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EXCESS LIABILITY INSURANCE

PATRICK R. GRIFFIN*

I. INTRODUCTION

Much has been written in recent times about an insurer's exposure to excess liability resulting from its misconduct in the handling and settlement of claims.¹ The law has now sufficiently developed that it can be stated with reasonable certainty that an insurer is subject to liability if it wrongfully refuses to defend or settle a claim made by a third party against the insured.² However, when the insured also carries additional liability policies which provide protection in excess of the primary insurer's policy limits, the results are somewhat unclear.

Where there is excess insurance coverage, if the primary carrier wrongfully refuses to defend or compromise a claim which results in a judgment against the insured in excess of the primary policy limits, primary responsibility for payment of the excess amount does not fall directly on the shoulders of the insured. Rather, the excess carrier, by virtue of its contract with the insured, is obligated to pay the excess judgment falling within its limits. In this article, the relationship between primary and excess insurance carriers will be examined. An attempt will be made to delineate the respective rights and obligations the insurers have to one another and to identify those situations where a primary carrier may be liable to an excess insurer for its misconduct in the handling of a claim.

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1. See, e.g., P. MAGARICK, *EXCESS LIABILITY* (1976) [hereinafter cited as MAGARICK]; Cochran, *The Obligation to Settle Within Policy Limits*, 1970 *INS. L. J.* 583 (1970); Kircher, *Insurer's Mistaken Judgment — A New Tort?*, 59 *MARQ. L. REV.* 775 (1976); Lipsig, *Limitless Horizons of Limited Policies of Insurance*, 20 *CLEV. ST. L. REV.* 1 (1971); Comment, *Excess Liability Suits — The Mounting Need for Strict Liability*, 13 *ST. LOUIS U.L.J.* 292 (1968).

2. See, e.g., *Comunale v. Traders & Gen. Ins. Co.*, 50 *Cal. 2d* 654, 328 *P.2d* 198 (1958); *Rova Farms Resort, Inc. v. Investors Ins. Co. of America*, 65 *N.J.* 474, 323 *A.2d* 495 (1974); *Alt v. American Family Mut. Ins. Co.*, 71 *Wis. 2d* 340, 237 *N.W.2d* 706 (1976).

II. THE AMORPHOUS LEGAL PERCEPTION OF THE RELATIONSHIP BETWEEN PRIMARY AND EXCESS INSURERS

To date, the relationship between primary and excess insurance carriers has not been authoritatively identified. This may be due, in part, to the fact that until recently there has been a dearth of case law on the subject.³ This noted absence of case law can be explained by the fact that until recently jury awards did not exceed the limits of most primary insurance policies.⁴ In those cases where an excess carrier's policy was involved as a result of misconduct on the part of the primary insurer, the subsequent disputes between the two carriers seldom went through the judicial system, the matters frequently being resolved through arbitration.⁵ Another explanation for the paucity of law on the subject has been that excess insurers rarely attempted to enforce their rights against primary carriers.⁶

While there have been a number of recent attempts to legislatively⁷ or administratively⁸ regulate the claims settlement practices of insurers, the regulations have not been altogether satisfactory. Specifically, they fail to address the relationship between primary and excess carriers.⁹ There is, however, a developing body of case law on the subject, stimulated by excess insurers' attempts to recover losses occasioned by escalating verdicts.

In a number of cases, excess insurance carriers have been

3. See, Bloom, *Recovery Against Primary Insurer by Excess Carrier for Bad Faith or Negligent Failure to Settle*, 36 INS. COUNSEL J. 235 (1969) [hereinafter cited as Bloom]. See also Hardies, *Guiding Principles (and Principals) in Primary and Excess Problems*, 1977 INS. L.J. 469.

4. Bloom, *supra* note 3, at 237; Lanzone, *Primary Insurer's Duty to Excess Insurer*, in *Insurance Law—Excess Liability 18* (Def. Research Inst. 1973) [hereinafter cited as Lanzone].

5. See MAGARICK, *supra* note 1, at 216-18. There, the author notes that the Claims Executive Council of the American Insurance Association and the American Mutual Insurance Alliance, together with some unaffiliated insurers, in 1974 proposed to their member companies the adoption of some guiding principles for the handling of liability claims where both a primary and an excess insurer are involved. The recommendations urge that any differences between the primary and excess carriers be resolved by arbitration.

6. Bloom, *supra* note 3, at 238.

7. See, e.g., OR. REV. STAT. § 746.230 (1976).

8. See, e.g., WIS. AD. CODE § Ins. 6.11 (1978).

9. Both the Oregon statute and the Wisconsin regulations, as well as those of most other jurisdictions, are based on the Model Unfair Claims Practices Settlement Act. See Houser, *First-Party Claims for More Than Policy Limits—A Defendant's Viewpoint*, 11 FORUM 529, 534-35 (1976).

allowed to recover their losses from primary insurers who were guilty of negligence or bad faith in the handling of a claim against an insured. Though several different theories of recovery have been recognized, the essence of the primary insurer's liability has not been well stated. Despite these variations there are a number of general principles which the courts consistently follow.

A primary insurer is solely responsible for claims made against an insured for amounts within the primary policy limits.¹⁰ The primary carrier must exhaust the full limits of its coverage before an excess insurer can be required to contribute toward a compromise settlement or judgment.¹¹ If the primary insurer violates any of its general duties of good faith and ordinary care in the handling of claims against the insured, its liability to the excess carrier will be for the loss caused by its misconduct which would have fallen on the shoulders of the insured absent the excess coverage.¹²

When an excess carrier sues a primary insurer for the mishandling of a claim, it appears that the excess carrier may sue either in tort or for breach of contract. If the excess carrier sues in tort, it may recover either in its own capacity as a foreseeable injured party¹³ or by asserting the rights of the insured through the doctrine of equitable subrogation.¹⁴ If the suit is for breach of contract, the excess carrier can only assert the insured's rights acquired through subrogation. In such situations the lack of privity between the two insurers and the lack of third party beneficiary principles prohibit the excess carrier from bringing an action in its own name against the primary carrier.¹⁵

While there is no direct contractual liability to the excess

10. MAGARICK, *supra* note 1, at 215.

11. *Id.*; *Valentine v. Aetna Ins. Co.*, 564 F.2d 292 (9th Cir. 1977); *St. Paul-Mercury Indem. Co. v. Martin*, 190 F.2d 455 (10th Cir. 1951); *Vencill v. Continental Cas. Co.*, 433 F. Supp. 1371 (S.D. W. Va. 1977).

12. See generally Bloom, *supra* note 3, at 238; Knepper, *Relationships Between Primary and Excess Carriers in Cases Where Judgment or Settlement Value Will Exhaust the Primary Coverage*, 20 INS. COUNSEL J. 207 (1953) [hereinafter cited as Knepper].

13. Holloway & Hamm, *Defenses to Excess Carrier's Suit Against a Primary Carrier—Refusal to Defend or Settle*, 11 FORUM 940, 941 (1976) [hereinafter cited as Holloway].

14. See generally Bloom, *supra* note 3, at 236-37.

15. See, e.g., *Universal Underwriters Ins. Co. v. Dairyland Mut. Ins. Co.*, 120 Ariz. 518, 433 P.2d 966 (1967); Holloway, *supra* note 13, at 941-42.

insurer, several courts have either implicitly or explicitly recognized the existence of a direct duty of conduct owed to excess insurers by primary carriers.¹⁶ Other courts have held that no such direct duty exists and concomitantly, that an excess carrier has no direct right of action against a primary carrier who fails to handle claims in good faith.¹⁷

The basis of the primary insurer's direct duty has never been clearly explained. By recognizing this duty, courts have accomplished openly what the subrogation doctrine only allowed indirectly and eliminated many of the problems encountered in the application of the principles of subrogation.¹⁸ However, by allowing recovery on the basis of a direct duty, courts have ventured into a new area, without the benefit of the traditional rules and defenses of subrogation. For example, if both the primary and excess insurers are guilty of some culpable conduct, with the primary's fault being greater, a question arises whether the excess carrier should be allowed to recover.

While the law of subrogation recognizes equitable defenses, the law governing direct liability of primary insurers has not sufficiently developed to provide an answer to the problem. The decisions which have held primary carriers liable for a breach of this direct duty have not adequately explained the basis of the duty or of the primary insurer's liability. The typical opinion merely recites the existence of the duty and proceeds to find the insurer liable for failing to conform to the standard of conduct required under the circumstances.

Perhaps the basis of a primary insurer's direct liability

16. *St. Paul-Mercury Indem. Co. v. Martin*, 190 F.2d 455 (10th Cir. 1951); *Continental Cas. 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*, 148 N.J. Super. 419, 372 A.2d 1124 (1977). See also R. KEETON, *BASIC TEXT ON INSURANCE LAW* § 7.8(d) (1971); Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1152 (1954) [hereinafter cited as Keeton]; *Lanzone*, *supra* note 4, at 18, 24.

17. *Universal Underwriters Ins. Co. v. Dairyland Mut. Ins. Co.*, 120 Ariz. 518, 433 P.2d 966 (1967); *Peter v. Travelers Ins. Co.*, 375 F. Supp. 1347, 1349 (C.D. Cal. 1974); *Allstate Ins. Co. v. Reserve Ins. Co.*, 116 N.H. 806, —, 373 A.2d 339, 340 (1977).

18. It is this writer's opinion that the subrogation doctrine has been so overused and misapplied by the courts that it now, in many instances, works as a mere legal fiction rather than an equitable principle. For a discussion of just a select few of the problems involved with the application of the subrogation doctrine, see Barron, "Heifetz" and the Collateral Source Rule, 48 WIS. B. BULL. 27 (1975); *Term of the Wisconsin Supreme Court — Insurance*, 61 MARQ. L. REV. 326, 326-36 (1977) [hereinafter cited as *Term of Court*]. See also *Rixmann v. Somerset Pub. Schools*, 83 Wis. 2d 571, 266 N.W.2d 326 (1978).

should best be considered to be negligence. Certainly, harm to the excess carrier is foreseeable if the primary insurer fails to reasonably settle a claim within policy limits.¹⁹ To extend a duty of due care to the primary insurer under such circumstances would do no violence to the law of negligence. Professor Prosser once remarked, "the courts will find a duty where, in general, reasonable men would recognize it and agree that it exists."²⁰ Moreover, since most courts have recognized that an insurer owes a duty to refrain from negligent conduct to its insured,²¹ it is a simple matter to extend this duty to excess carriers.²² The problem of culpable conduct on the part of both carriers could easily be handled through application of principles of comparative negligence. Additionally, the comparative negligence approach would seem to work more equitably than that of subrogation, for while unclean hands or culpable conduct will generally prevent a subrogee from recovering,²³ contributory negligence only serves to diminish the amount of the claimant's recovery.

Whether a court recognizes direct liability based on negligence or instead follows the subrogation approach should have little or no effect on claim settlement practices. As will be demonstrated, application of the principle of equitable subrogation has little impact on the scope of a primary carrier's duties in the handling and settling of claims.

As a general rule, an excess insurer has the same rights of subrogation as does any other insurer.²⁴ The majority of courts which have considered this question have held that an excess carrier may maintain an action against a primary insurer for negligence or bad faith handling of a claim under the doctrine of equitable subrogation.²⁵ The excess carrier acquires its right

19. Holloway, *supra* note 13, at 941.

20. W. PROSSER, *HANDBOOK OF THE LAW OF TORTS* § 54, at 327 (4th ed. 1971).

21. *See, e.g.,* *Rova Farms Resort, Inc. v. Investor Ins. Co. of America*, 65 N.J. 474, 323 A.2d 495 (1974); *Alt v. American Family Mut. Ins. Co.*, 71 Wis. 2d 340, 237 N.W.2d 706 (1976).

22. *See* *Continental Cas. Co. v. Reserve Ins. Co.*, 307 Minn. 5, 238 N.W.2d 862 (1976); *Estate of Penn*, 148 N.J. Super. 419, —, 372 A.2d 1124, 1127. *See also* Note, 25 Drake L. Rev. 923 (1976).

23. *See* *Economy Fire & Cas. Co. v. Western States Mut. Ins. Co.*, 49 Ill. App. 2d 59, 198 N.E.2d 723 (1964).

24. 16 G. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 62.53 (2d ed. 1966) [hereinafter cited as COUCH].

25. *See, e.g.,* *Valentine v. Aetna Ins. Co.*, 564 F.2d 292, 297 (9th Cir. 1977); *American Fidelity & Cas. Co. v. All Am. Bus Lines*, 179 F. 2d 7 (10th Cir. 1950), *on appeal*

of action upon payment of the insured's loss, and its right is not dependent on the inclusion of a subrogation provision in the insurance contract. Equitable subrogation arises purely by operation of law.²⁶

To recover under this theory, the excess insurer must prove six essential elements: first, a loss is sustained by the insured for which the primary carrier is responsible; second, the excess carrier has compensated the insured for the loss; third, the insured has an existing, assignable cause of action against the primary insurer; fourth, the excess insurer has suffered damages as a result of the primary carrier's errors or omissions; fifth, the excess carrier acted reasonably and was not a volunteer; and sixth, that justice requires that the loss be shifted from the excess carrier to the party producing it.²⁷

Some courts have taken the position that the excess carrier obtains no rights by operation of law or equity, and that such insurers may only be subrogated²⁸ to the rights of the insured, if the insurance contract expressly provides.²⁹ This trivial distinction has very little effect on excess carriers, since most insurance policies written today contain some subrogation or assignment clause.³⁰ Once an insurer is found to have subrogated rights, the source of the rights becomes irrelevant. The right to recover by subrogation, regardless of the specie, is determined by identical standards.³¹

following second trial, 190 F.2d 234 (10th Cir. 1951), *cert. denied*, 342 U.S. 851 (1951); *Peter v. Travelers Ins. Co.*, 375 F. Supp. 1347 (C.D. Cal. 1974); *Western World Ins. Co. v. Allstate Ins. Co.*, 150 N.J. Super. 481, 376 A.2d 177 (1977); *State Farm Mut. Auto. Ins. Co. v. Foundation Reserve Ins. Co.*, 78 N.M. 359, 431 P.2d 737 (1967). *See also* COUCH, *supra* note 24, at § 62.53; Bloom, *supra* note 3, at 236-37; Holloway, *supra* note 13, at 943; Keeton, *supra* note 16, at 1152.

26. *Garrity v. Rural Mut. Ins. Co.*, 77 Wis. 2d 537, 543, 253 N.W.2d 512, 515 (1977); *Kimball & Davis, The Extension of Insurance Subrogation*, 60 MICH. L. REV. 841 (1962) [hereinafter cited as *Kimball & Davis*]; *Term of Court*, *supra* note 18, at 329.

27. *Peter v. Travelers Ins. Co.*, 375 F. Supp. 1347, 1350 (C.D. Cal. 1974); *Patent Scaffolding Co. v. William Simpson Constr. Co.*, 256 Cal. App. 2d 506, 509, 64 Cal. Rptr. 187, 190 (1967).

28. Conventional subrogation arises as a result of an agreement between the parties that the insurer should be subrogated to the rights of the insured. *See Kimball & Davis, supra* note 26; *Term of Court, supra* note 18, at 330.

29. *See, e.g., Allstate Ins. Co. v. Reserve Ins. Co.*, 116 N.H. 806, ____, 373 A.2d 339, 340 (1977); Lanzone, *supra* note 4, at 19-20.

30. *See R. KEETON, BASIC TEXT ON INSURANCE LAW* § 3.10 (1971).

31. This is true in Wisconsin, *Garrity v. Rural Mut. Ins. Co.*, 77 Wis. 2d 537, 543, 253 N.W.2d 512, 515 (1977); *American Ins. Co. v. Milwaukee*, 51 Wis. 2d 346, 352-53, 187 N.W.2d 142, 145 (1971), as well as in most other jurisdictions. *See, e.g., Maryland*

The real question to be resolved with respect to the subrogation issue is whether the excess insurer has the same rights and obligations as the insured or is afforded only a lesser degree of protection. The majority of courts have held that the excess carrier, as subrogee, steps into the shoes of the insured thus making the rights of the insured and the excess carrier, vis-a-vis the primary carrier, identical.³² A number of writers however, have disputed these holdings and have argued that the rights of the excess carrier should not be equal in view of the insurer's greater knowledge, experience and expertise.³³

Subrogation, as an equitable doctrine, mandates that all relevant facts must be considered before a court can make a final determination. This principle opens the door for consideration of the excess carrier's ability to protect itself. In most cases this ability is minimal, since the primary carrier generally has full control of the handling of the claim, or at least through its initial stages. Excess insurers often find themselves receiving late notice or even no notice of the existence of the claim, thus making it impossible to take adequate protective measures.³⁴ Though the excess insurer's experience and knowledge should be considered, it is apparent that this factor cannot alone determine the outcome of the carrier's right to recover.

As already indicated, whether a jurisdiction follows the approach of equitable subrogation or recognizes a direct duty in tort, the ultimate results should remain the same. In either

Cas. Co. v. Cincinnati, C., C. & St. L. Ry., 74 Ind. App. 272, 124 N.E. 744 (1919); Providence Wash. Ins. Co. v. Hogges, 67 N.J. Super. 475, 171 A.2d 120 (1961); Lyons v. Hartford Acc. & Indem. Co., 25 Utah 2d 311, 480 P.2d 739 (1971). *Contra*, Shifrin v. McGuire & Hester Constr. Co., 239 Cal. App. 2d 420, 48 Cal. Rptr. 799 (1966); Blue Cross v. O'Donnel, 230 So. 2d 706 (Fla. Dist. Ct. App. 1970); Ervin v. Garner, 25 Ohio St. 2d 231, 267 N.E.2d 769 (1971).

32. See, e.g., Valentine v. Aetna Ins. Co., 564 F. 2d 292, 297 (9th Cir. 1977); Vencill v. Continental Cas. Co., 433 F. Supp. 1371, 1376 (S.D. W. Va. 1977); Peter v. Travelers Ins. Co., 375 F. Supp. 1347, 1350 (C.D. Cal. 1974); MAGARICK, *supra* note 1, at 215; Keeton, *supra* note 16, at 1152.

33. See Bloom, *supra* note 3, at 236-37; Holloway, *supra* note 13, at 944; Knepper, *supra* note 12, at 210.

34. See, e.g., Smoral v. Hanover Ins. Co., 37 App. Div. 23, 322 N.Y.S.2d 12 (1971). In *Smoral* the excess carrier received no notice of the claim until the primary had reached a settlement agreement with the claimant whereby the primary carrier was released from liability and given a credit for the amount of its policy limits, while the claimant reserved his rights to proceed against the insured and the excess insurer for the remainder of his claim. The excess carrier only learned of the claim when the primary carrier turned the matter over to the excess carrier to maintain the defense.

case, the primary insurer must afford the same protections to the excess carrier as it affords to the insured. This is clearly the trend in the development of the law on the subject,³⁵ and its development should be welcomed. There are strong public policy considerations which favor the extension of the protections guaranteed to the insured to those guaranteed excess carriers.

Extension of the primary carrier's duty to include the excess carrier reduces the insurer's temptation to speculate when faced with claims in excess of its policy limits. Absent some legal liability, the primary insurer may gamble with the excess carrier's money and has little to lose by refusing to reasonably settle.³⁶ The extension of these protections also encourages primary carriers to remain alert to settlement possibilities — even in instances where it is not clearly in their economic interest to do so.³⁷ Further, if primary carriers were relieved of their duty to accept reasonable settlement offers in cases where excess insurance coverage is available, extra and unanticipated costs to excess insurers could result, thereby increasing the price of such insurance without additional benefits or coverage.³⁸ If excess carriers were not allowed to recover against primary carriers for breach of their duty to settle, it would provide a disincentive for the primary carrier to settle a claim any time the offer was near the limits of the primary policy.³⁹ Furthermore, to preclude liability would undermine the interests of the public and the insured in obtaining prompt and just settlement of claims.⁴⁰

Thus, while some courts may follow different approaches to the question, it can be seen that a primary carrier owes essentially the same duties to an excess carrier as it owes to its insured. As a result, primary insurers should observe the same standards of conduct in handling claims against their insureds whether or not there is excess insurance coverage available. For

35. See, e.g., *Valentine v. Aetna Ins. Co.*, 564 F.2d 292 (9th Cir. 1977); *Vencill v. Continental Cas Co.*, 433 F. Supp. 1371 (S.D. W. Va. 1977); *Allstate Ins. Co. v. Reserve Ins. Co.*, 116 N.H. 806, 373 A.2d 339 (1977); *Western World Ins. Co. v. Allstate Ins. Co.*, 150 N.J. Super. 481, 376 A.2d 177 (1977).

36. *Holloway*, *supra* note 13, at 944-45; *Lanzone*, *supra* note 4, at 23.

37. *Bloom*, *supra* note 3, at 238.

38. *Peter v. Travelers Ins. Co.*, 375 F. Supp. 1347, 1351. See also *Valentine v. Aetna Ins. Co.*, 564 F.2d 292, 298 (9th Cir. 1977); *Continental Cas. Co. v. Reserve Ins. Co.*, 307 Minn. 5, —, 238 N.W.2d 862, 865 (1976).

39. See cases cited note 38 *supra*.

40. See cases cited note 38 *supra*.

all practical purposes then, an insurer who wishes to determine its obligations to an excess carrier need only look to the duties owed its insured and extend them accordingly. This is especially true since there is not a great deal of case law regarding the specific duties owed to excess carriers.

The remainder of this article will now examine a number of these specific duties and in particular consider the question of the excess carrier's right to actively pursue settlement within the limits of the primary policy.

III. SPECIFIC DUTIES WHICH A PRIMARY INSURER OWES TO AN EXCESS INSURER

A. *Duty to Defend; Responsibility for Defense Costs.*

As with many insurance issues, the contract language controls the duty to defend. The language of most primary policies provides that the insurer reserves the exclusive right to control selection and direction of the defense. Because of this contractual reservation, the primary duty to defend is on the primary carrier.⁴¹ However, an excess insurer may also be obligated to defend under its policy, and the duty is not necessarily extinguished by tendering the defense of an action to the underlying carrier. Since the duty to defend of each insurer is several and not joint,⁴² there may be instances where the excess carrier is required to assist the primary carrier in the defense of the claim.⁴³

Though a primary insurer's contractual duty to defend extends only to its insured,⁴⁴ a primary carrier can nevertheless be liable to an excess carrier if the former is negligent in the performance of its obligations.⁴⁵ As a general rule, if a primary insurer wrongfully refuses to defend, it will be liable to the excess carrier for the costs of the defense and reasonable expenses.⁴⁶ The primary insurer will also be liable to the excess for

41. Bloom, *supra* note 3, at 236; Holloway, *supra* note 13, at 945.

42. Keeton, *supra* note 16, at 1152.

43. Lujan v. Gonzales, 89 N.M. 229, ____, 501 P.2d 673, 677 (1972); MAGARICK, *supra* note 1, at 22.

44. United States Fidelity & Guar. Co. v. Tri-State Ins. Co., 285 F.2d 579, 581 (10th Cir. 1960); Bloom, *supra* note 3, at 236.

45. See Allstate Ins. Co. v. Reserve Ins. Co., 116 N.H. 806, ____, 373 A.2d 339, 340 (1977); Bloom, *supra* note 3, at 237.

46. See generally Western Pac. Ins. Co. v. Farmer's Ins. Exch., 69 Wash. 2d 11, ____, 416 P.2d 468, 472 (1966); MAGARICK, *supra* note 1, at 215; Bloom, *supra* note 3, at 236.

any amount paid by the excess insurer which is within the primary policy limits.⁴⁷

Although the initial duty to defend falls upon the carrier with primary coverage, the amount demanded may shift this responsibility in some jurisdictions. Where an action has been commenced and the ad damnum exceeds the primary policy limits, courts have differed on the parties' respective responsibilities for the defense of the action. While there is considerable authority for the proposition that the primary insurer has the principal obligation to defend,⁴⁸ many decisions have recognized an equal or coexisting duty to defend on the part of the excess insurer.⁴⁹ Where a coexistent duty to defend is recognized, the majority view holds that the excess carrier must share in the costs of defense.⁵⁰ Other decisions have held that the duty of each insurer is personal and several, thus preventing the insurer providing the defense from seeking contribution.⁵¹ At least one court has ruled that the excess carrier can be obligated to defend where the primary carrier refuses to do so.⁵² Still another court has held that the excess insurer has a primary duty to defend anytime the ad damnum exceeds primary policy limits.⁵³ A major factor in this latter decision was the fact that the primary carrier had already paid out its policy limits.⁵⁴ Whether the excess insurer had a duty to assume the defense absent an exhaustion of the underlying policy limits was left unanswered.

From the foregoing review of the relevant case law, it is

47. *Continental Cas. Co. v. Reserve Ins. Co.*, 307 Minn. 5, —, 238 N.W.2d 862 (1976); R. KEETON, *BASIC TEXT ON INSURANCE LAW* § 7.8(d) (1971).

48. *See, e.g., Allstate Ins. Co. v. Fidelity & Cas. Co.*, 73 N.J. Super. 407, 180 A.2d 168 (1962); *MAGARICK, supra* note 1, at 21.

49. *See, e.g., American Fidelity & Cas. Co. v. Pennsylvania Threshermen & Farmer's Mut. Cas. Ins. Co.*, 280 F.2d 453 (5th Cir. 1960); *St. Paul-Mercury Ins. Co. v. Huitt*, 215 F. Supp. 709 (W.D. Mich. 1963), *aff'd*, 336 F.2d 37 (6th Cir. 1964); *Southern Farm Bureau Cas. Ins. Co. v. Allstate Ins. Co.*, 150 F. Supp. 216 (D. Ark. 1957); *MAGARICK, supra* note 1, at 21.

50. *See, e.g., St. Paul-Mercury Ins. Co. v. Huitt*, 215 F. Supp. 709 (W.D. Mich. 1963), *aff'd*, 336 F.2d 37 (6th Cir. 1964); *MAGARICK, supra* note 1, at 21-22.

51. *United States Fidelity & Guar. Co. v. Tri-State Ins. Co.*, 285 F.2d 579 (10th Cir. 1960); *American Fidelity & Cas. Co. v. Pennsylvania Threshermen & Farmer's Mut. Cas. Ins. Co.*, 280 F.2d 453 (5th Cir. 1960); *Maryland Cas. Co. v. American Fidelity Ins. Group*, 199 Kan. 373, 429 P.2d 931 (1967).

52. *Continental Cas. Co. v. American Fidelity & Cas. Co.*, 275 F.2d 381 (7th Cir. 1960).

53. *Benroth v. Continental Cas. Co.*, 132 F. Supp. 270 (W.D. La. 1955).

54. *Id.* at 274.

apparent that there is a wide range of opinion as to which insurer is responsible for the conduct and costs of the defense in cases where the ad damnum exceeds the primary limits. The divergent opinions cannot coherently be reconciled. This suggests that the ad damnum cannot provide an appropriate basis for resolving this issue. Moreover, there are several other reasons why this clause is ill-suited for this purpose.

It is a fact of modern reality that the ad damnum clause bears little relation to the amount of the claimant's damages or ultimate recovery. Since the amount demanded in the complaint is not an accurate indicator of the value of the claim, its use as the determinative factor in deciding the responsibility for the control and cost of the defense should be strictly limited. In this writer's opinion, the settlement value of the claim is a more reliable and realistic standard for allocating the responsibility to defend. If the plaintiff's lowest settlement demand is below the primary policy limits, the primary insurer should be obligated to continue and complete the defense of the suit. On the other hand if the claimant's final demand exceeds the primary limits, it is more likely that the loss will ultimately fall on the excess carrier, and therefore, the excess carrier should be obligated to assume the defense. The excess carrier's duty should be contingent, however, on the continued cooperation of the underlying insurer. As a minimum, the primary carrier should make its file available to the excess insurer and render any necessary assistance.

B. Duty to Appeal

The standard liability insurance policy does not contain any provisions obligating an insurer to appeal an adverse verdict.⁵⁵ Moreover, several older decisions have held that there is no extracontractual duty to appeal an adverse verdict which is within the insurer's policy limits.⁵⁶ The general rule today regarding verdicts in excess of policy limits is that the duty to defend includes the duty to appeal where there are reasonable grounds on which an appeal could be based.⁵⁷ This rule should

55. MAGARICK, *supra* note 1, at 175.

56. *Ginder v. Harleysville Mut. Cas. Co.*, 49 F. Supp. 745 (E.D. Pa. 1942), *aff'd*, 135 F.2d 215 (3rd Cir. 1942); *Lincoln Park Arms Bldg. Corp. v. United States Fidelity & Guar. Co.*, 181 Ill. 512, 5 N.E.2d 773 (1936).

57. *See Reichert v. Continental Ins. Co.*, 290 So. 2d 730 (La. App. 1974); *Fidelity Gen. Ins. Co. v. Aetna Ins. Co.*, 27 App. Div. 2d 932, 278 N.Y.S.2d 787 (1967); MAGARICK, *supra* note 1, at 175-76.

equally apply when there is an excess carrier involved.

Whether the presence of excess insurance affects the primary insurer's duty to appeal is unsettled. The view most consistent with other obligations of the primary insurer is that the primary carrier owes the same duty to appeal to an excess carrier as is owed to the insured.⁵⁸ Despite this rule one federal circuit court has held that upon a primary insurer's payment of its policy limits into court there is no further responsibility to make an appeal or to pay for appeal costs.⁵⁹ This is true notwithstanding the presence of reasonable grounds to appeal.

These seemingly contradictory rulings can easily be reconciled. If the primary insurer is not guilty of bad faith in failing to settle, it should be allowed to buy its peace by tendering its limits into court. The excess insurer, having the most at stake, would then be free to appeal or pay the judgment as it sees fit. This view is consistent with the recommended industry settlement principles for primary and excess insurers.⁶⁰

C. *Duty to Communicate With the Excess Carrier*

Although there is very little law on the issue of notice, common sense would dictate that the primary insurer contact and communicate with an excess carrier when the latter's interests could be affected by a claim. Contrary to this practical approach, a New York court in *Smoral v. Hanover Insurance Co.*⁶¹ held that a primary carrier has no duty to give an excess insurer notice of the progress of the claim or of a settlement reached between the primary carrier and the third party claimant. This rule was applicable, said the court, even though the settling party reserved the right to proceed against the excess carrier for any amount in excess of the primary limits.⁶² The dissent in *Smoral* argued that the primary carrier should have a duty to inform the excess insurer of the status of the claim, and moreover, even if this were not a legal obligation, common courtesy

58. See Lanzone, *supra* note 4, at 22. See also *Home Ins. Co. v. Royal Indem. Co.*, 68 Misc. 2d 737, 327 N.Y.S.2d 745 (1972), *aff'd without opinion*, 332 N.Y.S.2d 1003 (1972).

59. *Indemnity Ins. Co. of North America v. Hawkeye Sec. Ins. Co.*, 260 F.2d 361 (10th Cir. 1958). See also MAGARICK, *supra* note 1, at 22, 217-18.

60. The text of these principles is set out in full in MAGARICK, *supra* note 1, at 216-18.

61. 37 App. Div. 23, 322 N.Y.S.2d 12 (1971).

62. *Id.* at 25, 322 N.Y.S.2d at 14.

would require that the excess carrier be given notice.⁶³

The recommended industry claim settlement procedures outline a standard of conduct which requires primary insurers to diligently investigate and evaluate all claims without regard to whether the primary limits will be consumed.⁶⁴ All relevant information is to be freely transferred to the excess insurer and an atmosphere of cooperation is to be encouraged. Since most courts extend the same protections to excess carriers as are afforded insureds, a primary insurer would be well advised to follow the industry claim settlement procedures, rather than relying on the aberrant holding of *Smoral*.

D. Duty to Cooperate

Once again, although there is no definitive case law regarding this particular duty, recommended claims handling procedures dictate that primary carriers cooperate fully and freely with any excess carriers involved in a claim.⁶⁵ The duty of cooperation appears to be a mutual one and equally applicable to either a primary or excess carrier. For example, if one company offers its proportional share to a reasonable settlement, and the other insurer unreasonably blocks the settlement and refuses to provide funds, the latter insurer has violated its duty to the insured and the other carrier and is liable for any amount which exceeds the settlement figure.⁶⁶ Recognition of this duty works no hardship on the insurer and promotes the policy goal of fair and expedient settling of insurance claims.

E. Duty to Settle

As a general rule, a primary carrier owes a duty to the insured, to exercise good faith in determining whether a settlement offer should be accepted or rejected.⁶⁷ This duty extends, at least indirectly, to excess insurers who also provide coverage.

Under the rule of equitable subrogation, a primary insurer is required to give adequate consideration to the interests of the excess carrier, as the excess insurer's rights are derived from those of the insured.⁶⁸ Where a direct duty is recognized,

63. *Id.* at 27, 322 N.Y.S.2d at 15.

64. *MAGARICK*, *supra* note 1, at 216-17.

65.. *Id.*

66. *Keeton*, *supra* note 16, at 1152.

67. *See, e.g., St. Paul-Mercury Indem. Co. v. Martin*, 190 F.2d 455 (10th Cir. 1951); *Alt v. American Family Mut. Ins. Co.*, 71 Wis. 2d 340, 237 N.W.2d 706 (1976).

68. *Peter v. Travelers Ins. Co.*, 375 F. Supp. 1347, 1350 (C.D. Cal. 1974).

the primary insurer has a direct obligation to consider the interests of the excess carrier and to act in good faith in the settlement of the claim.⁶⁹ In any event, it is generally recognized that an excess carrier can recover from a primary carrier any excess of loss caused by the negligence⁷⁰ or bad faith⁷¹ of the primary carrier in settling a claim.⁷²

IV. THE EXCESS CARRIER'S RIGHT TO ACTIVELY PURSUE SETTLEMENT WITHIN THE PRIMARY CARRIER'S POLICY LIMITS

As already noted, the primary carrier has the initial obligation and right to direct and control the defense of the suit. Because of this duty, the primary insurer also has the right of full control over the handling and settlement of claims made within its policy limits.⁷³ For example, if an action is started and the ad damnum clause of the complaint demands an amount less than the primary policy limits, the primary carrier has the exclusive right and duty to defend the action.⁷⁴ Only where the primary carrier refuses to provide a defense can the excess carrier take over the control and handling of the claim.

Because settlements are part and parcel of defending a claim, it seems logical that the right to control the settlement should track the insurer's duty to defend. Thus, where an excess carrier has a duty to defend,⁷⁵ it follows that it should also have the right to control the settlement negotiations.

Since the excess carrier will generally only be required to defend claims where the primary carrier refuses to defend,⁷⁶ or the claim value greatly exceeds the primary policy limits,⁷⁷

69. *Vencill v. Continental Cas. Co.*, 433 F. Supp. 1371, 1376 (S.D. W. Va. 1977); *MAGARICK*, *supra* note 1, at 215.

70. *See, e.g., Allstate Ins. Co. v. Reserve Ins. Co.*, 116 N.H. 806, —, 373 A.2d 339, 340 (1977).

71. *See, e.g., American Fidelity & Cas. Co. v. All Am. Bus Lines*, 179 F.2d 7 (10th Cir. 1949), *on appeal following second trial*, 190 F.2d 234 (10th Cir. 1951), *cert. denied*, 342 U.S. 851 (1951).

72. *See generally* Bloom, *supra* note 3, at 237.

73. *Brockstein v. Nationwide Mut. Ins. Co.*, 417 F.2d 703 (2d Cir. 1969); *Lanzone*, *supra* note 4, at 18.

74. *See, e.g., Priester v. Viligant Ins. Co.*, 268 F. Supp. 156 (S.D. Iowa 1967); *Lumbermen's Mut. Cas. Co. v. Connecticut Fire Ins. Co.*, 239 So. 2d 472 (La. App. 1970); *MAGARICK*, *supra* note 1, at 21.

75. *See* text accompanying notes 41-54 *supra*.

76. *See Continental Cas. Co. v. American Fidelity & Cas. Co.*, 275 F.2d 381 (7th Cir. 1960).

77. *See Benroth v. Continental Cas. Co.*, 132 F. Supp. 270 (W.D. La. 1955).

excess carriers will seldom be in a position of prejudicing the primary carrier's rights by unreasonably agreeing to settle for amounts within the limits of the primary coverage. Where the excess carrier is handling the claim because of the primary insurer's wrongful refusal, the primary carrier's misconduct should prevent any claim of bad faith occasioned by the excess insurer's action of settling the claim within primary policy limits. Where the excess carrier is defending a claim because the amount demanded is greater than the primary coverage, this situation is somewhat more delicate. Nevertheless, the excess insurer should have the right to seek a settlement for an amount within the primary limits, provided it receives the consent of the primary carrier. Such consent should not unreasonably be withheld.⁷⁸

In cases of questionable liability or exaggerated damages, an excess carrier cannot force a primary carrier to accept a settlement offer which the insurer would not otherwise be required to accept under its duties to the insured.⁷⁹ This rule is necessary to preserve the primary carrier's right to protect itself from ill-advised settlements and unwarranted losses. Should the primary carrier's intransigence be unreasonable, the excess carrier is adequately protected by the remedies available to it under the doctrines of bad faith refusal to settle.⁸⁰

There may be several tactical advantages for defendants if the excess carrier absents itself from participating in the handling of the claim. If during negotiations the claimant is unaware of the existence of the excess coverage a smaller settlement may be attainable. Just as too many cooks can spoil the soup, so too can too many participants spoil a compromise of a claim. If the primary insurer exercises good faith and due care in the handling of a claim and adequately cooperates and communicates with the excess insurer, the excess insurer has no need to actively seek a settlement within the primary policy limits.

78. Cf. *MAGARICK*, *supra* note 1, at 215.

79. *St. Paul-Mercury Indem. Co. v. Martin*, 190 F.2d 455, 457, (10th Cir. 1951); *Peter v. Travelers Ins. Co.*, 375 F. Supp. 1347, 1350 (C.D. Cal. 1974); *Bloom*, *supra* note 3, at 237.

80. *Peter v. Travelers Ins. Co.*, 375 F. Supp. 1347, 1350-51, (C.D. Cal. 1974); *Allstate Ins. Co. v. Reserve Ins. Co.*, 116 N.H. 806, ___, 373 A.2d 339, 340 (1977).

V. CONCLUSION

The law on many aspects of the relationship between primary and excess insurers is both scarce and incomplete. Nevertheless, it is clear that a primary insurer must exercise good faith and due care at all stages in the claims handling process. Primary insurers who breach these duties of good faith and due care expose themselves to liability for any damages caused to excess insurers.

In this area, practical considerations are often paramount to legal theories and technical rules. While the law has not adequately developed to the stage where all the intricacies of the relationship between primary and excess carriers are perfectly defined, common sense, available precedent and industry standards provide a more than adequate guide for insurers. In one sense, perhaps, it would be best if the law never developed beyond this stage. Case law could not develop if the standards of good faith and fair dealing were scrupulously observed by all concerned. Where differences of opinion arise, these internecine disputes can be resolved through arbitration where arbitrators, because of their specialized experience, could better handle these practical problems. Be that as it may, a primary insurer must keep uppermost in its mind the fact that an insurer who subordinates the interest of its insured or the insured's excess insurer to its own, does so at its peril and should be prepared to pay for its folly.