend is a contractual issue, the duty to indemnify depends heavily on the applicable law in the underlying action giving rise to a claim under the policy.<sup>18</sup> The most significant difference between the two duties, however, is that the duty to defend is broader than the duty to indemnify.<sup>19</sup>

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14. See *Rocky Mountain Fire & Casualty Co. v. Dairyland Ins. Co.*, 452 F.2d 603 (9th Cir. 1971); *Dumas v. State Farm Mut. Auto. Ins. Co.*, 111 N.H. 43, 274 A.2d 781 (1971); *Reisen v. Aetna Life & Casualty Co.*, 225 Va. 327, 302 S.E.2d 529 (1983).

The Wisconsin Supreme Court has emphasized that the duty to exercise good faith toward the insured in determining whether a settlement should be undertaken arises from the insurance contract. *Hilker v. Western Auto. Ins. Co.*, 204 Wis. 1, 231 N.W. 257, 235 N.W. 413 (1931); see *Kranzush v. Badger State Mut. Casualty Co.*, 103 Wis. 2d 56, 307 N.W.2d 256 (1981); *Alt v. American Family Mut. Ins. Co.*, 71 Wis. 2d 340, 237 N.W.2d 706 (1976).

15. *Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 429, 426 P.2d 173, 176, 58 Cal. Rptr. 13, 16 (1967); see *St. Paul-Mercury Indem. Co. v. Martin*, 190 F.2d 455 (10th Cir. 1951); *Rova Farms Resort v. Investors Ins. Co. of Am.*, 65 N.J. 474, 323 A.2d 495 (1974); *Alt*, 71 Wis. 2d 340, 237 N.W.2d 706.

Most standard liability policies contain "settlement" clauses stating that the company may settle a claim. The right to settle claims within policy limits is absolute, as long as fraud is not involved. However, the company forfeits this right if it violates its own obligations to settle and defend in good faith. See P. MAGARICK, *supra* note 5, at 129-30.

16. *Peter v. Travelers Ins. Co.*, 375 F. Supp. 1347, 1350 (C.D. Cal. 1974); accord *Centennial Ins. Co. v. Liberty Mut. Ins. Co.*, 62 Ohio St. 2d 221, \_\_\_, 404 N.E.2d 759, 762 (1980); *Estate of Penn v. Amalgamated Gen. Agencies*, 148 N.J. Super. 419, 423-24, 372 A.2d 1124, 1126-27 (1977).

17. See cases cited *supra* notes 11 & 14. If the insurer breaches its duty to settle in good faith within the policy limits, the insured has a cause of action against the insurer for the amount of judgment in excess of the policy limits. *Crisci*, 66 Cal. 2d at 430-31, 426 P.2d at 177, 58 Cal. Rptr. at 17; see *Lange v. Fidelity & Casualty Co.*, 290 Minn. 61, 185 N.W.2d 881 (1971).

18. See *St. Paul Fire and Marine Ins. Co. v. Three "D" Sales, Inc.*, 518 F. Supp. 305 (D.N.D. 1981); *Commercial Union Ins. Co. v. Albert Pipe & Supply Co.*, 484 F. Supp. 1153 (S.D.N.Y. 1980).

19. See, e.g., *Sherman v. Ambassador Ins. Co.*, 670 F.2d 251, 258-59 (D.C. Cir. 1981); *Maneikis v. St. Paul Ins. Co.*, 655 F.2d 818, 822 (7th Cir. 1981); *Howard v. Russell Stover Candies, Inc.*, 649 F.2d 620, 625 (8th Cir. 1981); *St. Paul Fire & Marine*

## II. THE RELATIONSHIP BETWEEN THE INSURERS AND THE INSURED

### A. *The Primary Insurer's Obligation to the Insured*

The primary insurer's initial and perhaps sole duty is to investigate, evaluate, defend and settle the insured's claim.<sup>20</sup> Indeed, most primary policy language provides that the company controls the litigation and reserves the right to control the selection of counsel and direction of the defense. These features are especially evident where the amount claimed is within the primary limits.<sup>21</sup> Aside from paying the costs of defense of an action, the primary insurer is also responsible for indemnifying the insured for any recovery against the insured up to the primary policy limits.<sup>22</sup>

In exchange for the primary insurer's agreement to protect the rights and liabilities of its insured, the primary collects a premium contemplating the risk, investigatory expenses and

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Ins. Co. v. Sears, Roebuck & Co., 603 F.2d 780, 786 (9th Cir. 1979); *Donnelly v. Transportation Ins. Co.*, 589 F.2d 761, 765 (4th Cir. 1978); *United States Fidelity & Guar. Co. v. Louis A. Roser Co.*, 585 F.2d 932, 936 (8th Cir. 1978); *Fresno Economy Import Used Cars, Inc. v. United States Fidelity & Guar. Co.*, 76 Cal. App. 3d 272, 278, 142 Cal. Rptr. 681, 685 (1977); *ADA Resources, Inc. v. Don Chamblin & Assocs.*, 361 So. 2d 1339, 1342 (La. Ct. App. 1978); *Sturges Mfg. Co. v. Utica Mut. Ins. Co.*, 37 N.Y.2d 69, 72, 332 N.E.2d 319, 321 371 N.Y.S.2d 444, 447 (1975); *Gross v. Lloyds of London Ins. Co.*, 121 Wis. 2d 78, 86, 358 N.W.2d 266, 270 (1984).

Thus, the duty to defend often extends beyond the duty to indemnify. There may even be an obligation to defend without an obligation to indemnify. See *Oliver B. Cannon & Son v. Fidelity & Casualty Co.*, 484 F. Supp. 1375, 1385 (D. Del. 1980); *Conway v. Country Casualty Ins. Co.*, 92 Ill. 2d 388, —, 442 N.E.2d 245, 247 (1982). An insurer is not absolved from the duty to defend merely because it is forbidden by law, or the insurance contract itself, to indemnify the liability-causing action. See *Previews, Inc. v. California Union Ins. Co.* 640 F.2d 1026 (9th Cir. 1981); *St. Paul Fire & Marine Ins. Co. v. Weiner*, 606 F.2d 864 (9th Cir. 1979); *Sears*, 603 F.2d 780; *Val's Painting & Drywall, Inc. v. Allstate Ins. Co.*, 53 Cal. App. 3d 576, 126 Cal. Rptr. 267 (1975).

20. *Daniels v. Horace Mann Mut. Ins. Co.*, 422 F.2d 87, 88 (4th Cir. 1970); *Continental Casualty Co. v. United States Fidelity & Guar. Co.*, 516 F. Supp. 384, 387 (N.D. Cal. 1981); *Vencill v. Continental Casualty Co.*, 433 F. Supp. 1371, 1377-78 (S.D. W. Va. 1977); *Western World Ins. Co. v. Allstate Ins. Co.*, 150 N.J. Super. 481, 486-87, 376 A.2d 177, 180 (1977); see *Griffin, Excess Liability Insurance*, 62 MARQ. L. REV. 375, 383 (1978-79); *Holloway & Hamm, Defenses to Excess Carrier's Suit Against a Primary Insurer — Refusal to Defend or Settle*, 11 FORUM 940, 945 (1975-76).

21. See, e.g., *Aetna Casualty & Sur. Co. v. Certain Underwriters at Lloyds*, 56 Cal. App. 3d 791, 129 Cal. Rptr. 47 (1976); *Lumbermens Mut. Casualty Co. v. Connecticut Fire Ins. Co.*, 239 So. 2d 472 (La. Ct. App. 1970); 7C J. APPLEMAN, *supra* note 8, § 4691, at 274; *Griffin, supra* note 20, at 377, 388.

22. See generally *Lanzone & Ringel, Duties of a Primary Insurer to an Excess Insurer*, 61 NEB. L. REV. 259 (1982).

defense costs.<sup>23</sup> The premium reflects the payment of defense attorneys' fees and expenses.<sup>24</sup> Accordingly, a primary insurer "should undertake the defense at its own cost . . . even when its policy limit has been exhausted by partial settlement or tender of its limits into court."<sup>25</sup>

The obligations of the primary insurer cease after the limits of its policy have been exhausted by payment of judgment or settlement.<sup>26</sup>

[P]olicy limits are exhausted when an insurer pays its policy limits in full or partial satisfaction of a judgment rendered against its insured or pursuant to a complete settlement of a claim against its insured. Thereafter, the insurer has no duty to defend the insured in a separate action arising out of the same occurrence or to represent the insured on appeal for the judgment or to defend the insured in a co-defendant's action for contribution or indemnification.<sup>27</sup>

The primary insurer's duty to the insured may also be terminated by tendering the policy limits into court and requesting exoneration.<sup>28</sup> Other courts have maintained, however, that the duty to defend is not terminated by such conduct be-

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23. See Hardies, *Guiding Principles (and Principals) in Primary and Excess Problems*, 1977 INS. L.J. 469, 472-73.

24. *Aetna Casualty*, 56 Cal. App. 3d at 805-07, 129 Cal. Rptr. at 56-57.

25. S. COZEN & D. DEY, *RIGHTS AND DUTIES OF PRIMARY AND EXCESS CARRIERS — A NUTS AND BOLTS APPRAISAL* 17 (Defense Research Institute Monograph No. 1, 1984).

26. See *Allstate Ins. Co. v. Montgomery Trucking Co.*, 328 F. Supp. 415 (N.D. Ga. 1971); *Commercial Union Ins. Co. v. Adams*, 231 F. Supp. 860 (S.D. Ind. 1964); *Aetna Casualty*, 56 Cal. App. 3d 791, 129 Cal. Rptr. 47; *Elas v. State Farm Mut. Auto. Ins. Co.*, 39 Ill. App. 3d 944, 352 N.E.2d 60 (1976).

Several principles of law considering whether exhaustion of policy limits terminates an insurer's duty to defend have developed. First, the nature and extent of the duty to defend is a matter of contract to be determined by established principles of contract interpretation. Second, any limitation on the duty must be clear and comprehensible to the average insured. Finally, even if the duty has been terminated, the insurer is not entitled to desert the insured. Van Vugt, *Termination of the Insurer's Duty to Defend by Exhaustion of Policy Limits*, 44 INS. COUNS. J. 254, 255 (1977).

27. Van Vugt, *supra* note 26, at 263.

28. *General Casualty Co. v. Whipple*, 328 F.2d 353 (7th Cir. 1964); *Adams*, 231 F. Supp. 860. The Wisconsin Supreme Court in *Gross v. Lloyds of London Ins. Co.*, 121 Wis. 2d 78, 358 N.W.2d 266 (1984), concluded that the insurer could be relieved of its duty to defend upon tender of its policy limits only if language to that effect was conspicuously highlighted in the policy.



cause it exists independent of the duty to pay,<sup>29</sup> even where the insured has an excess policy.<sup>30</sup> It appears then that the primary insurer should be guided by the advice of counsel on whether it has the right to tender its limits and shed its obligation of a continued defense thereunder.<sup>31</sup> The insured's interests, however, may still demand the continued protection of the primary insurer, despite only a threatened exhaustion of the policy limits.<sup>32</sup>

The fact that the insured has a policy with an excess insurer should not alter the obligation of the primary insurer.<sup>33</sup> The primary's decision whether to settle or to try a case must be approached as if there were no policy limit applicable and no excess insurer involved. The duty remains unchanged even though it is possible that the excess carrier might be involved in a verdict in excess of the primary policy limits.<sup>34</sup> Furthermore, though the interests of the excess company are greatly

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29. See, e.g., *Anchor Casualty Co. v. McCaleb*, 178 F.2d 322 (5th Cir. 1949); *Simmons v. Jeffords*, 260 F. Supp. 641 (E.D. Pa. 1966); *Conway v. Country Casualty Ins. Co.*, 92 Ill. 2d 388, 442 N.E.2d 245 (1982).

30. *National Casualty Co. v. Insurance Co. of N. Am.*, 230 F. Supp. 617 (N.D. Ohio 1964).

31. S. COZEN & D. DEY, *supra* note 25, at 21. One writer contends that in an agreement where an insurer tenders its limits to a claimant in exchange for a partial release of his claim against the insured, it is not in fact a "settlement" but merely a credit against the insured's ultimate liability. Therefore, payment of the limits would not terminate the duty to defend. Van Vugt, *supra* note 26, at 264. Under this analysis it would be logical to conclude that not paying the full limits would not terminate the duty to defend. See *infra* notes 176-81 and accompanying text.

32. See *Landando v. Bluth*, 292 F. Supp. 975 (N.D. Ill. 1968); *Simmons*, 260 F. Supp. 641; *National Casualty*, 230 F. Supp. 617.

33. *Peter v. Travelers Ins. Co.*, 375 F. Supp. 1347, 1350 (C.D. Cal. 1974); see 7C J. APPLEMAN, *supra* note 8, at 30, 32-33.

Any reduction in the duties of the primary carrier to accept reasonable settlement offers due to the presence of excess coverage would have two detrimental results. It would imperil "the public and judicial interests in fair and reasonable settlement of lawsuits" by creating a disincentive for the primary insurer to settle. It also would result in an unfair distribution of losses among insurers "by thwarting the different kinds of coverages and rating structures if the excess carrier must cover both primary and excess liability."

P. HIX, W. KURLANDER & S. FARRUGGIA, ALLOCATION OF DEFENSE COSTS BETWEEN PRIMARY AND EXCESS CARRIERS 53 (Defense Research Institute Monograph No. 1, 1984). (citing *Continental Casualty Co. v. Reserve Ins. Co.*, 307 Minn. 5, \_\_\_, 238 N.W.2d 862, 864-65 (1976) (footnotes omitted)).

34. *Continental Ins. Co. v. Bayless & Roberts, Inc.*, 608 P.2d 281 (Alaska 1980); P. MAGARICK, *supra* note 5, at 21.

affected by the actions of the primary insurer,<sup>35</sup> the fact that the primary might be liable in some way to the excess does not increase the overall duty or liability of the primary carrier.<sup>36</sup>

### B. *The Excess Insurer's Obligation to the Insured*

While primary policies have a "duty to defend" clause, excess policies normally do not; however, if they do have one, it is somewhat limited.<sup>37</sup> The "duty to defend" clause usually provides that it "follows form" to that of the primary clause with the significant exceptions of premium, amount of coverage and duty of defense.<sup>38</sup> "The excess carrier usually does not have the *right* to exercise *control* in the investigation and legal handling, and is, to a large degree, much 'at the mercy' of the primary's judgment (or lack thereof)."<sup>39</sup> In sum, while the primary insurer is responsible to indemnify *and* pay defense costs, the excess is simply obligated to indemnify the insured for amounts recovered in excess of the primary insurer's policy limits.<sup>40</sup>

Excess policies usually require that valid primary insurance be maintained by the insured, otherwise the policy will be deemed void.<sup>41</sup> The underlying reason for this requirement is that when no primary insurance is available, the excess carrier is exposed to a greater risk than it contemplated in its policy. In addition, the excess insurer's premium does not reflect the primary coverage responsibility.<sup>42</sup> Courts may be re-

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35. *Peter*, 375 F. Supp. at 1350.

36. See cases cited *supra* note 16.

37. For examples of typical defense clauses, see N. MANN, AN INTRODUCTION TO THE RELATIONSHIP OF PRIMARY AND EXCESS INSURERS 4 (Defense Research Institute Monograph No. 1, 1984).

38. See German & Gallagher, *Duties of Defense*, *supra* note 5, at 244. But see *Off-shore Logistics Servs., Inc. v. Arkwright-Boston Mfrs. Mut. Ins. Co.*, 469 F. Supp. 1099 (E.D. La. 1979), *modified*, 639 F.2d 1142 (5th Cir. 1981) (excess carrier found liable for defense costs where policy covered all liability described in the primary policy).

This is not the situation in "coincidence" cases where there is a duty to defend clause in each insurance policy. Normally, however, "other insurance" clauses in "coincidence" policies do not apply to defense costs. See Comment, *supra* note 5, at 374-76, 378-79.

39. Hardies, *supra* note 23, at 473 (emphasis in original).

40. See Lanzzone & Ringel, *supra* note 22.

41. See, e.g., *Mid-Century Ins. Exch. v. State Farm Mut. Auto. Ins. Co.*, 98 Ill. App. 3d 493, 424 N.E.2d 686 (1981).

42. P. MAGARICK, EXCESS LIABILITY 152-53 (2d ed. Supp. 1986).

luctant, however, to forfeit primary coverage in such a situation.<sup>43</sup>

Taking into consideration the existence and underlying limits of the primary policy, the excess policy is written at a lower premium than that of the primary policy.<sup>44</sup> The assumption, of course, is that the excess carrier knows the identity and conditions of the underlying insurance.

The excess carrier for a much lesser premium, agrees to assume the monetary liability of an insured beyond a "sum certain" and to a maximum stated amount or limit — *but only after* all sums for loss, handling expense, and legal *have been paid* to the sum certain by the primary carrier.<sup>45</sup>

For the most part, merely comparing the premium paid for the respective policies would indicate which of the two is the excess policy.<sup>46</sup>

An important part of the primary policy as far as the excess insurer is concerned is the policy limits. These limits create the need for the excess carrier, whose lower limit usually begins where the primary carrier's maximum limit ends. The unique feature of the excess policy is that it provides that the excess insurer realizes no obligation to the insured until the primary insurer has exhausted its policy limits.<sup>47</sup> The excess

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43. See, e.g., *Vencill v. Continental Ins. Co.*, 433 F. Supp. 1371 (S.D. W. Va. 1977) (primary policy construed in a manner to insure proper "fit" with the excess policy). This rule is in contrast to "coincidence" cases where "other insurance" provisions are written to cover the possibility that the insured might have other coverage available. See German & Gallagher, *Duties of Defense*, *supra* note 5, at 244.

44. See, e.g., *Loy v. Bunderson*, 107 Wis. 2d 400, 404, 320 N.W.2d 175, 179 (1982).

45. *Hardies*, *supra* note 23, at 473 (emphasis in original).

46. See 16 G. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 62:46, at 483 (2d ed. 1983). Historically, premiums for excess carriers are significantly lower than premiums for primary carriers. See *infra* note 164. For example, a review of the court of appeals opinion and the briefs filed in *Signal Cos. v. Harbor Ins. Co.*, 27 Cal. 3d 359, 362, 612 P.2d 889, 891, 165 Cal. Rptr. 799, 801 (1980), revealed that the primary insurer received \$106,000 in premiums for \$25,000 in coverage, whereas the excess premium was about \$150,000 for \$10,000,000 in coverage. See *Valentine v. Aetna Ins. Co.*, 564 F.2d 292, 296 (9th Cir. 1977); *Continental Casualty Co. v. Reserve Ins. Co.*, 307 Minn. 5, —, 238 N.W.2d 862, 865 (1976); Gallagher & German, *Settlement Conflicts*, *supra* note 1, at 349 & n.260.

47. See, e.g., *Priester v. Vigilant Ins. Co.*, 268 F. Supp. 156 (S.D. Iowa 1967); *Universal Underwriters Ins. Co. v. Aetna Ins. Co.*, 249 Cal. App. 2d 144, 57 Cal. Rptr. 240 (1967); *New Amsterdam Casualty Co. v. Certain Underwriters at Lloyds*, 34 Ill. 2d 424, 216 N.E.2d 665 (1966); *Occidental Fire & Casualty Co. v. Underwriters at Lloyd's*, 19 Ill. App. 3d 265, 311 N.E.2d 330 (1974); *Reserve*, 307 Minn. 5, 238 N.W.2d 862; *Lumbermens Mut. Casualty Co. v. Connecticut Fire Ins. Co.*, 239 So. 2d 472 (La.

carrier has no obligation to defend or contribute to a settlement or judgment where the final loss figure, whether by judgment or settlement, is within the primary coverage limit, even where the amount claimed exceeds the primary limits.<sup>48</sup> Where the amount claimed is within the primary limits, the excess insurer can generally only defend where the primary insurer refuses to do so.<sup>49</sup> If the excess insurer does provide the initial defense for the insured, the excess has the right to be reimbursed by the primary insurer.<sup>50</sup> While the duty to defend between multiple insurers is several and not joint, some court decisions recognize an equal or coexisting duty to defend on the part of the excess company.<sup>51</sup>

### III. THE RELATIONSHIP BETWEEN PRIMARY AND EXCESS INSURERS

#### A. Privity of Contract

Although both the primary and excess carrier owe a direct contractual duty to the insured, generally speaking there is no privity of contract between the two insurers.<sup>52</sup> In *American Surety Co. v. State Farm Mutual Automobile Insurance Co.*,<sup>53</sup> the Minnesota Supreme Court decided that a primary insurer was not entitled to recover attorneys' fees and expenses in-

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Ct. App. 1970); 16 G. COUCH, *supra* note 46, § 62:48, at 487 n.8; P. MAGARICK, *supra* note 5, at 256 n.23; German & Gallagher, *Duties of Defense*, *supra* note 5, at 244; Griffin, *supra* note 20, at 377, 388.

48. See, e.g., *Bettenburg v. Employers Liab. Assurance Corp.*, 350 F. Supp. 873 (D. Minn. 1972); *American Sur. Co. v. State Farm Mut. Auto. Ins. Co.*, 274 Minn. 81, 142 N.W.2d 304 (1966). There is a range of opinion as to which insurer is responsible for the cost and conduct of the defense where the amount requested in the complaint is within the primary limits. See generally Griffin, *supra* note 20, at 383-85.

49. *Priester*, 268 F. Supp. 156; *Lumbermens*, 239 So. 2d 472.

50. *Zurich Ins. Co. v. New Amsterdam Casualty Co.*, 117 Ga. App. 426, 160 S.E.2d 803 (1968); *Maryland Casualty Co. v. Marquette Casualty Co.*, 143 So. 2d 249 (La. Ct. App. 1962); *Farmers Ins. Group v. Progressive Casualty Ins. Co.*, 84 Mich. App. 474, 269 N.W.2d 647 (1978); *State Farm Mut. Auto. Ins. Co. v. Foundation Reserve Ins. Co.*, 78 N.M. 359, 431 P.2d 737 (1967).

51. See, e.g., *Aetna Casualty & Sur. Co. v. Certain Underwriters at Lloyds*, 56 Cal. App. 3d 791, 801, 129 Cal. Rptr. 47, 53 (1976); *Lujan v. Gonzales*, 84 N.M. 229, —, 501 P.2d 673, 677-78 (1972).

52. See, e.g., *United States Fidelity & Guar. Co. v. Tri-State Ins. Co.*, 285 F.2d 579 (10th Cir. 1960); *Commercial Union Assurance Cos. v. Safeway Stores, Inc.*, 27 Cal. 3d 912, 610 P.2d 1038, 164 Cal. Rptr. 709 (1980); *Josten's Inc. v. Mission Ins. Co.*, 354 N.W.2d 575 (Minn. Ct. App. 1984).

53. 274 Minn. 81, 142 N.W.2d 304 (1966).

curred in its defense from the excess insurer because the excess had no contractual obligation to the primary to defend the action.<sup>54</sup> The Wisconsin Supreme Court similarly concluded in *Loy v. Bunderson*<sup>55</sup> that the primary insurer had no contractual duty running to the excess insurer.<sup>56</sup>

Mutually imposed duties do not exist to a large extent simply because there is often an insufficient relationship between the two insurers, particularly in the case of excess coverage resulting from an "other insurance" clause.<sup>57</sup> In addition:

[R]arely is the excess insurer not more sophisticated than the insured and better able to look after its own interests. Thus, it seems burdensome to impose upon the primary the same duty of care towards the excess from whom it receives no compensation as it has towards the innocent insured.<sup>58</sup>

Therefore, given the fact that there is no contractual obligation running between the two insurers, "[o]ne insurer has no right of action against another insurer to recover the cost of defending the insured."<sup>59</sup>

### B. Notice to the Excess Insurer

Unfortunately, it is not altogether impossible for an excess insurer to be unaware of the fact that its insured is involved in a lawsuit in which the primary insurer has undertaken the defense. The excess carrier might not even be notified of its impending obligation until after a judgment or settlement has been recovered against the insured in excess of the primary limits. Then, upon notification, the excess is expected to contribute its share to the insured based on its contract with the insured.<sup>60</sup>

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54. *Id.* at \_\_\_, 142 N.W.2d at 306.

55. 107 Wis. 2d 400, 320 N.W.2d 175 (1982).

56. *Id.* at 427-28, 320 N.W.2d at 190; see *Teigen v. Jelco of Wis., Inc.*, 124 Wis. 2d 1, 10-11, 367 N.W.2d 806, 811 (1985). Excess insurance should be distinguished from reinsurance at this point. While no direct contractual relationship between the reinsurer and the person or entity insured under the direct insurer's policy exists, there is such a relationship between the direct insurer and reinsurer. See A. ANDERSON, WISCONSIN INSURANCE LAW § 5.4, at 161-62 (2d ed. 1986).

57. See *Universal Underwriters Ins. Co. v. Dairyland Mut. Ins. Co.*, 102 Ariz. 518, 433 P.2d 966 (1967).

58. Holloway & Hamm, *supra* note 20, at 944.

59. *Josten's Inc. v. Mission Ins. Co.*, 354 N.W.2d 575, 577 (Minn. Ct. App. 1984).

60. See *Lanzone & Ringel*, *supra* note 22.

Though the primary insurer is largely unaffected by the existence of excess insurance in conducting its defense,<sup>61</sup> the primary ought to notify the excess of the impending action, even though technically only the insured can call upon the excess carrier for the performance of its duty to defend.<sup>62</sup> The primary insurer owes a duty, in appropriate cases, to determine if excess insurance exists and to report the incident if requested to do so by the insured, or have the insured report the matter, to the excess carrier.<sup>63</sup> The primary insurer should "advise the excess carrier of tactical and strategic decisions which it makes so that the excess carrier is put on notice and has an opportunity to complain if it decides to do so."<sup>64</sup>

### C. *The Primary Insurer's Duty to the Excess Insurer*

Strictly speaking, although primary and excess insurers are not in privity with each other, the general rule now is that a primary owes an excess the same good faith or due care duty that it owes to its insured in the handling of a claim, its defense and settlement.<sup>65</sup> The manner in which this duty is imposed upon the primary insurer, however, is a subject of debate.

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61. See *supra* notes 33-36 and accompanying text.

62. 7C J. APPLEMAN, *supra* note 8, at 30.

63. P. MAGARICK, *supra* note 42, at 150-52.

64. S. COZEN & D. DEY, *supra* note 25, at 21; see also *id.* at 18-19 (for helpful suggestions on what primary insurer should do about discovering existence of claim and notifying excess insurer at preliminary investigative stage).

65. See, e.g., *North River Ins. Co. v. St. Paul Fire & Marine Ins. Co.*, 600 F.2d 721 (8th Cir. 1979); *Portland Gen. Elec. Co. v. Pacific Indem. Co.*, 579 F.2d 514 (9th Cir. 1978); *Valentine v. Aetna Ins. Co.*, 564 F.2d 292 (9th Cir. 1977); *Vencill v. Continental Casualty Co.*, 433 F. Supp. 1371 (S.D. W. Va. 1977); *Peter v. Travelers Ins. Co.*, 375 F. Supp. 1347 (C.D. Cal. 1974); *Northwestern Mut. Ins. Co. v. Farmers Ins. Group*, 76 Cal. App. 3d 1031, 143 Cal. Rptr. 415 (1978); *General Accident Fire & Life Assurance Corp. v. American Casualty Co.*, 390 So. 2d 761 (Fla. Dist. Ct. App. 1980); *Ranger Ins. Co. v. Travelers Indem. Co.*, 389 So. 2d 272 (Fla. Dist. Ct. App. 1980); *Continental Casualty Co. v. Reserve Ins. Co.*, 307 Minn. 5, 238 N.W.2d 862 (1976); *Western World Ins. Co. v. Allstate Ins. Co.*, 150 N.J. Super. 481, 376 A.2d 177 (1977); *Estate of Penn v. Amalgamated Gen. Agencies*, 148 N.J. Super. 419, 372 A.2d 1124 (1977); *Hartford Accident & Indem. Co. v. Michigan Mut. Ins. Co.*, 92 A.D.2d 337, 462 N.Y.S.2d 175 (1983); *St. Paul Fire & Marine Ins. Co. v. United States Fidelity & Guar. Co.*, 43 N.Y.2d 977, 375 N.E.2d 733, 404 N.Y.S.2d 552 (1978); *Centennial Ins. Co. v. Liberty Mut. Ins. Co.*, 62 Ohio St. 2d 221, 404 N.E.2d 759 (1980).

*Contra* *Universal Underwriters Ins. Co. v. Dariyland Mut. Ins. Co.*, 102 Ariz. 518, 433 P.2d 966 (1967) (held that the primary carrier owes no duty whatsoever to the excess insurer, but the language appeared to be dicta).

## 1. Equitable Subrogation Theory

The principal means by which excess carriers have enforced actions against primary insurers is through the doctrine of equitable subrogation.<sup>66</sup> The excess carrier absorbs the loss falling on the insured and becomes entitled to enforce whatever rights the insured would have had against the primary insurer.<sup>67</sup> The excess carrier reimbursing the insured has an equitable right to be subrogated to the interests of the insured against the primary, subject to any equitable defenses. Technically the excess has no direct right of action against the primary, but rather comes to "stand in the shoes" of the insured. For this reason, the excess insurer is given the same rights and duties as the insured against the primary insurer.<sup>68</sup>

Accordingly, the primary has a good faith duty to the excess to accept reasonable settlement offers within the limit of its coverage.<sup>69</sup> If a settlement falls within the primary's limits, no excess coverage is needed, and the excess insurer cannot be primarily or secondarily liable.<sup>70</sup> If the primary refuses to settle a claim within the limits of the primary policy,<sup>71</sup> the pri-

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66. See, e.g., *Blevins v. Commercial Standard Ins. Cos.*, 544 F.2d 967 (8th Cir. 1976); *Vencill*, 433 F. Supp. 1371; *Peter*, 375 F. Supp. 1347; *Ranger*, 389 So. 2d 272; *Gianinni v. Bluthart*, 132 Ill. App. 2d 454, 270 N.E.2d 480 (1971); *Farmers Ins. Group v. Progressive Casualty Ins. Co.*, 84 Mich. App. 474, 269 N.W.2d 647 (1978); *Reserve*, 307 Minn. 5, 238 N.W.2d 862; *Western World*, 150 N.J. Super. 481, 376 A.2d 177; *Estate of Penn*, 148 N.J. Super. 419, 372 A.2d 1124; *St. Paul Fire & Marine*, 43 N.Y.2d 977, 375 N.E.2d 733, 404 N.Y.S.2d 552.

67. *Continental Casualty Co. v. United States Fidelity & Guar. Co.*, 516 F. Supp. 384 (N.D. Cal. 1981); *Ranger*, 389 So. 2d 272.

68. See *Ranger*, 389 So. 2d 272; *Reserve*, 307 Minn. 5, 238 N.W.2d 862; *Estate of Penn*, 148 N.J. Super. 419, 372 A.2d 1124. Some courts, when imposing liability, place heavy emphasis on the primary insurer acting in bad faith. See, e.g., *Transport Ins. Co. v. Michigan Mut. Liab. Ins. Co.*, 340 F. Supp. 670 (E.D. Mich. 1972). Other courts have in effect found the primary carrier strictly liable for rejecting settlement offers within its policy limits. See, e.g., *Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

69. *Valentine*, 564 F.2d at 297-98; *Continental*, 516 F. Supp. at 387; *Centennial*, 62 Ohio St. 2d at \_\_\_, 404 N.E.2d at 762.

70. See *Canal Ins. Co. v. Hartford Ins. Co.*, 415 So. 2d 1295, 1299 (Fla. Dist. Ct. App. 1982); *Nortex Oil & Gas Corp. v. Harbor Ins. Co.*, 456 S.W.2d 489, 494 (Tex. Civ. App. 1970).

71. See *Priester v. Vigilant Ins. Co.*, 268 F. Supp. 156 (S.D. Iowa 1967); *Lumbermens Mut. Casualty Co. v. Connecticut Fire Ins. Co.*, 239 So. 2d 472 (La. Ct. App. 1970).

mary may be responsible to the excess insurer for the amount over and above the primary policy limits.<sup>72</sup>

In utilizing the doctrine of equitable subrogation to redress the prejudice caused to an excess carrier who cannot control settlement negotiations, courts have understood the "disparity between the position of the primary and excess insurers in the management and control of litigation, in negotiation of settlements, and in the respective premiums charged for each policy."<sup>73</sup> In *Continental Casualty Co. v. Reserve Insurance Co.*,<sup>74</sup> for instance, the Minnesota Supreme Court held that an excess carrier was subrogated to the insured's rights against the primary carrier for breach of the primary's good faith duty to settle. The court reasoned that the holding would encourage settlements and prevent primary insurers from "imperil[ing] the public and judicial interests in fair and reasonable settlement[s] of lawsuits."<sup>75</sup> In addition, the court recognized the fact that the premium rates of primary and excess carriers are based on entirely different considerations, such that when the primary insurer refuses to settle an action, the excess must then make a reasonable settlement covering both the primary insurer's obligations as well as its own.<sup>76</sup>

Subrogating the claim thus has the effect of maintaining the essential purposes of the different coverages without thwarting the rate structures of the two insurers. The *Continental* rationale has been accepted with approval in subsequent decisions.<sup>77</sup>

## 2. Direct Duty Approach

Although many decisions appear to rely on the subrogation doctrine, language indicating a direct duty owed to the

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72. See *Valentine*, 564 F.2d 292; *Northwestern Mut. Ins. Co. v. Farmers Ins. Group*, 76 Cal. App. 3d 1031, 143 Cal. Rptr. 415 (1978); *General Accident Fire & Life Assurance Corp. v. American Casualty Co.*, 390 So. 2d 761 (Fla. Dist. Ct. App. 1980); *Centennial*, 62 Ohio St. 2d 221, 404 N.E.2d 759.

73. *Lanzone & Ringel*, *supra* note 22, at 282.

74. 307 Minn. 5, 238 N.W.2d 862 (1976).

75. *Id.* at 9, 238 N.W.2d at 864-65.

76. *Id.* at 9, 238 N.W.2d at 865.

77. See, e.g., *Valentine v. Aetna Ins. Co.* 564 F.2d 292 (9th Cir. 1977).



excess insurer often permeates the rationale.<sup>78</sup> For example, *Peter v. Travelers Insurance Co.*<sup>79</sup> held that the primary insurer's breach of duty to its insured was actionable by the excess insurer by way of equitable subrogation.<sup>80</sup> The District Court for the Central District of California also stated, however, that based upon this theory "the duty owed an excess insurer is identical to that owed the insured."<sup>81</sup> Technically this "identical" element does not comply with equitable subrogation principles. A similar contradiction in terms can be found in the New Jersey Superior Court's reversal of a trial court's denial of recovery to the excess carrier in *Estate of Penn v. Amalgamated General Agencies*.<sup>82</sup> After proposing that it would follow *Peter* and other equitable subrogation cases,<sup>83</sup> the court stated that "the primary carrier owes to the excess carrier the *same* positive duty to take the initiative and attempt to negotiate a settlement within its policy limit that it owes to its assured."<sup>84</sup>

Thus, another developing theory of liability involves a direct and independent duty on the part of the primary carrier to the excess carrier based upon their relationship in the scheme of providing insurance coverage to the insured.<sup>85</sup> In *Puritan Insurance Co. v. Canadian Universal Insurance Co.*,<sup>86</sup> for instance, a Pennsylvania federal court held that a primary carrier owed a duty to the excess carrier which required it to "refrain from acting in a manner which would unnecessarily

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78. See generally S. CELENTANI & D. DEY, PRIMARY INSURER'S LIABILITY TO EXCESS INSURER FOR FAILURE TO SETTLE WITHIN POLICY LIMITS 36-39 (Defense Research Institute Monograph No. 1, 1984).

79. 375 F. Supp. 1347 (C.D. Cal. 1974).

80. The *Peter* court noted that there are several elements that comprise an insurer's cause of action based upon equitable subrogation: (1) the insured has suffered a loss; (2) the insurer has compensated the insured for the loss; (3) the insured has an existing assignable cause of action; (4) the insurer has suffered damages; (5) justice requires that the loss be shifted from the insurer; and (6) the insurer's damages are in a stated sum. *Id.* at 1350.

81. *Id.*; accord *Estate of Penn. v. Amalgamated Gen. Agencies*, 148 N.J. Super. 419, \_\_\_, 372 A.2d 1124, 1126-27 (1977).

82. 148 N.J. Super. 419, 372 A.2d 1124 (1977).

83. *Id.* at \_\_\_, 372 A.2d at 1126-27.

84. *Id.* at \_\_\_, 372 A.2d at 1127 (emphasis added).

85. See *Peter*, 375 F. Supp. 1347; *Estate of Penn.*, 148 N.J. Super. 419, 372 A.2d 1124; *Hartford Accident & Indem. Co. v. Michigan Mut. Ins. Co.*, 92 A.D.2d 337, 462 N.Y.S.2d 175 (1983).

86. 586 F. Supp. 84 (E.D. Pa. 1984).

and unreasonably subject [the excess insurer] to a claim by an injured party."<sup>87</sup>

Nevertheless, despite this development, the direct duty approach to resolving conflicts between primary and excess insurers has not been widely accepted.<sup>88</sup> Wisconsin has also been skeptical. In *Loy v. Bunderson*,<sup>89</sup> an action was brought against the insured, a primary insurer with a liability coverage maximum of \$50,000, and a "coincidental" excess insurer with policy limits of \$500,000. A release<sup>90</sup> was executed in which the claimant agreed, in consideration of \$20,000 from the primary insurer, to release all parties of any liability up to \$50,000. The claimant reserved his claim against the excess insurer, however, for any amount between \$50,000 and the \$500,000 policy limit. The insured was also released from any liability in excess of \$500,000. In addition, the claimant agreed to indemnify, defend and hold the insured and primary insurer harmless in the event of any claim by the excess insurer.

One issue addressed by the Wisconsin Supreme Court was the validity of the settlement agreement.<sup>91</sup> The court stated that the fact of excess coverage in this situation was "a mere

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87. *Id.* at 88.

In Pennsylvania it is fundamental that where there is danger of injury to person or property of another, one is under a duty to use reasonable care to avoid the occurrence of such injury. . . . Moreover, a duty to use reasonable care does not arise only when one is in a privity relationship with another but rather, arises when the wrongdoer could have anticipated and foreseen the likelihood of harm to another or another's property.

*Id.* (citations omitted).

88. See, e.g., *Vencill v. Continental Casualty Co.*, 433 F. Supp. 1371 (S.D. W. Va. 1977); *Universal Underwriters Ins. Co. v. Dairyland Mut. Ins. Co.*, 102 Ariz. 518, 433 P.2d 966 (1967).

89. 107 Wis. 2d 400, 320 N.W.2d 175 (1982).

90. The release is now generally referred to as a "Loy Release/Covenant Not To Sue." *Teigen*, 124 Wis. 2d at 4, 367 N.W.2d at 808.

91. The primary issue in *Loy* was whether the trial court had correctly determined that the action for declaratory judgment involving the release was a justiciable issue under the Uniform Declaratory Judgment Act. The court of appeals reversed solely on the grounds that no justiciable controversy was presented to the court. *Loy v. Bunderson*, 101 Wis. 2d 215, 304 N.W.2d 140 (Ct. App. 1981). The Wisconsin Supreme Court reversed the court of appeals, concluding that all the elements of justiciability were present. 107 Wis. 2d at 407, 320 N.W.2d at 180. The court did not stop at that point, however, but went on to address the excess insurer's contention that the provisions of the release were erroneous as a matter of law.

coincidence,"<sup>92</sup> and that therefore the excess insurer had a contractual duty to defend from the beginning. As a result, the agreement was not fundamentally unfair because the excess insurer's rights were not prejudiced.<sup>93</sup> The court noted that because no contract existed between the insurers, the tort of bad faith could not arise between them on any theory.<sup>94</sup> The most the primary insurer was obligated to do was protect the excess insurer from any possible liability up to the primary's limit of \$50,000.<sup>95</sup>

The problem in comparing *Loy* with cases relying upon the equitable subrogation doctrine is that in the other cases the insureds were deemed liable for a specific amount, usually greater than the primary limits. Thus, in these cases, the excess insurer had something to which it could subrogate its claim. No such facts presented themselves in *Loy*, however. Given the opportunity to expand the obligations owed to the excess insurer by the primary insurer, the court in *Loy* declined to follow a direct duty theory.<sup>96</sup>

In 1985, the Wisconsin Supreme Court again reviewed the issue of allocating defense obligations among primary and excess insurers in *Teigen v. Jelco of Wisconsin, Inc.*<sup>97</sup> The fact pattern was basically the same as in *Loy*. The primary policy provided coverage up to \$500,000 and the excess policy up to

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92. *Loy*, 107 Wis. 2d at 404, 320 N.W.2d at 179.

[T]his is not a situation in which a particular named insured purchased basic coverage and then purchased additional coverage in excess of its primary contract . . . . It is only because of the recital in [the excess] policy that its coverage is claimed to be excess over the limits afforded by the [primary] policy. In the absence of [the primary's] policy, [the excess] coverage would commence at 'dollar-one.' It is clear, then, that [the excess insurer] is not a true excess carrier, because the policy was not written under circumstances where rates were ascertained after giving due consideration to known existing and underlying basic or primary policies. Nothing in the record shows that [the employer] was in any way benefitted [sic] in its premium structure by reason of the existence of [the insured's primary] policy.

*Id.* at 404-05, 320 N.W.2d at 179.

93. In fact, the court stated that the excess insurer was "benefited by a fortuitous coincidence." *Id.* at 418, 320 N.W.2d at 185.

94. *Id.* at 428, 320 N.W.2d at 190.

95. "All that remains is for [the excess insurer] to perform the obligation under its own policy for which it has been paid a premium which it considered appropriate at the time it made its contract with [its insured]." *Id.* at 429, 320 N.W.2d at 191.

96. *See id.* at 427-28, 320 N.W.2d at 190.

97. 124 Wis. 2d 1, 367 N.W.2d 806 (1985).

\$2,000,000 over and above the primary limits. The insured and his primary carrier entered into a "Loy Release/Covenant Not To Sue"<sup>98</sup> whereby the primary carrier paid \$390,000 to release itself from all liability and to release the insured up to \$500,000. In addition, the insured was released from any liability over and above the excess policy limits. The claimant reserved any claim it had against the excess carrier and any recovery against the insured was to be credited in the amount of \$500,000. The court addressed the issue of whether the trial court had correctly relied on *Loy* when it dismissed the primary carrier from the action.<sup>99</sup>

The main difference between *Teigen* and *Loy* is that in *Teigen* the excess carrier was in fact a "true" excess insurer.<sup>100</sup> The court determined, however, that the distinction was insignificant.<sup>101</sup> "The desirability of *Loy*-type agreements lies in the encouragement of partial settlements in future cases, thereby fostering effective and expeditious resolution of lawsuits. Partial settlements not only benefit the parties involved, but the justice system as a whole."<sup>102</sup> In addition, because the insured was fully protected by the settlement, the court held that the primary carrier had acted in good faith toward its insured in settling the claim. However, the Wisconsin Supreme Court again refused to extend this good faith settlement duty to the excess carrier.<sup>103</sup> The court reasoned that no unfair burden was placed on the excess carrier because it was asked to do no more than that for which it had contracted, namely, to provide coverage in excess of that provided by the primary carrier.<sup>104</sup>

#### D. Settlements Within Primary Policy Limits

Most authority considering the relationship between primary and excess insurers focuses upon the situation where a

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98. See *supra* note 90.

99. *Teigen*, 124 Wis. 2d at 5, 367 N.W.2d at 808.

100. *Id.* at 7, 367 N.W.2d at 809; cf. *supra* note 92 and accompanying text (for the *Loy* situation).

101. *Teigen*, 124 Wis. 2d at 7, 367 N.W.2d at 809.

102. *Id.* at 7, 367 N.W.2d at 810; accord *Swanigan v. State Farm Ins. Co.*, 99 Wis. 2d 179, 299 N.W.2d 234 (1980); *Pierringer v. Hoger*, 21 Wis. 2d 182, 124 N.W.2d 106 (1963).

103. See *Teigen*, 124 Wis. 2d at 11, 367 N.W.2d at 811.

104. *Id.* at 11-12, 367 N.W.2d at 811-12.

judgment or settlement is recovered against the insured over and above the primary insurer's limits.<sup>105</sup> Few cases have had the opportunity to consider the situation in which the claimant settles with the primary carrier for a sum within the primary limits and the excess carrier defends the insured in a subsequent action. Of these cases, the outcome appears to turn upon what the court considers to be "exhaustion" of the policy limits. Given that excess insurance does not attach until all primary insurance is exhausted,<sup>106</sup> it becomes critical to determine the point at which "exhaustion" occurs.

### 1. "Exhaustion" as Not Constituting Settlement Within Primary Limits

Under one theory, where the primary insurer settles with the claimant for an amount within its limits, the settlement does not constitute "exhaustion" of the limits. Therefore, the excess insurer is not bound to defend or indemnify the insured for the difference between the settlement figure and the primary limits. It is now settled in California, for instance, that the primary carrier has the duty to defend up to its policy limits and that the excess carrier, unless it voluntarily contributes, has no duty to do so before that time. In *Hellman v. Great American Insurance Co.*,<sup>107</sup> the primary carrier entered into a settlement for less than its policy limits. The California Court of Appeals stated that an excess insurer's<sup>108</sup> liability "does not arise until the limit of the primary insurer's coverage has been exhausted."<sup>109</sup> In this case, the excess insurer's

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105. See, e.g., Bloom, *Recovery Against Primary Insurer by Excess Carrier for Bad Faith or Negligent Failure to Settle*, 36 INS. COUNS. J. 235 (1969); Conley, *Relations Between Primary and Excess Insurance Carriers*, 32 FED'N INS. COUNS. Q. 123 (1981-82); Gallagher & German, *Settlement Conflicts*, *supra* note 1; German & Gallagher, *Duties of Defense*, *supra* note 5; Griffin, *supra* note 20; Hardies, *supra* note 23; Holloway & Hamm, *supra* note 20; Ingram, *Triangular Reciprocity in the Duty to Settle Insurance Claims*, 13 PAC. L.J. 859 (1981-82); Lanzone, *Primary Insurer's Duty to Excess Insurer*, 1979 INS. L.J. 382; Lanzone & Ringel, *supra* note 22; Comment, *supra* note 5.

But see Ghiardi & Ferris, *Excess Insurer Beware: The Primary Insurer has Found the Back Door*, FOR THE DEF., Feb. 1986, at 12.

106. See *supra* text accompanying note 47.

107. 66 Cal. App. 3d 298, 136 Cal. Rptr. 24 (1977).

108. The excess insurer's duties in *Hellman* arose as a result of the "other insurance" clause in its policy.

109. *Hellman*, 66 Cal. App. 3d at 305, 136 Cal. Rptr. at 28.

obligation to defend did not arise because the maximum coverage had not been exhausted.<sup>110</sup>

In *Signal Cos. v. Harbor Insurance Co.*,<sup>111</sup> the California Supreme Court held that a primary insurer had a continuing obligation to defend, and that the excess carrier could not be required to participate in the defense as soon as it was notified of the claim where the primary policy was not exhausted. *Signal* is significant for two reasons. First, it distinguishes between "coincidental" and "true" excess insurers.<sup>112</sup> Second, the court delineates several reasons for finding that the primary insurer's limit must be exhausted: the language of the "true" excess policy explicitly provided that its liability would not attach until the primary coverage had been exhausted;<sup>113</sup> the policy provided that the excess carrier must consent to the extra costs, which it did not do in this action;<sup>114</sup> the insured was fully protected under the terms of the primary policy;<sup>115</sup> and holding otherwise would be contrary to prior case law.<sup>116</sup>

In *Olympic Insurance Co. v. Employers Surplus Lines Insurance Co.*,<sup>117</sup> the California Court of Appeals held that liability does not attach to the excess carrier until all primary insurance has been exhausted, even if the total amount of the primary coverage exceeds the amount contemplated in the excess policy.<sup>118</sup> Excess coverage "is coverage whereby, *under the terms of the policy*, liability attaches only after a predetermined amount of primary coverage has been exhausted."<sup>119</sup> In this way the excess carrier can greatly reduce the risk of

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110. *Id.* at 307, 136 Cal. Rptr. at 29.

111. 27 Cal. 3d 359, 612 P.2d 889, 165 Cal. Rptr. 799 (1980).

112. *Id.* at 369, 612 P.2d at 895, 165 Cal. Rptr. at 805. *Contra Teigen*, 124 Wis. 2d at 7, 367 N.W.2d at 809.

113. *Signal*, 27 Cal. 3d at 367, 612 P.2d at 894, 165 Cal. Rptr. at 804. The excess policy in *Signal* provided that its coverage would not attach until either the primary insurer had admitted liability or the insured had been adjudged liable and the full primary exposure had been paid and satisfied. *Id.* at 362, 612 P.2d at 891, 165 Cal. Rptr. at 801.

114. *Id.* at 367, 612 P.2d at 894, 165 Cal. Rptr. at 804.

115. *Id.*

116. *Id.* at 367-68, 612 P.2d at 894, 165 Cal. Rptr. at 804.

117. 126 Cal. App. 3d 593, 178 Cal. Rptr. 908 (1981).

118. *Id.* at 600, 178 Cal. Rptr. at 912; see *Nabisco, Inc. v. Transport Indem. Co.*, 143 Cal. App. 3d 832, 192 Cal. Rptr. 207 (1983).

119. *Olympic*, 126 Cal. App. 3d at 598, 178 Cal. Rptr. at 910.

loss which is reflected in its premiums.<sup>120</sup> In addition, the court noted that because the duty to defend and liability for settlement arise simultaneously, where there is no duty to defend there also cannot be any liability for defense costs.<sup>121</sup>

Other jurisdictions have followed the California approach. In *United States Fire Insurance Co. v. Lay*,<sup>122</sup> a settlement agreement required the primary insurer to pay \$70,000 of its \$100,000 policy limit to the claimant. The settlement released the primary insurer from further payment obligations, and the primary insurer and the insured were given a "credit" of \$100,000, with any recovery in excess of the policy limit being marked as satisfied within the available coverages. The claimant later recovered a judgment against the insured, the primary insurer defending, for \$150,000.

The Seventh Circuit held that under the language of the excess policy,<sup>123</sup> the excess carrier was liable only if and when the insured sustained a loss exceeding its \$100,000 retained limit.<sup>124</sup> Because the insured was released from any liability in excess of \$70,000, he could not sustain a loss greater than \$100,000, and therefore the excess carrier's obligation to the insured never arose.<sup>125</sup> The court further noted:

A settlement for less than the primary limit that imposed liability on the excess carrier would remove the incentive of the primary insurer to defend in good faith or to discharge its duty . . . to represent the interests of the excess carrier. Here the primary insurer had no incentive whatsoever to reach a settlement at a figure between \$70,000 and \$100,000.<sup>126</sup>

Along the same lines, the Supreme Court of Oregon noted in *Liberty Mutual Insurance Co. v. Truck Insurance Ex-*

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120. *Id.* at 598 n.2, 178 Cal. Rptr. at 910 n.2. Some of the policies in this case, however, provided excess coverage only by way of "other insurance" clauses; therefore, a premium rate comparison would not effectively apply to those insurers.

121. *Id.* at 601-02, 178 Cal. Rptr. at 912-13.

122. 577 F.2d 421 (7th Cir. 1978).

123. "The Company agrees to indemnify the insured for ultimate net loss in excess of the retained limit . . ." *Id.* at 422. The excess policy had a limit of liability of \$1,000,000 for each occurrence for a loss in excess of the primary limits. The "retained limit" was therefore \$100,000.

124. *Id.* at 423. The court termed the excess policy "a contract for indemnity against liability." *Id.*

125. *Id.*

126. *Id.*; accord *Estate of Penn*, 148 N.J. Super. 419, 372 A.2d 1124.

change<sup>127</sup> that carriers who have written excess policies do so at premiums traditionally lower than primary policy premiums.<sup>128</sup> For this reason, excess carriers should not be required to cover risks on an equal basis with primary carriers. Therefore, carriers which had written excess coverage "by design" were not required to pay a pro rata portion of the loss until the first layer of coverage was exhausted.<sup>129</sup>

## 2. "Exhaustion" as Constituting Settlement Within Primary Limits

Another line of cases requires an excess carrier to defend the insured where the primary carrier settles out of the action for an amount within its policy limits. For example, in *Futch v. Fidelity & Casualty Co.*,<sup>130</sup> the plaintiff received a \$6,000 settlement from a primary insurer having a \$10,000 limit. The Supreme Court of Louisiana disagreed with the excess insurer's contentions that its liability had not yet arisen and was unavailable. The court reasoned that the release credited the primary insurer with its total primary coverage of \$10,000, and that therefore the primary had released itself of all liability.<sup>131</sup> A Louisiana appellate court was faced with a similar issue in *American Home Assurance Co. v. Commercial Union Assurance Co.*<sup>132</sup> A primary insurer with policy limits of \$300,000 settled for \$214,000, the plaintiffs reserving their right to continue their claim against the insured and the excess insurer for amounts over and above the primary limits. The excess carrier subsequently settled the case for \$62,500 and then attempted to recover that amount from the primary insurer under the theories of equitable subrogation and unjust enrichment. The court held that *Futch* controlled and denied

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127. 245 Or. 30, 420 P.2d 66 (1966).

128. *Id.* at \_\_\_, 420 P.2d at 69.

129. *Id.* Some of the policies in this case, however, provided excess coverage "coincidentally"; accordingly, the same reasoning would not apply.

130. 246 La. 688, 166 So. 2d 274 (1964). *Futch* involved a "coincidental" excess insurer.

131. *Id.* at \_\_\_, 166 So. 2d at 278. "The circumstance that Allstate [the primary insurer] was able to settle its liability for \$6,000 is of no consequence in determining the responsibility of F & C [the excess insurer] for excess coverage." *Id.* at \_\_\_, 166 So.2d at 278; see *Benroth v. Continental Casualty Co.*, 132 F. Supp. 270 (W.D. La. 1955); *Wirick v. Wyble*, 300 So. 2d 571 (La. Ct. App. 1974).

132. 379 So. 2d 757 (La. Ct. App. 1979), *cert. denied*, 449 U.S. 871 (1980).



recovery on the grounds that the excess carrier had settled for its own liability only and not that of the primary insurer.<sup>133</sup>

A primary insurer also settled out of a suit for an amount less than its limits in *Stargatt v. Fidelity & Casualty Co.*<sup>134</sup> The excess insurer argued that it could not be found liable because the clause in its policy stating, "'only when the primary policy . . . has been exhausted,' should be read to mean 'only when the primary policy limits have been actually paid.'"<sup>135</sup> The excess carrier contended that this interpretation constituted the plain meaning of the policy language. The Federal District Court for the District of Delaware disagreed, stating that the plain meaning of "exhausted" is "entirely used up," and that the primary coverage had been "entirely used up" by the settlement within its limits.<sup>136</sup>

"[T]he defendant had no rational interest in whether the insured *collected* the full amount of the primary policies, 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 limits 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."<sup>137</sup>

An excess policy provided coverage up to a \$10,000 limit under a standard "other insurance" clause in *Deblon v.*

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133. *Id.* at 758.

This case leaves some unanswered questions. Unless the excess insurer agreed to the conditional release, or unless it was impossible to get an agreement to settle with a general release against all parties for an amount within the primary limits at the time of the original settlement by the primary insurer, the decision could be a miscarriage of justice.

P. MAGARICK, *supra* note 5, at 252; *see also* *Gasquet v. Commercial Union Ins. Co.*, 391 So. 2d 466 (La. Ct. App. 1980) (where the court expressly refused to follow *Lay*, 577 F.2d 421, and allowed plaintiff to release primary insurer for less than full primary limits, while granting credit for full primary limits and reserving right against excess insurer).

134. 67 F.R.D. 689 (D. Del. 1975).

135. *Id.* at 690.

136. *Id.* at 690 n.3.

137. *Id.* at 691 (quoting *Zeig v. Massachusetts Bonding & Ins. Co.*, 23 F.2d 665 (2d Cir. 1928) (emphasis in original)).

*Beaton*.<sup>138</sup> The plaintiff executed a "covenant not to sue on claim" in consideration of a \$46,500 payment from the primary insurer, releasing the insured and primary insurer, but reserving her rights against the excess insurer. The primary policy had limits of \$50,000. The Superior Court of New Jersey upheld the validity of the covenant not to sue, reasoning that settlements ought to be encouraged and that from the plaintiff's point of view it makes no difference who pays the recovery.<sup>139</sup> The partial settlement did not prejudice the excess insurer. If anything, the excess carrier was benefited in the sense that it was not exposed to any liability beyond its policy limit by the terms of the settlement.<sup>140</sup> In response to the excess insurer's argument that such reasoning encourages collusion between claimants and insureds, the court noted that insurers could rely upon the "cooperation" clauses in their policies.<sup>141</sup>

Wisconsin follows these cases with regard to exhaustion of policy limits. *Loy v. Bunderson*<sup>142</sup> held that by settling within its policy limits, the primary insurer had discharged its duty by satisfying the claim to the extent of its policy limits. Hence, the primary had the right to be dismissed from further liability.<sup>143</sup> Meanwhile, the excess insurer was required "to continue with the defense for the potential liability reserved."<sup>144</sup> The court in essence adopted the *Deblon* rationale.<sup>145</sup>

Similarly, the court in *Teigen v. Jelco of Wisconsin, Inc.*<sup>146</sup> determined that the primary carrier had satisfied all duties owed to its insured when it settled for an amount within its limits. The primary policy provided that the insurer would have the right and duty to defend, but that it would not be obligated "to defend any suit after the applicable limit of the company's liability has been exhausted by payment of judg-

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138. 103 N.J. Super. 345, 247 A.2d 172 (1968).

139. *Id.* at \_\_\_, 247 A.2d at 175.

140. *Id.* at \_\_\_, 247 A.2d at 176.

141. *Id.* at \_\_\_, 247 A.2d at 176.

142. 107 Wis. 2d 400, 320 N.W.2d 175 (1982).

143. *Id.* at 418, 320 N.W.2d at 185-86.

144. *Id.* at 418, 320 N.W.2d at 185. The "potential liability reserved" in *Loy* was the liability falling between the primary policy limits and excess policy limits. *Id.*

145. *Id.* at 424-26, 320 N.W.2d at 188-89.

146. 124 Wis. 2d 1, 367 N.W.2d 806 (1985).

ments or *settlements*.'"<sup>147</sup> The court concluded that under this language, the primary carrier had released itself and the insured "just as if the full \$500,000 policy limit had been paid in settlement."<sup>148</sup> In other words, the primary carrier had *exhausted* its liability by virtue of the "Loy Release/Covenant Not To Sue."

#### IV. A PRACTICAL APPLICATION AFTER *LOY* AND *TEIGEN*

Several propositions can be gleaned from *Loy v. Bunder-son*<sup>149</sup> and *Teigen v. Jelco of Wisconsin, Inc.*<sup>150</sup> to form a basis for the present state of the law in Wisconsin on primary and excess insurer relationships. As a way of illustration, consider the following hypothetical situation:

*X*, a bus passenger, is injured as a result of the negligence of *B*, a bus company. *B*'s primary insurer, *P*, provides coverage up to \$500,000. *P*'s policy provides that it shall have the right to defend any suit against *B*, but that it shall not be obligated to defend any suit after the applicable limit of *P*'s liability has been exhausted by payment of judgments or settlements. *B*'s excess insurer, *E*, provides coverage up to \$4,000,000 with a retained limit of \$500,000.

*X*, *B* and *P* enter into a "Loy Release/Covenant Not To Sue." In consideration of *P*'s payment of \$100,000, *X* releases *B* up to \$500,000 and for any amount in excess of \$4,000,000. In addition, *P* is released from all liability. Furthermore, *X* reserves a claim against *E* up to *E*'s limit, crediting any recovery by the amount of *P*'s limit.

Applying the *Loy* and *Teigen* principles<sup>151</sup> to the above fact pattern, *P* has satisfied its duty to defend and obligation of good faith to *B*. *P* has exhausted its liability by virtue of the release just as if the full \$500,000 policy limit had been paid. *P* owed no duty to *E* in the past, nor does *P* owe one now.

*E*, on the other hand, must provide a defense for *B*, should *X* pursue a claim against *B*. If the actual amount recovered against *B* is between \$500,000 and \$4,000,000, *E* will indem-

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147. *Id.* at 8, 367 N.W.2d at 810 (quoting from the primary policy) (emphasis in original).

148. *Id.* at 8, 367 N.W.2d at 810.

149. 107 Wis. 2d 400, 320 N.W.2d 175 (1982).

150. 124 Wis. 2d 1, 367 N.W.2d 806 (1985).

151. See *supra* notes 89-104, 142-48 and accompanying text.

nify *B*. If the amount recovered is less than \$500,000, then *X* cannot recover from any of these parties. If the amount is over \$4,000,000, *X* will not be able to collect any of the recovery over and above the \$4,000,000. Whatever the result, *E* has no right to recover from *P* the defense costs that it incurs.

The question of whether *E* is a "true" or "coincidental" excess insurer is unimportant. The Wisconsin courts' rationale for upholding the release is based upon the notion that settlements are encouraged and favored by the law. Public interest requires that a plaintiff be permitted to settle claims against some exposed parties without releasing others. Furthermore, because none of the parties' rights are prejudiced, the agreement is fundamentally fair.

## V. CRITIQUE

### A. Language of Insurance Policies

Policy language and controlling law determine the existence of relationships between insurers and the duties of each to the other, as well as to the insured.<sup>152</sup> Because the duty of defense is contractual,<sup>153</sup> insurance policies ought to be construed accurately and given the effect their language clearly commands.<sup>154</sup> In *Occidental Fire & Casualty Co. v. Underwriters at Lloyd's*,<sup>155</sup> for instance, an Illinois court emphasized that an excess insurer's defense clause must be given its literal meaning, such that the duty of defense will not shift to the excess until all conditions precedent set forth in its policy are met.<sup>156</sup> To be sure, "courts must construe and enforce such agreements as made and not make new contracts for the parties."<sup>157</sup>

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152. See, e.g., *Western Pac. Ins. Co. v. Farmers Ins. Exch.*, 69 Wash. 2d 11, \_\_\_, 416 P.2d 468, 471-72 (1966).

153. See *supra* text accompanying notes 11-12.

154. "No decision regarding the allocation of defense costs can be made in a specific case without first analyzing the policy provisions of the particular primary and excess policies. A liability policy could appropriately disclaim any responsibility for defense costs." P. HIX, W. KURLENDER & S. FARRUGGIA, *supra* note 37, at 52 (emphasis in original).

155. 19 Ill. App. 3d 265, 311 N.E.2d 330 (1974).

156. See German & Gallagher, *Duties of Defense*, *supra* note 5, at 255.

157. *McPhee v. American Motorists Ins. Co.*, 57 Wis. 2d 669, 673, 205 N.W.2d 152, 155 (1973); see *Bulman v. Bulman*, 271 Wis. 286, 73 N.W.2d 599 (1955).

Two sources of conflict often arise in cases allocating defense costs between carriers. First, policy language may be vague and ambiguous.<sup>158</sup> Second, courts tend to reach inconsistent results "by varying their interpretations of the language . . . in order to reach results deemed desirable for protection of the insured, to achieve some sort of 'fairness,' or for public policy reasons."<sup>159</sup> To combat these problems, insurers should convey their defense clauses in clear and unambiguous layperson's language. Furthermore, courts should give defense clauses "a *literal* interpretation consistent with their plain meaning."<sup>160</sup>

### B. Premiums

An insurer's obligation to defend does not continue indefinitely "with total disregard for the amount of coverage purchased, particularly if the insured had the opportunity to buy higher limits for an additional premium."<sup>161</sup> The excess carrier's duty to defend, however, does not arise haphazardly. The premium paid to the primary insurer includes considerable structuring to account for the fact that the primary carrier will be undertaking the duty of investigation of the claim and the defense of the litigation.<sup>162</sup> Recognizing this fact, excess insurers normally underwrite premiums on the basis of what

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158. "This problem is particularly acute in coincidence cases, where the 'other insurance' clauses fail to adequately address which carrier shall have the duties of defense." German & Gallagher, *Duties of Defense*, *supra* note 5, at 260. The application of "other insurance" clauses "is still characterized by confusion, inconsistency and the absence of rational guidelines for interpretation," despite longstanding industry awareness of it and attempts to clear it up. Kahn, *The "Other Insurance" Clause*, 19 FORUM 591, 593 (1983-84).

159. German & Gallagher, *Duties of Defense*, *supra* note 5, at 260.

160. *Id.* at 261 (emphasis in original); see also *McPhee*, 57 Wis. 2d at 673, 205 N.W.2d at 155 ("Contracts of insurance rest upon and are controlled by the same principles of law that are applicable to other contracts, and parties to an insurance contract may provide such provisions as they deem proper as long as the contract does not contravene law or public policy.").

161. P. MAGARICK, *supra* note 5, at 11.

[T]he insured should not be left without a prompt and proper defense and if a primary insurer fails to assume the defense, for any reason, the excess carrier still has the obligation to provide a defense and, to do justice, should be entitled to recoup its costs from the primary insurer.

7C J. APPLEMAN, *supra* note 8, at 33; see cases cited *supra* note 50 and accompanying text.

162. See *supra* text accompanying notes 23-25.

the liability exposure for loss of payment would be. Moreover, they consider the fact that information about the investigation and defense will be obtained from the primary insurers.<sup>163</sup> For this reason, premiums for excess insurance are lower than premiums for primary insurance.<sup>164</sup>

The excess insurer's rate structure does not envision a rule which permits another party to expand the excess insurer's potential liability.<sup>165</sup> *Loy v. Bunderson* and *Teigen v. Jelco of Wisconsin, Inc.*, however, appear to dictate such a result. The excess insurer is required to come in and cover the primary insurer's contractual obligations as well as its own. An excess insurer may be forced to raise premiums to afford the cost of participating in the defense of the insured if the purposes of the different kinds of coverage become distorted and uncertain.<sup>166</sup> The issue is further complicated by the fact that *Loy* and *Teigen* failed to distinguish between "true" and "coincidental" excess insurance. Though *Loy* indicated that an insurer must prove its rate structure to show that the insurer obtained a different rate,<sup>167</sup> *Teigen* ignored this factor even though the "true" excess carrier could show that it had ob-

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163. "The premium charged by the primary insurer supports more localized claims adjustment facilities than those of the excess carrier." *Lanzone*, *supra* note 105, at 383; see *Peter v. Travelers Ins. Co.*, 375 F. Supp 1347, 1350 (C.D. Cal. 1974); *Transit Casualty Co. v. Spink Corp.*, 94 Cal. App. 3d 124, 135, 156 Cal. Rptr. 360, 367 (1979); *supra* text accompanying notes 44-46.

164. "The premium paid by the insured generally is computed by reference to the risks being insured against; the more likely a specified 'risk,' the higher the premium." *Alleman*, *supra* note 5, at 76; see *supra* note 46.

165. *Valentine v. Aetna Ins. Co.*, 564 F.2d 292, 298 (9th Cir. 1977); *Continental Casualty Co. v. Reserve Ins. Co.*, 307 Minn. 5, \_\_\_, 238 N.W.2d 862, 865 (1976); *Ingram*, *supra* note 105, at 883.

166. *Valentine*, 564 F.2d at 297-98; *Reserve*, 307 Minn. at \_\_\_, 238 N.W.2d at 864. A rule dictating such a result would be both uneconomical and inequitable. *Holloway & Hamm*, *supra* note 20, at 951-52; see *Sutterfield, Relationships Between Excess and Primary Insurers: The Excess Judgment Problem*, 52 INS. COUNS. J. 638 (1985).

On the other hand, most excess insurance is written on a national basis. As a result, cases deciding that an excess carrier will have to defend an action, the cost of which was not originally contemplated in its premium, may not adversely affect the premium structure of excess insurers to a great degree. Telephone interview with Bob Schmidt, Underwriter at The American Companies, Inc. (Feb. 27, 1985).

167. "[The excess insurer] is not in fact an excess insurer which had the opportunity, consciously, to adjust its premium rates on the basis that there was an underlying policy purchased by the same insured." *Loy v. Bunderson*, 107 Wis. 2d 400, 417, 320 N.W.2d 175, 185 (1982); see *supra* note 95.

tained a different rate based on the underlying policy.<sup>168</sup> It therefore appears that if an excess insurer does not intend to provide investigatory and defense costs, the policy should state so explicitly.

### C. *Nature of the Duty*

An important distinction exists between the theories of equitable subrogation and direct duty owed to the excess carrier. Under equitable subrogation, the rights of the subrogee (the excess carrier) can never be greater than those of the subroger (the insured). This fact can produce inequitable results. For instance, if the primary insurer and insured have colluded to improperly reject a settlement offer within the primary's limits, the wrongful conduct by the insured would bar the excess from recovering from the primary on an equitable subrogation theory. If, on the other hand, a direct duty theory were implemented, the insured's conduct would present no obstacle to the excess carrier's cause of action against the primary insurer.<sup>169</sup>

The weakness in the equitable subrogation theory led the California courts to adopt "triangular reciprocity" as a means of allowing the excess carrier recovery.<sup>170</sup> Under a "triangular reciprocity" theory, the insured, the primary insurer and the excess insurer occupy a three-way relationship which engender reciprocal duties of care.<sup>171</sup> This three-way duty concept is based upon the fundamental idea that reasonable foreseeability of harm creates a duty of care. Indeed, it only makes sense that the excess carrier is a foreseeably injured party

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168. The excess carrier in *Teigen* argued that *Loy* was inapplicable because the insured's premium "was set and its policy was written based on the coverage afforded" to the insured by the primary insurer, and that "the premium was calculated with the expectation that the cost of defense of any claim would be borne by . . . the primary carrier." *Teigen v. Jelco of Wis., Inc.*, 124 Wis. 2d 1, 7, 367 N.W.2d 806, 809 (1985).

169. See *Kaiser Found. Hosps. v. North Star Reinsurance Corp.*, 90 Cal. App. 3d 786, 153 Cal. Rptr. 678 (1979) (where collusion between the primary insurer and the insured was not allowed to destroy the rights of the excess insurer).

170. See *Transit Casualty Co. v. Spink Corp.*, 94 Cal. App. 3d 124, 156 Cal. Rptr. 360 (1979). *Spink* was disapproved on other grounds in *Commercial Union Assurance Cos. v. Safeway Stores, Inc.*, 26 Cal. 3d 912, 921, 610 P.2d 1038, 1043, 164 Cal. Rptr. 709, 714 (1980), but later approved in *Signal Cos. v. Harbor Ins. Co.*, 27 Cal. 3d 359, 365, 612 P.2d 889, 892-93, 165 Cal. Rptr. 799, 802-03 (1980). See *Russo v. Rochford*, 123 Misc. 2d 55, —, 472 N.Y.S.2d 954, 959 (1984).

171. *Spink*, 94 Cal. App. 3d at 134, 156 Cal. Rptr. at 366.

when the primary carrier is negotiating a settlement. Therefore, the excess carrier should have a direct cause of action in tort against the primary carrier.<sup>172</sup> If an insured has excess coverage, the insured should not care if there is an excess judgment. "Thus, it seems rather peculiar that the excess carrier's rights against the primary should arise by 'stepping into the shoes' of the insured."<sup>173</sup>

Courts are often preoccupied with benefits to the insured, in which case an equitable subrogation analysis may make sense. Where the insured has suffered no harm, however, it is illogical to speak in terms of the insured having a claim. By adopting a direct duty analysis, courts can more easily conclude that a primary insurer owes the same standard of conduct to the excess insurer as it owes to the insured in the absence of an excess policy.<sup>174</sup> Several policy considerations

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172. See, e.g., Holloway & Hamm, *supra* note 20, at 941, 951-52.

173. Ingram, *supra* note 105, at 872.

174. See generally Ingram, *supra* note 105, at 881-84; Lanzone & Ringel, *supra* note 22, at 282-83. One commentator contends that the direct duty theory will gain greater acceptance when, and if, the "'Guiding Principles for Insurers of Primary and Excess Coverages' find more adherence, since becoming party signatories to them might further the development of a sufficient relationship between the parties to allow imposition of a direct duty." N. MANN *supra* note 33; see P. MAGARICK, *supra* note 5, at 261; Sutherland, *supra* note 166, at 642-43.

The *Guiding Principles for Insurers of Primary and Excess Coverages* provide:

(1) The primary insurer must discharge its duty of investigating promptly and diligently, even those cases in which it is apparent that its policy limit may be consumed.

(2) Liability must be assessed on the basis of all the relevant facts which a diligent investigation can develop and in the light of applicable legal principles. The assessment of liability must be reviewed periodically throughout the life of the claim.

(3) Evaluation must be realistic and without regard to the policy limit.

(4) When, from evaluation of all aspects of a claim, settlement is indicated, the primary insurer must proceed promptly to attempt a settlement, up to its policy limit if necessary, negotiating seriously and with an open mind.

(5) If, at any time, it should reasonably appear that the insured may be exposed beyond the primary limit, the primary insurer shall give prompt written notice to the excess insurer, when known, stating the results of investigation and negotiation and giving any other information deemed relevant to a determination of the total exposure, and inviting the excess insurer to participate in a common effort to dispose of the claim.

(6) Where the assessment of damages, considered alone, would reasonably support payment of a demand within the primary policy limit, but the primary insurer is unwilling to pay the demand because of its opinion that liability either does not exist or is questionable and the primary insurer recognizes the possibility of a verdict in excess of its policy limit, it shall give notice of its position to



should be noted in favor of finding a direct relationship between primary and excess carriers. Such a finding would: (1) encourage settlements; (2) discourage gambling with the excess insurer's funds; (3) prevent unnecessary premium hikes for excess insurers; (4) reduce the overall cost of claims; and (5) reflect the duty of the primary carrier to perform that which it alone has assumed, that is, to provide total coverage within the primary policy limits.<sup>175</sup>

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the excess insurer, when known. It shall also make available its file to the excess insurer for examination, if requested.

(7) The primary insurer shall never seek a contribution to a settlement within its policy limit from the excess insurer. It may, however, accept contribution to a settlement within its policy limit from the excess insurer when such contribution is voluntarily offered.

(8) In the event of a judgment in excess of the primary policy limit, the primary insurer shall consult the excess insurer as to further procedure. If the primary insurer undertakes an appeal with the concurrence of the excess insurer, the expense shall be shared by the primary and the excess insurer in such manner as they may agree upon. In the absence of such an agreement, they shall share the expense in the same proportions that their respective shares of the outstanding judgment bear to the total amount of the judgment. If the primary insurer should elect not to appeal, taking appropriate steps to pay or to guarantee payment of its policy limit, it shall not be liable for the expense of the appeal or interest on the judgment from the time it gives notice to the excess insurer of its election not to appeal and tenders its policy limit. The excess insurer may then prosecute an appeal at its own expense, being liable also for interest accruing on the entire judgment subsequent to the primary insurer's notice of its election not to appeal. If the excess insurer does not agree to an appeal, it shall not be liable to share the cost of any appeal prosecuted by the primary insurer.

(9) The excess insurer shall refrain from coercive or collusive conduct designed to force a settlement. It shall never make formal demand upon a primary insurer that the latter settle a claim within its policy limit. In any subsequent proceeding between excess insurer and primary insurer, the failure of the excess insurer to make formal demand that the claim be settled shall not be considered as having any bearing on the excess insurer's claim against the primary insurer.

*Guiding Principles for Insurers of Primary and Excess Coverages*, CLAIMS EXECUTIVES COUNCIL, AMERICAN INS. ASS'N & MUT. INS. ALLIANCE (1974) (cited in N. MANN, *supra* note 33, at 8-9; Lanzone & Ringel, *supra* note 22, at 280-81).

According to some authors on the subject, however, the actual effectiveness of the *Guiding Principles* is subject to dispute. Lanzone, *Duties Owed by a Primary Insurer and an Insured with a Self-Insured Retention to an Excess Insurer — An Update*, 28 FED'N INS. COUNS. Q. 267, 277-79 (1977-78) [hereinafter Lanzone, *Update*]; Lanzone & Ringel, *supra* note 22, at 281-82.

175. See *United States Fidelity & Guar. Co. v. Tri-State Ins. Co.*, 285 F.2d 579 (10th Cir. 1960); *Peter v. Travelers Ins. Co.*, 375 F. Supp. 1347 (C.D. Cal. 1974); P. MAGARICK, *supra* note 5, at 284; Griffin, *supra* note 20, at 382; Holloway & Hamm, *supra* note 20, at 944-45; Ingram, *supra* note 105, at 881-84; Lanzone, *supra* note 105, at 400.

### D. Exhaustion of Policy Limits

Limits of liability provisions in excess policies specifically provide that the carrier will indemnify the insured only after the primary limits have been exhausted.<sup>176</sup> A workable definition of the word "exhaust" is to "use up" or "consume entirely."<sup>177</sup> Under *Loy* and *Teigen*, exhaustion occurs when the primary carrier satisfies its duty to the insured by tendering a settlement amount that is within the primary's limits.<sup>178</sup> Such reasoning violates the plain meaning of the policy language.

As a way of illustration, consider a person having a \$200 pool of spending money available for a particular time period. If at the end of that time period all of the money has been spent, it can be said that the pool of money has been "exhausted." If, however, at the end of the time period the person has spent \$150 of the \$200, it would not be logical to say that the pool has been "exhausted." Nevertheless, such is the reasoning in those cases holding that a primary insurer exhausts its coverage by paying only part of its maximum limit.<sup>179</sup>

In *Teigen*, the primary's policy provided that it would not be obligated "to defend any suit after the applicable limit of the company's liability has been exhausted by payment of judgments or settlements."<sup>180</sup> The court in essence concludes that a settlement of *any* size exhausts a company's liability. It is difficult, if not impossible, to conceive of a primary insurer "exhausting," "using up" or "consuming entirely" its liability or policy limits when it pays to the insured an amount less

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176. See cases cited *supra* note 47; see also *Valentine v. Aetna Ins. Co.*, 564 F.2d 292, 296 (9th Cir. 1977); *Vencill v. Continental Casualty Co.*, 433 F. Supp. 1371, 1373 (S.D. W. Va. 1977); *Signal Cos. V. Harbor Ins. Co.*, 27 Cal. 3d 359, 362, 612 P.2d 889, 891, 165 Cal. Rptr. 799, 801 (1980); *McConnell v. Underwriters at Lloyds*, 56 Cal. 2d 637, \_\_\_, 365 P.2d 418, 424, 16 Cal. Rptr. 362, 368 (1961); *Schweisthal v. Standard Mut. Ins. Co.*, 48 Ill. App. 2d 226, 231, 198 N.E.2d 860, 862 (1964); *Ryder Truck Lines, Inc. v. Carolina Casualty Ins. Co.*, 270 Ind. 315, \_\_\_, 385 N.E.2d 449, 452 (1979); *Fireman's Fund Ins. Co. v. Rairigh*, 59 Md. App. 305, \_\_\_, 475 A.2d 509, 518 (1984).

177. WEBSTER'S NEW COLLEGIATE DICTIONARY 400 (1977). "Exhaust" is not defined in the fifth edition of *Black's Law Dictionary*. Of course, the initial place to look for definitions is in the policy itself, and if the policy contains a definition for the desired word or phrase, then reference to outside sources is not necessary.

178. See *supra* text accompanying notes 142-48.

179. See *supra* text accompanying notes 130-48.

180. *Teigen v. Jelco of Wis., Inc.*, 124 Wis. 2d 1, 8, 367 N.W.2d 806, 810 (1985) (citing from the primary policy) (emphasis in original).

than the policy limits. Certainly, a reasonable person in the position of the insured would not have understood the word "exhausted" to have such a meaning.<sup>181</sup>

## VI. CONCLUSION

Confrontations among primary and excess insurers are increasing for various reasons: (1) significantly higher jury awards involve excess insurance with greater frequency; (2) most primary carriers' product liability policies contain an aggregate limit which, once exhausted, triggers excess insurers' coverages; and (3) primary insurers tend to gamble on the outcome of trial whenever a proposed settlement would exhaust the policy limits. The problem is that the gambled funds may really be those of the excess insurer.<sup>182</sup>

Regardless of costs incurred by a primary insurer, an excess insurer has no responsibility unless and until the primary limits have been exhausted.<sup>183</sup> From the excess insurer's perspective, an important benefit of an excess policy is the full protection of the primary limits. Neither the insured nor the insurers expect that the excess carrier will defend, settle or satisfy claims which can be settled or defended for an amount below the excess carrier's retention. This expectation is reflected in the premium structure,<sup>184</sup> in the fact that excess policies specifically require that the insured maintain primary insurance in specified amounts,<sup>185</sup> and in the limits of liability provisions of the excess policy.<sup>186</sup>

To be sure, settlements like those in *Loy* and *Teigen* ought to be encouraged among parties. However, one party should not be allowed to impose a burden upon another where the latter's obligation has not yet arisen. Any contrary result sim-

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181. "An insurance policy must be construed in accordance with the test of what a reasonable person in the position of the insured would have understood the word to mean." *RTE Corp. v. Maryland Casualty Co.*, 74 Wis. 2d 614, 624, 247 N.W.2d 171, 176 (1976); see *McPhee v. American Motorists Ins. Co.*, 57 Wis. 2d 669, 676, 205 N.W.2d 152, 156-57 (1973).

182. See Lanzzone, *Update*, *supra* note 174.

183. See *supra* text accompanying notes 47-51.

184. See *supra* text accompanying notes 161-68.

185. See *supra* notes 41-43 and accompanying text.

186. See *supra* text accompanying notes 47-51.

ply prejudices the rights of the excess insurer, namely, the right to defend in accordance with the terms of its policy.

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