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# RIGHTS AND RESPONSIBILITIES OF EXCESS INSURERS

DOUGLAS R. RICHMOND\*

## I. INTRODUCTION

The terms “primary,” “excess” and “umbrella” are generic labels for the types of liability insurance policies sold today. A primary policy provides the first layer of insurance coverage. Primary coverage attaches immediately upon the happening of an “occurrence,” or as soon as a claim is made.<sup>1</sup> The primary insurer is first responsible for defending and indemnifying the insured in the event of a covered or potentially covered occurrence or claim.<sup>2</sup> Because most losses are within primary policy limits and therefore create greater exposure for primary insurers, and because primary insurers are generally obligated to defend their insureds, primary insurers charge larger premiums for coverage than do excess and umbrella carriers.<sup>3</sup> Primary policies are widely seen and understood by way of example: individuals purchase automobile and homeowners insurance, professionals purchase errors and omissions (E&O) coverage, businesses purchase commercial general liability (CGL) policies, and many financial institutions and corporations insure themselves and their leaders under directors’ and officers’ (D&O) liability policies. Larger businesses often self-insure up to some amount, with their self-insured retentions (SIRs) substituting for primary insurance.

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1. *Am. Home Assur. Co. v. Republic Ins. Co.*, 984 F.2d 76, 77 (2d Cir. 1993) (“The word ‘primary’ is used also in the field of excess insurance to distinguish coverage which attached immediately upon the happening of an occurrence, from excess coverage, which attaches only after a predetermined amount of ‘primary’ coverage has been exhausted.”); *See Fireman’s Fund Ins. Co. v. Md. Cas. Co.*, 77 Cal. Rptr. 2d 296, 311 (Ct. App. 1998) (“Primary coverage provides immediate coverage upon the ‘occurrence’ of a ‘loss’ or the ‘happening’ of an ‘event’ giving rise to liability.”); *Bailey v. State Farm Fire & Cas. Co.*, 642 N.E.2d 1323, 1326 (Ill. App. Ct. 1994) (“Primary insurance coverage is insurance which attaches immediately upon the happening of the occurrence that gives rise to the liability.”). In the liability insurance context, “occurrence” is a term of art. Standard liability insurance policies define an “occurrence” to mean “an accident, including continuous or repeated exposure to substantially the same general harmful conditions.” 1 SUSAN J. MILLER & PHILIP LEFEBVRE, *MILLER’S STANDARD INSURANCE POLICIES ANNOTATED* 419 (4th ed. 1995).

2. *See Fireman’s Fund*, 77 Cal. Rptr. 2d at 311 (“[A] primary insurer generally has the primary duty to defend and to indemnify the insured, unless otherwise excused or excluded by specific policy language.”); *See also Frankenmuth Mut. Ins. Co. v. Cont’l Ins. Co.*, 537 N.W.2d 879, 881 (Mich. 1995) (“The logical rule . . . is that the ‘true’ excess insurer is liable for defense costs only after the primary insurer is excused under the terms of its policy.”).

3. *See Reliance Nat’l Indem. Co. v. Gen. Star Indem. Co.*, 85 Cal. Rptr. 2d 627, 638-39 (Ct. App. 1999); *Associated Wholesale Grocers, Inc. v. Americold Corp.*, 934 P.2d 65, 81 (Kan. 1997); *Keck, Mahin & Cate v. Nat’l Union Fire Ins. Co.*, 20 S.W.3d 692, 700-01 (Tex. 2000).

An excess policy provides specific coverage above an underlying limit of primary insurance. Excess insurance is priced on the assumption that primary coverage exists; indeed, an excess policy usually requires by its terms that the insured maintain in force scheduled limits of primary insurance. In keeping with the reasonable expectations of the parties, including the insured, which paid separate premiums for its primary and excess policies, excess coverage generally is not triggered until the underlying primary limits are exhausted by way of judgments or settlements.<sup>4</sup> Because an excess insurer's duties to its insured are not triggered until the limits of the underlying primary policy (or policies) are exhausted within the meaning of the excess policy,<sup>5</sup> courts sometimes refer to excess insurance as "secondary insurance,"<sup>6</sup> or as "supplemental" or "supplementary insurance."<sup>7</sup> Additionally, the first layer of coverage above an SIR is sometimes described as "excess insurance."<sup>8</sup>

A true excess policy does not broaden the underlying coverage.<sup>9</sup> While an excess policy increases the *amount* of coverage available to compensate for a loss, it does not increase the *scope* of coverage.<sup>10</sup> An excess policy may be written on a "stand alone" basis or as a policy that "follows form." A stand-alone excess policy relies exclusively on its own insuring agreement, conditions, definitions, and exclusions to grant and limit coverage. A following form excess policy incorporates by reference the terms, conditions, and exclusions of the underlying policy.<sup>11</sup> An excess policy that follows form is designed to match the coverage provided by the underlying policy, although some following form policies contain

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4. See generally *Tex. Employers Ins. Ass'n v. Underwriting Members of Lloyds*, 836 F. Supp. 398, 407 (S.D. Tex. 1993) (noting that to require an excess insurer to share in defense costs incurred before the primary carrier's policy limits were exhausted "would overturn the reasonable expectations of the parties").

5. See *Safety Nat'l Cas. Corp. v. Pac. Employers Ins. Co.*, 927 P.2d 748, 751 (Alaska 1996); *M.H. Detrick Co. v. Century Indem. Co.*, 701 N.E.2d 156, 161 (Ill. App. Ct. 1998), *appeal denied*, 707 N.E.2d 1240 (Ill. 1999); *Northfield Ins. Co. v. Montana Ass'n of Counties*, 10 P.3d 813, 817 (Mont. 2000); *Allstate Ins. Co. v. United Servs. Auto. Ass'n*, 452 S.E.2d 859, 861-62 (Va. 1995); *Rees v. Viking Ins. Co.*, 892 P.2d 1128, 1130 (Wash. Ct. App. 1995).

6. See, e.g., *Steinberg v. Universal Underwriters Ins. Co.*, 650 N.E.2d 14, 17 (Ill. App. Ct. 1995); *Northfield*, 10 P.3d at 817.

7. See, e.g., *Penn Am. Ins. Co. v. Fla. Power & Light Co.*, 710 So. 2d 597, 600 (Fla. Dist. Ct. App. 1998) (describing excess insurer as "the supplemental insurance provider"); *George v. Empire Fire & Marine Ins. Co.*, 519 S.E.2d 107, 111 (S.C. Ct. App. 1999) ("An excess policy is designed as supplementary insurance and would not exist except for the underlying primary policy.").

8. See, e.g., *Vons Cos. v. U.S. Fire Ins. Co.*, 92 Cal. Rptr. 2d 597, 604-05 (Ct. App. 2000).

9. See *Wells Fargo Bank v. Cal. Ins. Guar. Ass'n*, 45 Cal. Rptr. 2d 537, 539 n.2 (Ct. App. 1995) (differentiating between excess and umbrella policies, and defining "'excess coverage' or 'excess policy' to mean insurance that begins only after a predetermined amount of underlying coverage is exhausted and that does not broaden the underlying coverage").

10. See *Globe Indem. Co. v. Jordan*, 634 A.2d 1279, 1283 (Me. 1993).

11. See *Gen. Accident Ins. Co. of Am. v. Safety Nat'l Cas. Corp.*, 825 F. Supp. 705, 707 (E.D. Pa. 1993); *Rivere v. Heroman*, 688 So. 2d 1293, 1294 (La. Ct. App. 1997); *Mass. Bay Transp. Auth. v. Allianz Ins. Co.*, 597 N.E.2d 439, 443 (Mass. 1992).

exclusions beyond those found in the primary policy, and policy provisions sometimes conflict.<sup>12</sup> To the extent the language of a primary policy and a following form excess policy differ, the terms of the excess policy control where the excess coverage is implicated. Of course, an insured that purchases two or more concurrent excess policies to insure against large risks may layer both stand alone and following form policies.<sup>13</sup>

An umbrella policy is like an excess policy in that it is written in addition to a primary policy to protect the insured against liability for catastrophic losses that would exceed the limits of affordable primary coverage.<sup>14</sup> Like many excess policies, umbrella policies are written to stand alone. An umbrella policy differs from an excess policy in a critical aspect: an umbrella policy typically insures against certain risks that a concurrent primary policy does not cover.<sup>15</sup> An umbrella policy is thus a “gap filler”;<sup>16</sup> by design, it provides first dollar liability coverage where a primary policy and an excess policy do not.<sup>17</sup> For example, an umbrella policy may insure against “personal injury” when a primary policy only insures against “bodily injury” and “property damage.” By essentially dropping down to provide primary coverage or by filling a gap in primary coverage, an umbrella policy broadens the insured’s primary coverage where an excess policy does not.<sup>18</sup> The terms “excess policy” and “umbrella policy” are not synonymous.<sup>19</sup>

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12. See *Housing Group v. Cal. Ins. Guarantee Ass’n*, 56 Cal. Rptr. 2d 378, 381-82 (Ct. App. 1996); See, e.g., *Gen. Accident Ins. Co. of Am. v. Am. Ins. Co.*, No. CIV. A. 99-3869, 2000 WL 92097, at \*3 (E.D. Pa. Jan. 27, 2000).

13. Following form policies are often used in multi-layer insurance packages because repeating identical exclusions in multiple policies is cumbersome, and because they contribute to uniform coverage and the spreading of risk among the insurers. See *Rummel v. St. Paul Surplus Lines Ins. Co.*, 945 P.2d 985, 989 (N.M. 1997).

14. See *Bailey v. State Farm Fire & Cas. Co.*, 642 N.E.2d 1323, 1326 (Ill. App. Ct. 1994) (discussing an umbrella policy that provided both primary and excess coverage, and stating that “[t]he purpose of excess insurance is to protect the insured from ‘catastrophic loss’”); *Rivere*, 688 So. 2d at 1294 (stating that an umbrella policy is designed to guard against catastrophic loss, and discussing lower cost of umbrella and excess coverage); *Davis v. Allied Processors, Inc.*, 571 N.W.2d 692, 694-95 (Wis. Ct. App. 1997) (observing that umbrella coverage insures against catastrophic loss, and explaining why it costs less than primary coverage), *rev. denied*, 579 N.W. 2d 45 (Wis. 1998).

15. See *Am. States Ins. Co. v. Md. Cas. Co.*, 628 A.2d 880, 886 (Pa. Super. Ct. 1993).

16. See *Commercial Union Ins. Co. v. Walbrook Ins. Co.*, 7 F.3d 1047, 1053 (1st Cir. 1993); *Wells Fargo Bank v. Cal. Ins. Guar. Ass’n*, 45 Cal. Rptr. 2d 537, 539 n.2 (Ct. App. 1995) (quoting *Reserve Ins. Co. v. Pisciotto*, 640 P.2d 764, 771 (Cal. 1982)).

17. Typically, umbrella policies are intended to provide comprehensive excess liability coverage and are not intended to insure against first party losses, as an underlying homeowners or automobile policy might. See *Doto v. Russo*, 659 A.2d 1371, 1374-75 (N.J. 1995).

18. This does not mean that primary policies and umbrella policies are equivalents, for they clearly are not. See *Meyer v. Mich. Mut. Ins. Co.*, 607 N.W.2d 333, 336 (Wis. Ct. App.), *review denied*, 612 N.W.2d 733 (Wis. 2000). In addition, regardless of whether an umbrella policy’s coverage is primary or excess, the policy still affords only that coverage for which its terms provide. Umbrella coverage is not boundless. See, e.g., *Greene v. Hanover Ins. Co.*, 700 So. 2d 1354, 1358

The importance of excess insurance and excess insurers' involvement in coverage disputes and related controversies has grown significantly in recent years.<sup>20</sup> This is because more insureds are purchasing excess coverage, excess insurers are increasingly involving themselves in the supervision and management of litigation implicating their policies, and many areas of tort litigation have become characterized by sizable jury verdicts and a lottery ticket mentality or atmosphere.<sup>21</sup> As might be expected, the relationships between primary insurers, excess insurers, and their insureds now raise difficult questions in a variety of circumstances. The question is no longer simply one of settlement within primary policy limits versus a primary insurer's bad faith liability to an excess or umbrella carrier for failing to do so, although such disputes are common. Notice of a loss is an issue at many levels, exhaustion of underlying policies is a recurring source of controversy, excess insurers are increasingly willing to sue defense counsel hired by primary insurers for perceived malpractice, and relationships between insurers become complicated when an insured is covered by overlapping or successive policies, all of which are implicated by a particular loss.<sup>22</sup>

This article attempts to explain critical excess insurance issues in a manner useful to courts, practitioners, and scholars alike. Part II looks at primary and excess insurance fundamentals and differences, including notice of loss requirements, as well as excess and umbrella insurers' obligations to participate in the defense of their insureds. It is important to note here that while the insurance industry promulgates standard primary liability insurance policies, there are no standard forms for excess insurance policies. Excess policy terms therefore vary widely. Part III examines the duty of good faith and fair dealing in the excess insurance context. Part IV discusses exhaustion and allocation issues. Finally, Part V examines an excess insurer's ability to sue defense counsel hired by a primary carrier for malpractice. The article points out differences between umbrella coverage and excess coverage as the need arises, rather than devoting a section to umbrella coverage.

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(Ala. 1997) ("Regardless of whether the Umbrella Policy coverage takes the form of excess or non excess coverage, it is still subject to the Umbrella Endorsement's exclusion for [the] injuries [at issue].").

19. Unfortunately, some courts and commentators wrongly believe that the terms "excess policy" and "umbrella policy" are synonymous. See, e.g., *Heyman Assocs. No. 1 v. Ins. Co. of the State of Pa.*, 653 A.2d 122, 125 n.3 (Conn. 1995) ("An excess liability policy, also known as an 'umbrella policy,' provides coverage that is secondary to an insured's primary policy.").

20. See Scott M. Seaman & Charlene Kittredge, *Excess Liability Insurance: Law and Litigation*, 32 TORT & INS. L.J. 653, 653 (1997).

21. See *id.* at 653-54.

22. See Shaun McParland Baldwin & Dawn Midkiff, *Primary and Excess Relationships: Examining the Evolving Duties*, in THE RIGHTS AND DUTIES OF PRIMARY AND EXCESS INSURANCE CARRIERS 1, 1 (Def. Research Inst. 1993).

## II. PRIMARY AND EXCESS INSURANCE: SOME FUNDAMENTALS AND DIFFERENCES

Insureds purchase liability insurance, including excess and umbrella policies, for peace of mind. There are, however, key differences between primary and excess coverage. These differences often manifest themselves in the notice of loss context and when it comes time to defend an insured against a claim or suit by a third-party.

### A. Notice of Loss

Liability insurance policies require the insured to give the insurer notice of a loss shortly after an occurrence, or when a claim is made or a suit is filed against the insured. Timely notice is a condition precedent to coverage.<sup>23</sup> The primary purpose of a notice of loss provision is to give the insurer the opportunity to adequately investigate the circumstances of the occurrence, claim, or suit so that it can defend or settle as appropriate.<sup>24</sup> The longer the wait between an occurrence and notice to an interested insurer, the greater the chance that evidence will be destroyed or lost, or that potential witnesses will disappear or their memories will fade.<sup>25</sup>

Excess and umbrella policies, like primary liability policies, contain notice requirements. A typical excess policy provides:

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23. See *Greycoat Hanover F Street Ltd. P'ship v. Liberty Mut. Ins. Co.*, 657 A.2d 764, 768 (D.C. 1995); *S.E. Express Sys., Inc. v. S. Guar. Ins. Co.*, 482 S.E.2d 433, 436 (Ga. Ct. App. 1997); *Northbrook Prop. & Cas. Ins. Co. v. Applied Sys., Inc.*, 729 N.E.2d 915, 920-21 (Ill. App. Ct.), *appeal denied*, 738 N.E.2d 928 (Ill. 2000); *Askren Hub States Pest Control Servs., Inc. v. Zurich Ins. Co.*, 721 N.E.2d 270, 277 (Ind. Ct. App. 1999); *Fireman's Fund Ins. Co. v. ACC Chem. Co.*, 538 N.W.2d 259, 262 (Iowa 1995); *Koski v. Allstate Ins. Co.*, 572 N.W.2d 636, 639 (Mich. 1998); *Craig v. Dye*, 526 S.E.2d 9, 11-12 (Va. 2000).

24. See *Sybron Transition Corp. v. Sec. Ins. Co.*, 107 F.3d 1250, 1257 (7th Cir. 1997); *S.E. Express*, 482 S.E.2d at 436; *Northbrook*, 729 N.E.2d at 921; *Herman Bros., Inc. v. Great W. Cas. Co.*, 582 N.W.2d 328, 333, 335-36 (Neb. 1998); *Ormet Primary Aluminum Corp. v. Employers Ins. of Wausau*, 725 N.E.2d 646, 655 (Ohio 2000); See also *Nat'l Union Fire Ins. Co. v. FDIC*, 957 P.2d 357, 363 (Kan. 1998) ("From the insurer's perspective, notice of a loss . . . would trigger an investigation, and delay might hamper a thorough independent investigation."). There are other valid reasons for requiring prompt notice of a loss. The early discovery of information may help insurers defeat fraudulent claims. See *Sybron*, 107 F.3d at 1257. Notice also plays a role in the rate-setting process: the shorter the time between a loss and notice, the more predictable the amount of the insurer's payment becomes. This tends to reduce the level of reserves that insurers must maintain, and makes it more likely that rates will fairly reflect insurers' risks. See *Tenovsky v. Alliance Syndicate, Inc.*, 677 N.E.2d 1144, 1146 (Mass. 1997) (quoting *Chas. T. Main, Inc. v. Fireman's Fund Ins. Co.*, 551 N.E. 2d 28, 29-30 (Mass. 1990)); See also ROBERT H. JERRY, II, UNDERSTANDING INSURANCE LAW § 81[a], at 524 (2d ed. 1996).

25. See *Fireman's Fund Ins. Co.*, 538 N.W.2d at 266 ("The appearance of the site had been changed. At least one key witness had died, many had left, and many relevant documents had been destroyed. The witnesses who were available could not reasonably be expected to fully recall the events of five years earlier."); *Ormet Primary Aluminum Corp.*, 725 N.E.2d at 655-56 (discussing late notice and the problems posed by key witnesses dying, witnesses' memories fading and documents being destroyed).

Upon the happening of any occurrence reasonably likely to involve the coverage of this policy, written notice containing particulars sufficient to identify the insured and also reasonably obtainable information with respect to the time, place, and circumstances thereof, and the names and addresses of the injured and of available witnesses, shall be given by or for the insured to the company or any of its authorized agents as soon as practicable.<sup>26</sup>

Many excess policies actually include two notice requirements, one linked to an occurrence that may result in a claim or suit, and the second addressing the insured's responsibilities when a claim is made or a suit is filed.<sup>27</sup> For example:

#### DUTIES IN THE EVENT OF OCCURRENCE, CLAIM, OR SUIT

1. You must see to it that WE receive prompt written notice of an occurrence which may result in a claim. Notice should include:
  - a. How, when and where the occurrence took place;
  - b. The names and addresses of any injured persons and witnesses.
2. If a claim is made or a suit is brought against YOU, YOU must see to it that WE receive prompt written notice of the claim or suit.<sup>28</sup>

Notice provisions can be quite simple. For example, the umbrella policy at issue in *State Farm Fire & Casualty Co. v. Nikitow*<sup>29</sup> provided that "[i]f something happens that might involve this policy, you must let us know promptly."<sup>30</sup>

#### 1. Notice: Whose Obligation?

It is normally the insured's obligation to give an insurer notice of a loss.<sup>31</sup> This seems a simple proposition, inasmuch as the insured is a party to the contract imposing the notice requirement, and a standard policy expressly assigns the obligation to the insured.<sup>32</sup> As far as notice

26. 1 MILLER & LEFEBVRE, *supra* note 1, at 626.

27. See generally *Am. Ins. Co. v. Fairchild Indus., Inc.*, 56 F.3d 435, 439 (2d Cir. 1995) (explaining the difference between the two types of notice provisions).

28. TIG Insurance Co., Excess Liability Policy, at 3 (1992) (on file with the author).

29. 924 P.2d 1084 (Colo. Ct. App. 1995).

30. *Nikitow*, 924 P.2d at 1087.

31. See *Am. Home Assur. Co. v. Int'l Ins. Co.*, 684 N.E.2d 14, 18 (N.Y. 1997) (noting that excess policies were direct agreements with the insured, and stating that excess carriers were entitled to notice from the insured).

32. It should not matter to the insurer who timely notifies it of a loss inasmuch as a notice provision is included in a policy for the insurer's benefit. See *Gencorp, Inc. v. Am. Int'l Underwriters*, 178 F.3d 804, 817 (6th Cir. 1999) (observing that notice provision exists for insurer's benefit).

to an excess insurer, a primary insurer might be in a better position than the insured to evaluate the severity of the loss or to predict verdict potential, such that it might fairly be required to give an excess insurer notice of a loss that implicates the excess insurer's coverage. If a primary insurer owes a duty to an excess insurer to notify it of a loss, that duty must be implied as part of a duty of good faith and fair dealing that exists by virtue of the excess carrier's reliance on the primary carrier to control the insured's defense.<sup>33</sup>

A primary insurer's obligation to notify an excess insurer of a loss was at issue in *American Centennial Insurance Co. v. Warner-Lambert Co.*<sup>34</sup> In 1979, Warner-Lambert was insured under a \$3 million combined single limit primary policy issued by Continental Insurance Co. and a \$4 million excess policy issued by American Centennial Insurance Co. (ACIC). Unknown to ACIC, Continental had relinquished to Warner-Lambert all authority to negotiate and settle product liability claims in exchange for Warner-Lambert's promise to reimburse it for all related costs and expenses up to Continental's policy limits.<sup>35</sup>

In 1982, Donna and Thomas Ricci sued a Warner-Lambert subsidiary in a product liability action. Warner-Lambert sent ACIC a standardized form indicating that the Riccis had made a claim. This was the only notice provided to ACIC during the seven and one-half years that the Ricci suit lingered. ACIC was never informed of settlement demands that implicated its policy. ACIC was not even notified of the Ricci suit when, in 1986, Continental determined that its primary policy limits were exhausted, such that ACIC was directly at risk.<sup>36</sup>

In July 1989, the Riccis received a \$2,165,000 verdict against Warner-Lambert's subsidiary. In November 1989, Warner-Lambert finally advised ACIC of the Ricci litigation and of the fact that its policy might be obligated to pay the full amount of the judgment. ACIC ultimately paid over \$500,000 in partial satisfaction of the judgment.<sup>37</sup> ACIC then filed a declaratory judgment action against Warner-Lambert and Continental seeking, among other things, a refund of its payment toward the Ricci judgment.<sup>38</sup>

Continental argued that it could not be liable to ACIC because under established New Jersey precedent, an insurer cannot avoid paying a claim based on late notice unless improper notice is given *by the insured*

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Of course, in most instances the insured is best positioned to notify the insurer by virtue of its knowledge of the occurrence, claim, or suit, and its knowledge of the insurer's identity.

33. See Baldwin & Midkiff, *supra* note 22, at 2. For a discussion of primary and excess insurers' duties of good faith and fair dealing, see *infra* Section III.

34. 681 A.2d 1241 (N.J. Super. Ct. Law Div. 1995).

35. See *Am. Centennial Ins. Co.*, 681 A.2d at 1243.

36. See *id.* at 1244.

37. See *id.*

38. See *id.* at 1243.



and the insurer suffers appreciable prejudice as a result.<sup>39</sup> The *Warner-Lambert* court disagreed, reasoning that what constitutes proper notice to a primary insurer may differ from what constitutes proper notice to an excess carrier. "When a primary carrier/excess carrier relationship is involved, proper notice entails the primary carrier, not the insured, advising the excess carrier of the existence of the claim."<sup>40</sup> To ensure proper notice, the primary carrier must further notify the excess insurer on an ongoing basis of any pending litigation or settlement discussions.<sup>41</sup>

The *Warner-Lambert* court concluded that ACIC was not properly notified of the Riccis' claim because the insured, not Continental, gave inadequate notice. "Adequate notice cannot constitute a single mailing of a form letter."<sup>42</sup> Moreover, Continental failed in its notice obligation twice: it first failed to provide initial notice of the Riccis' claim and it then failed to advise ACIC of any settlement discussions or litigation developments.<sup>43</sup> Continental's notice obligation arose out of its "distinctive relationship" with ACIC.<sup>44</sup>

The unique relationship results because the excess insurer relies upon the primary carrier to act in good faith in processing claims. This includes reliance upon a primary carrier to act reasonably in: (1) discharging its claims handling obligations; (2) discharging its defense obligations; (3) *properly disclosing and apprising the excess carrier of events which are likely to effect that carrier's coverage*; and (4) safeguarding the rights and interests of the excess carrier by not placing the primary carrier's own interests above that of the excess insurer.<sup>45</sup>

In imposing a notice obligation on Continental as a primary insurer, the *Warner-Lambert* court also looked to industry custom and, more particular, to "The Guiding Principles for Primary and Excess Insurance Companies."<sup>46</sup> Both Continental and ACIC were signatories to the Guiding Principles, the fifth of which provided:

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

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39. See *id.* at 1245 (emphasis added).

40. *Am. Centennial Ins. Co. v. Warner-Lambert Co.*, 681 A.2d 1241, 1245 (N.J. Super. Ct. Law Div. 1995).

41. See *Am. Centennial Ins. Co.*, 681 A.2d at 1245.

42. *Id.*

43. See *id.* at 1245-46.

44. *Id.* at 1246.

45. *Id.* (emphasis added).

46. See *Am. Centennial Ins. Co. v. Warner-Lambert Co.*, 681 A.2d 1241, 1246 (N.J. Super. Ct. Law Div. 1995).

inviting the excess insurer to participate in a common effort to dispose of the claim.<sup>47</sup>

Continental clearly violated this Guiding Principle. It disregarded its obligation to notify ACIC of the Riccis' claim, instead allowing its insured to provide inadequate notice. Continental never advised ACIC of its investigation or settlement negotiations, and never invited ACIC to try to participate in disposing of the claim.<sup>48</sup>

Because Continental failed to notify ACIC of the Riccis' claim, and because Continental breached its duty of good faith to ACIC in other ways, the *Warner-Lambert* court granted ACIC's motion for summary judgment.<sup>49</sup> The court ordered Continental to reimburse ACIC for its payment toward satisfying the Ricci judgment, plus interest.<sup>50</sup>

Not all jurisdictions follow the *Warner-Lambert* direct duty approach to notice. In *Evanston Insurance Co. v. Stonewall Surplus Lines Insurance Co.*,<sup>51</sup> a third-level excess insurer (Evanston) sued a primary insurer (Truck Insurance Exchange) and two second-level excess insurers (Stonewall) for bad faith for failing to timely notify it of a lawsuit implicating its policy limits. The trial court awarded Truck and Stonewall summary judgment because they neither owed nor breached any duty to Evanston. They had no direct contractual relationship with Evanston. Their contractual relationships were with their common insured, Schneider National Carriers. If Evanston had any rights against either Truck or Stonewall, those rights derived from their policies issued to Schneider. Furthermore, under principles of equitable subrogation, Truck and Stonewall could assert all defenses against Evanston they could assert against Schneider.<sup>52</sup>

Schneider was based in Green Bay, Wisconsin, and the accident at issue occurred in Georgia. Applying Georgia and Wisconsin law, the *Evanston* court concluded that neither Truck nor Stonewall owed Evanston a direct duty. Any duties Truck or Stonewall owed Evanston derived from their contractual relationships with Schneider.<sup>53</sup> Inasmuch as Schneider (through its chosen defense counsel) never suspected that a verdict or judgment might implicate Evanston's policy limits, Truck and Stonewall could not be liable on Evanston's claims of late notice. The Eleventh Circuit therefore affirmed the lower-level insurers' motion for summary judgment.<sup>54</sup>

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47. *Am. Centennial Ins. Co.*, 681 A.2d at 1246 (emphasis added).

48. *See id.* at 1247.

49. *See id.* at 1248.

50. *See id.*

51. 111 F.3d 852 (11th Cir. 1997).

52. *See Evanston Ins. Co.*, 11 F.3d at 858.

53. *See id.*

54. *See id.* at 859-60.

In summary, the assignment of responsibility for notifying an excess insurer of a loss as between the insured and a primary insurer is controversial.<sup>55</sup> Even if a primary insurer does not technically have a duty to notify an excess insurer, however, it probably would be wise to do so. A primary insurer's failure to give an excess insurer timely notice of a loss, which implicates the excess carrier's policy, risks extra-contractual liability, as *Warner-Lambert* and other cases illustrate.<sup>56</sup> At the very least, a primary insurer that believes a loss will exceed its policy limits should inform the insured of that fact, so that the insured knows to put the excess carrier on notice.<sup>57</sup>

## 2. Timeliness of Notice

The initial problem in determining when notice must be given to an insurer is ascertaining those facts or circumstances that give life to an insured's contractual obligation.<sup>58</sup> This problem is more acute in the excess insurance context. There are times when a loss clearly exceeds the available limits of primary insurance, such that an insured's duty to notify its excess insurer should be obvious.<sup>59</sup> In other situations an insured may not have enough information when it first learns of a loss or when a suit is first filed to determine whether potential damages exceed its primary policy limits. Additionally, notice requirements in excess policies often afford an insured some discretion in determining when notice is required.<sup>60</sup>

Excess policies that require notice to be given "promptly," "as soon as practicable," or upon "the happening of an occurrence reasonably likely" to trigger a policy's coverage all include an element of reasonableness when it comes to providing timely notice.<sup>61</sup> To the extent that an excess policy includes a reasonableness element, notice to an excess car-

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55. See Baldwin & Midkiff, *supra* note 22, at 2.

56. See, e.g., *Sequoia Ins. Co. v. Royal Ins. Co. of Am.*, 971 F.2d 1385, 1393-94 (9th Cir. 1992) (applying California law).

57. See Baldwin & Midkiff, *supra* note 22, at 2.

58. See JERRY, *supra* note 24, § 81[c], at 526.

59. See, e.g., *Interstate Power Co. v. Ins. Co. of N. Am.*, 603 N.W.2d 751, 758 (Iowa 1999) (noting "gross disparity" between the amount of environmental remediation costs and available insurance coverage).

60. See *Aetna Cas. & Sur. Co. v. Dow Chem. Co.*, 10 F. Supp. 2d 800, 829-30 (E.D. Mich. 1998); *Employers Liab. Assur. Corp. v. Hoechst Celanese Corp.*, 684 N.E.2d 600, 606 (Mass. App. Ct. 1997).

61. See, e.g., *Ormet Primary Aluminum Corp. v. Employers Ins. of Wausau*, 725 N.E.2d 646, 655 (Chio 2000) (stating that an excess insurance policy provision "requiring notice to the insurer 'as soon as practicable' requires notice within a reasonable time in light of the surrounding facts and circumstances"); See also *Helman v. Hartford Fire Ins. Co.*, 664 N.E.2d 991, 995 (Ohio Ct. App. 1995) (stating in a case involving an excess policy that "[a] policy provision requiring prompt or immediate notice requires notice within a reasonable time in light of all of the surrounding facts and circumstances").

rier may not need to be given as soon as notice to a primary carrier.<sup>62</sup> A primary insurer has pressures to investigate a loss and to defend the insured that an excess insurer arguably does not feel.<sup>63</sup> An excess carrier that wants immediate notice of a loss should word its policy accordingly. Even in the reasonableness continuum, a policy that requires the insured to give notice "promptly" is more demanding than one that requires notice to be given "as soon as practicable."<sup>64</sup>

In *Reynolds Metal Co. v. Aetna Casualty & Surety Co.*,<sup>65</sup> the insured sued its primary and excess insurers during policy years 1959-86 seeking coverage for three environmental actions brought by federal and state authorities, and the St. Regis Mohawk Tribe. Reynolds had received a "Potentially Responsible Party" or "PRP" letter from New York's Department of Environmental Conservation (DEC). The trial court concluded that Reynolds knew of "events occurring prior to December 1986 from which it should have reasonably concluded that it was likely to incur remediation costs," such that it was then required to notify its insurers.<sup>66</sup> Reynolds did not notify its insurers of its potential environmental liability until 1988.<sup>67</sup>

The implicated insurance policies typically contained notice of occurrence provisions that required notice by the insured "as soon as practicable,"<sup>68</sup> and notice of claim provisions that required the insured to "immediately forward" relevant pleadings or similar documents if a claim was made or suit was brought.<sup>69</sup> The trial court held that Reynolds failed to give its insurers timely notice of claims and occurrences, and granted the insurers' summary judgment motions.<sup>70</sup>

On appeal, Reynolds argued that its good faith belief that its policies did not provide coverage and its similar good faith belief that it was not liable excused its late notice.<sup>71</sup> As to its believed lack of coverage, Reynolds's risk manager testified below that his reading of the "owned property" exclusions in the insurance policies deprived the insured of coverage. As for non-liability, the DEC's PRP letter did not identify a possible contamination site, and a later letter suggested that the contamination

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62. See *Gen. Cas. Co. v. Juhl*, 669 N.E.2d 1211, 1214 (Ill. App. Ct. 1996).

63. See *Providence Washington Ins. Co. v. Container Freight, Inc.*, 68 Cal. Rptr. 2d 776, 783 (Ct. App. 1997). In denying review, the California Supreme Court ordered the opinion not to be officially published, removing precedent value. See *id.* at 776 n.\* (citing California Supreme Court Rules).

64. See *Juhl*, 669 N.E.2d at 1214.

65. 696 N.Y.S.2d 563 (App. Div. 1999).

66. *Reynolds Metal Co.*, 696 N.Y.S.2d at 565-66.

67. See *id.* at 569.

68. *Id.* at 566 n.1.

69. *Id.* at 568 n.3.

70. See *id.* at 569.

71. See *Reynolds Metal Co. v. Aetna Cas. & Sur. Co.*, 696 N.Y.S.2d 563, 567 (App. Div. 1999).

might not warrant immediate action because it did not present an immediate threat to public health or the environment.<sup>72</sup>

Under New York law, an insured's good faith belief that it is not liable or that a loss is not covered excuse late notice, so long as those beliefs are reasonable under the circumstances.<sup>73</sup> The reasonableness of the insured's belief ordinarily is a question of fact.<sup>74</sup> In the *Reynolds Metal* court's view, the insured had presented sufficient evidence below to raise a material question as to the reasonableness of its beliefs bearing on notice, such that the trial court should not have entered summary judgment for the insurers.<sup>75</sup>

The insurers ineffectively argued that the insured's reasonable belief regarding non-coverage and non-liability only excused its late notice of an occurrence. Thus, the late notice of claim provisions in the policies still operated to preclude coverage.<sup>76</sup> The *Reynolds Metal* court rejected this argument, seeing no reason to differentiate between the two notice provisions. The court thought it "illogical that insureds should be required to promptly notify insurers of every claim no matter how remote the possibility of liability or coverage but be excused from doing so if a reasonable evaluation of an occurrence yields the same conclusion."<sup>77</sup>

Finally, with respect to the excess insurers, Reynolds' notice to them in the summer of 1988 was not late as a matter of law because until that time it may not have known that their policies were implicated. Reynolds did not receive actual estimates for cleanup costs before it notified its excess carriers.<sup>78</sup> There was not sufficient evidence in the record to demonstrate that Reynolds knew that cleanup costs would exhaust its primary coverage, which only then would have required it to give notice to the excess insurers.<sup>79</sup>

### 3. Late Notice as a Coverage Defense: The "Notice-Prejudice Rule" and Excess Insurance

Insurers routinely argue that an insured's late notice of an occurrence, claim, or suit operates as a complete coverage defense; that is, by not giving timely notice, the insured has failed to satisfy a condition precedent to coverage. In some jurisdictions, an insured's unexcused delay in providing notice will relieve the insurer of its obligations under its policy without regard for whether the insurer has been prejudiced by

72. See *Reynolds Metal Co.*, 696 N.Y.S.2d. at 567.

73. See *id.* (citing numerous cases).

74. See *id.*

75. See *id.* at 567-68.

76. See *id.* at 568.

77. *Reynolds Metal Co. v. Aetna Cas. & Sur. Co.*, 696 N.Y.S.2d 563, 568 (App. Div. 1999).

78. See *Reynolds Metal Co.*, 696 N.Y.S.2d at 569.

79. See *id.* at 569-70.

the delay.<sup>80</sup> In the significant majority of jurisdictions, however, an insurer must prove that its rights have been prejudiced by the insured's delay in giving notice in order successfully to deny coverage.<sup>81</sup> The requirement that an insurer be able to demonstrate prejudice attributable to the insured's late notice in order to avoid its potential defense and indemnity obligations has become known as the "notice-prejudice rule."<sup>82</sup>

Some courts do not require a primary insurer to prove prejudice to successfully raise late notice as a coverage defense; the clear minority position has nonetheless adopted the notice-prejudice rule where excess insurance is concerned.<sup>83</sup> As the Alabama Supreme Court explained in *Midwest Employers Casualty Co. v. East Alabama Health Care*, excess insurers do not have the same duties and responsibilities that form the basis for the minority view that no prejudice is required to void coverage.<sup>84</sup> An excess insurer that disclaims any duty to defend, investigate, or settle claims against its insured, should not be allowed to avoid its obligations by claiming that the insured's late notice deprived it of the opportunity to do these very things. Of course, an excess insurer that actually is interested in investigating an occurrence or claim, or involving itself in settlement discussions (because its policy is implicated), can attempt to prove that its insured's failure to give it timely notice materi-

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80. See *Midwest Employers Cas. Co. v. E. Ala. Health Care*, 695 So. 2d 1169, 1172 (Ala. 1997); *State Farm Fire & Cas. Co. v. Nikitow*, 924 P.2d 1084, 1087 (Colo. Ct. App. 1995); *Greycoat Hanover F Street Ltd. P'ship v. Liberty Mut. Ins. Co.*, 657 A.2d 764, 768 (D.C. Cir. 1995); *S.E. Express Sys. Inc. v. S. Guar. Ins. Co.*, 482 S.E.2d 433, 436 (Ga. Ct. App. 1997); *Am. Home Assur. Co. v. Int'l Ins. Co.*, 684 N.E.2d 14, 17-18 (N.Y. 1997); *Whaley v. Underwood*, 922 S.W.2d 110, 112-13 (Tenn. Ct. App. 1995).

81. See *Midwest Employers*, 695 So. 2d at 1172 & n.6; See also *Hosp. Underwriting Group, Inc. v. Summit Health Ltd.*, 63 F.3d 486, 493 (6th Cir. 1995) ("[T]he majority trend is for courts to require a showing of prejudice . . .").

82. The notice-prejudice rule only applies where the policy at issue is an "occurrence" based policy. There are, of course, two kinds of liability insurance policies. An "occurrence" policy provides coverage if the event insured against takes place within the policy period, regardless of the date of discovery, or when the injured or damaged party sues the insured. See *U.S. Fire Ins. Co. v. Fleekop*, 682 So. 2d 620, 622 (Fla. Dist. Ct. App. 1996); *Titan Indem. Co. v. Williams*, 743 So. 2d 1020, 1024 (Miss. Ct. App. 1999); *Employers Reinsurance Corp. v. Landmark*, 547 N.W.2d 527, 531 (N.D. 1996). A "claims made" policy provides coverage only if the third-party's claim against the insured is made during the policy period. See *Lexington Ins. Co. v. St. Louis Univ.*, 88 F.3d 632, 633-34 (8th Cir. 1996); *Landmark*, 547 N.W.2d at 531. Though both types of policies include notice requirements, with a claims made policy the notice requirement "defines the limit of the insurer's obligation." *Lexington*, 88 F.3d at 634. Because the notice requirement defines the "scope of coverage under a claims made policy, to excuse a delay in notice beyond the policy period would alter a basic term of the insurance contract." *Ins. Placements, Inc. v. Utica Mut. Ins. Co.*, 917 S.W.2d 592, 597 (Mo. Ct. App. 1996). Accordingly, an insurer that issued a claims made policy does not have to prove prejudice attributable to the insured's failure to give notice during the policy period in order to deny coverage. See *id.* "Claims-made policies necessarily include a presumption that the insurer suffers prejudice when [it] does not receive timely notice of [a] claim during the policy period, preventing the insured from Seeking coverage under subsequent policies." *Bianco Prof'l Ass'n v. Home Ins. Co.*, 740 A.2d 1051, 1057 (N.H. 1999).

83. See *Hartford Accident & Indem. Co. v. Rush-Presbyterian-St. Luke's Med. Ctr.*, 595 N.E.2d 1311, 1316 (Ill. App. Ct. 1992); See also *Midwest Employers*, 695 So. 2d 1169 (Ala. 1997).

84. *Midwest Employers*, 695 So.2d at 1173.

ally prejudiced its ability to do so.<sup>85</sup> That is exactly what the notice-prejudice rule contemplates.

New York courts, which champion the minority view that prejudice is not required to deny coverage, adhere to this position even where excess insurance is involved. In *American Home Assurance Co. v. International Insurance Co.*,<sup>86</sup> lower level excess insurer American delayed some four months in giving several upper-level excess carriers notice of a significant lawsuit.<sup>87</sup> The case ultimately settled, but three of the upper-level excess insurers refused to contribute to the settlement because of American's late notice.<sup>88</sup> American then sued the disclaiming carriers.<sup>89</sup>

The upper-level carriers prevailed at summary judgment and American appealed.<sup>90</sup> A lower appellate court reversed the trial court, based on what it perceived to be differences in primary and excess insurers' roles.<sup>91</sup>

[We] perceive the role of an excess level insurance carrier as being functionally more akin to that of a reinsurer and significantly different from that of a primary insurance carrier, which typically undertakes the defense and direction of the underlying litigation against the insured. It follows, therefore, that the reasons behind the "no prejudice" exception carved out of the general rules of contract for primary insurers are inapplicable to the claim brought here by an excess insurance carrier against another excess insurance carrier.<sup>92</sup>

The upper-level excess carriers then appealed to the Court of Appeals, the state's highest court.<sup>93</sup>

The Court of Appeals was not persuaded by the lower appellate court's attempt to analogize excess insurers to reinsurers. The lower court's comparative analysis overlooked the importance of prompt notice to an excess carrier.<sup>94</sup> Timely notice affords an excess insurer the opportunity to participate in settlement discussions at a time when its input is most likely to be meaningful.<sup>95</sup> Even if the upper-level excess insurers had opted not to conduct independent investigations, they surely would have insisted on a role in the settlement discussions that triggered their

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85. *See id.*

86. 684 N.E.2d 14 (N.Y. 1997).

87. *See Am. Home Assur. Co.*, 684 N.E.2d at 15.

88. *See id.*

89. *Id.*

90. *See Am. Home Assur. Co. v. Int'l Ins. Co.*, 641 N.Y.S.2d 241, 241 (App. Div. 1996), *rev'd*, 684 N.E.2d 14 (N.Y. 1997).

91. *See Am. Home Assur. Co.*, 641 N.Y.S.2d. at 245-46.

92. *Id.* at 242.

93. *See Am. Home Assur. Co. v. Int'l Ins. Co.*, 684 N.E.2d 14, 17 (N.Y. 1997).

94. *See Am. Home Assur. Co.*, 684 N.E.2d at 17.

95. *See id.*

policy obligations.<sup>96</sup> Even if American had the greatest exposure, and thus the greatest motivation to negotiate a favorable settlement, the exclusion of the upper-level carriers at the outset left the court with no way of knowing what the outcome would have been had the upper-level carriers' voices been heard early in the decision-making process.<sup>97</sup> Accordingly, the late notice problem was not mitigated by American's notice to the other excess insurers after it failed to settle the lawsuit for the combined limits of the primary policy and its own excess policy.<sup>98</sup>

After considering the contractual rights and obligations of reinsurers and excess insurers, the *American Home* court concluded that they have little in common.<sup>99</sup> In fact, excess insurers have the same interests that make prompt notice to primary insurers a condition precedent to coverage.<sup>100</sup> Apart from the fact that their coverage attaches only after primary coverage is exhausted, excess insurers have most of the rights and duties of primary insurers.<sup>101</sup> Excess insurers have the right to investigate claims, to participate in settlement negotiations, and to make their own settlement decisions.<sup>102</sup> Excess policies do not contain the "follow the fortunes" clauses found in reinsurance contracts that leave reinsurers with little ability to challenge their reinsureds' conduct in a given case.<sup>103</sup> As a result, "all of the salient factors point to the conclusion that excess carriers have the same vital interest in prompt notice as do primary insurers."<sup>104</sup>

The *American Home* court held that the upper-level excess insurers were entitled to assert a late notice defense, even if they could not demonstrate that they were prejudiced by American's delay.<sup>105</sup> The Court of Appeals therefore reversed the lower appellate court and reinstated the trial court's summary judgment order.<sup>106</sup>

#### 4. Conclusion

An excess insurer should not be forced to rely on its insured or a primary insurer to protect its interests when timely notice would allow the excess insurer to conduct its own investigation or otherwise assess a situation.<sup>107</sup> Notice requirements in excess policies are a valid condition

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96. *See id.*

97. *See id.* at 17-18.

98. *See id.* at 18.

99. *See Am. Home Assur. Co. v. Int'l Ins. Co.*, 684 N.E.2d 14, 18 (N.Y. 1997).

100. *See Am. Home Assur. Co.*, 684 N.E.2d at 18.

101. *See id.*

102. *See id.*

103. *See id.*

104. *Id.*

105. *See Am. Home Assur. Co. v. Int'l Ins. Co.*, 684 N.E.2d 14, 18 (N.Y. 1997).

106. *See Am. Home Assur. Co.*, 684 N.E.2d at 18.

107. *See Kerr v. Ill. Cent. R.R. Co.*, 670 N.E.2d 759, 765 (Ill. App. Ct. 1996); *Herman Bros., Inc. v. Great W. Cas. Co.*, 582 N.W.2d 328, 335-36 (Neb. 1998).



precedent to coverage; they are not just fluff that an insured can ignore or act on at its convenience.<sup>108</sup> An excess insurer often has a huge financial stake in litigation. It may want to involve itself in the insured's defense, even if it is not obligated to do so. Timely notice allows an excess insurer to inject itself into settlement negotiations at a point when its contributions, whether strategic or strictly financial, can be most meaningful.<sup>109</sup> Furthermore, an excess insurer has a right to insist on timely notice from the insured, rather than relying on a primary insurer to which the insured has abdicated its responsibility.<sup>110</sup> An excess insurer's contract is with its insured—an excess carrier has no direct relationship with underlying insurers.

In summary, courts and commentators who suggest that excess insurers do not need timely notice of occurrences or suits potentially implicating their policies are plain wrong. Insureds should always notify their excess insurers of losses with any potential to exceed the limits of their primary coverage, even if slight, as soon as it is possible to do so.

#### B. *Excess Insurers' Defense Obligations*

Generally, it is a primary insurer's responsibility to defend an insured against a potentially covered claim or suit. An excess insurer typically has no duty to defend its insured until the limits of underlying coverage are exhausted,<sup>111</sup> or until the insured's SIR is exhausted.<sup>112</sup> However, an excess insurer may elect to participate in its insured's defense where its policy limits are implicated. This right is contractual. For example, an excess policy may provide:

WE shall not be called upon to assume charge of the investigation, settlement or defense of any claim made or suit brought against you, but WE shall have the right and be given the opportunity to be associated in the defense and trial of any claims or suits relative to any oc-

108. See *Kerr*, 670 N.E.2d at 765.

109. See *id.* at 767 (observing that if the excess insurers had been given the opportunity to participate in settlement negotiations, such that the case settled earlier, they might have saved \$2.8 million in prejudgment interest).

110. See *Am. Home Assur. Co. v. Int'l Ins. Co.*, 684 N.E.2d 14, 18 (N.Y. 1997).

111. See *Grace v. Ins. Co. of N. Am.*, 944 P.2d 460, 466 (Alaska 1997); *Philadelphia Indem. Ins. Co. v. Barerra*, 998 P.2d 1064, 1069 (Ariz. Ct. App. 1999); *Montgomery Ward & Co. v. Imperial Cas. & Indem. Co.*, 97 Cal. Rptr. 2d 44, 56 (Ct. App. 2000); *City of Oxnard v. Twin City Fire Ins. Co.*, 44 Cal. Rptr. 2d 177, 179 (Ct. App. 1995); *Ticor Title Ins. Co. v. Employers Ins. of Wausau*, 48 Cal. Rptr. 2d 368, 373 (Ct. App. 1995); *Associated Wholesale Grocers, Inc. v. Americold Corp.*, 934 P.2d 65, 81 (Kan. 1997); *Frankenmuth Mut. Ins. Co. v. Cont'l Ins. Co.*, 537 N.W.2d 879, 881 (Mich. 1995); *Fireman's Fund Ins. Co. v. TIG Ins. Co.*, 14 S.W.3d 230, 232 (Mo. Ct. App. 2000).

112. See *Gen. Star Indem. Co. v. Superior Court*, 55 Cal. Rptr. 2d 322, 325 (Ct. App. 1996). *But see Montgomery Ward & Co.*, 97 Cal. Rptr. 2d at 55-57 (holding that insurer had duty to defend without exhausting SIR, based on language of particular policies at issue).

currence which, in OUR opinion, may create liability on the part of US under the terms of this policy.

If WE assume such right and opportunity, WE shall not be obligated to defend any suit after the applicable limits of this policy have been exhausted by the payment of the ULTIMATE NET LOSS.<sup>113</sup>

Excess insurers need an option to defend in order to protect themselves in cases where the insured's exposure exceeds its primary policy limits and the primary insurer is not mounting a strong defense. Most courts hold that even where an excess policy gives the insurer the right and option to defend, such language does not create a *duty* to defend.<sup>114</sup> The intent of policy provisions granting an excess insurer a right and option to participate in its insured's defense is to protect the insurer, not the insured. The majority position also makes sense because an insurer's duty to defend is expressly contractual, and if there is no policy language requiring an insurer to defend, there can be no duty to do so.<sup>115</sup>

The fact that an excess insurer seldom has any defense obligations to its insured does not mean that there are not related controversies. The most common of these are discussed below.

### 1. Excess to Primary: You're Not Exhausted, You're Just Tired

There are cases in which potential damages clearly exceed the limits of the insured's primary coverage. In such cases, the primary insurer may tender its policy limits almost immediately in the hope of avoiding significant defense costs. Of course, the plaintiff will not accept a settlement offer of primary policy limits where there is excess coverage, and an excess insurer will not accept the primary carrier's tender because it wants the primary insurer to fund the insured's defense.<sup>116</sup> The primary insurer's duty to defend the insured continues until the lawsuit is concluded, until its policy limits are exhausted, or until there is otherwise no potential for coverage under its policy.<sup>117</sup> In order to exhaust its policy

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113. TIG Insurance Co., Excess Liability Policy, at 1 (1992) (on file with the author).

114. See, e.g., *Inst. of London Underwriters v. First Horizon Ins. Co.*, 972 F.2d 125, 126 (5th Cir. 1992) (applying Louisiana law); *Schwinn Cycling & Fitness, Inc. v. Hartford Accident & Indem. Co.*, 863 F. Supp. 784, 787 (N.D. Ill. 1994) (applying Illinois law); *Grace*, 944 P.2d at 466; *FMC Corp. v. Plaisted & Cos.*, 72 Cal. Rptr. 2d 467, 508-10 (Ct. App. 1998).

115. See *Fireman's Fund*, 14 S.W.3d at 232.

116. See Brian L. Blakely, *The Current Status of Excess v. Primary Bad Faith Litigation, in EXTRA-CONTRACTUAL LIABILITY* 119, 132 (Def. Research Inst. 1999) ("The primary carrier may tender its limits almost immediately but, of course, find no one willing to take them.").

117. See *Hartford Accident & Indem. Co. v. Superior Court*, 29 Cal. Rptr. 2d 32, 34-36 (Ct. App. 1994); See also *Foster-Gardner, Inc. v. Nat. Union Fire Ins. Co.*, 959 P.2d 265, 273 (Cal. 1998) (stating that an insurer's duty to defend continues until a case is concluded or until the insurer shows that there is no potential for coverage); *Dairy Rd. Partners v. Island Ins. Co.*, 992 P.2d 93, 118-19 (Haw. 2000) (holding that insurer's duty to defend continues until potential indemnity obligation is extinguished); *Vigilant Ins. Co. v. Luppino*, 723 A.2d 14, 18 (Md. 1999) ("[T]he duty to defend, by its very nature, is a continuing one that extends throughout the tort suit by the third party against the insured."); *Home Sav. Ass'n v. Aetna Cas. & Sur. Co.*, 854 P.2d 851, 855 (Nev. 1993) (stating that

limits, a primary insurer must actually pay them in settlement in exchange for its insured's release, or in full or partial satisfaction of a judgment against its insured.<sup>118</sup> A primary insurer cannot simply tender its policy limits to an excess insurer and wash its hands of its duty to defend their common insured.<sup>119</sup> A primary insurer cannot, in other words, "dump its limits" or "pay and walk," as *National Union Fire Insurance Co. v. Travelers Insurance Co.* illustrates.<sup>120</sup>

In *National Union*, a resort owner, Palm-Aire, was insured under two liability policies: a primary policy with \$1 million limits issued by Travelers and an excess policy issued by National Union.<sup>121</sup> A child, Ryan Smith, was injured when he fell from a balcony at the resort.<sup>122</sup> His parents sued Palm-Aire and its franchiser, Choice Hotels, in a Florida state court.<sup>123</sup> Choice Hotels cross-claimed against Palm-Aire for contribution and indemnity.<sup>124</sup>

Travelers defended Palm-Aire against all the claims in the Florida state court litigation.<sup>125</sup> Travelers realized, however, that the plaintiffs' damages would exceed its policy limits.<sup>126</sup> With settlement discussions under way, Travelers tendered its \$1 million policy limits to National Union, who was participating in the negotiations.<sup>127</sup>

While the Florida state court litigation was still pending, Choice Hotels amended a complaint it had previously filed against Palm-Aire in a Maryland federal court regarding a franchise fee dispute to include an indemnity claim for any damages awarded in the Florida state court liti-

an insurer's duty to defend "continues throughout the course of litigation against the insured"); *Aetna Cas. & Sur. Co. v. Ply Gem Indus., Inc.*, 712 A.2d 717, 721 (N.J. Super. Ct. Law Div. 1997) ("The insurer must defend . . . until it can show that there is no potential liability remaining in issue in the case."); *Conrad R. Sump & Co. v. Home Ins. Co.*, 701 N.Y.S.2d 103, 105 (App. Div. 1999) ("The insurance carrier may be relieved of its duty to defend only if it can establish as a matter of law that there is no possible factual or legal basis on which it might eventually be obligated to indemnify its insured, or by proving that the claim falls within a policy exclusion."); *Stevens Painton Corp. v. First State Ins. Co.*, 746 A.2d 649, 655 (Pa. Super. Ct. 2000) (stating that it is the insurer's duty "to defend a claim that would support recovery until such time as it is determined that the claim is not covered under the policy").

118. See *California Cas. Ins. Co. v. State Farm Mut. Auto. Ins. Co.*, 913 P.2d 505, 508-10 (Ariz. Ct. App. 1996); *Cont'l Ins. Co. v. Burr*, 706 A.2d 499, 500-01 (Del. 1998).

119. See *Yonkers Contracting Co. v. Gen. Star Nat'l Ins. Co.*, 14 F. Supp. 2d 365, 371 (S.D.N.Y. 1998); *Texas Employers Ins. Ass'n v. Underwriting Members of Lloyds*, 836 F. Supp. 398, 409-10 (S.D. Tex. 1993).

120. *Nat'l Union Fire Ins. Co. v. Travelers Ins. Co.*, 214 F.3d 1269 (11th Cir. 2000).

121. See *Nat'l Union Fire Ins. Co.*, 214 F.3d at 1271.

122. See *id.*

123. See *id.*

124. See *id.*

125. See *id.*

126. See *Nat'l Union Fire Ins. Co. v. Travelers Ins. Co.*, 214 F.3d 1269, 1271 (11th Cir. 2000).

127. See *Nat'l Union Fire Ins. Co.*, 214 F.3d at 1271.

gation.<sup>128</sup> Palm-Aire asked Travelers to defend it against the new indemnity claim in the Maryland litigation, but Travelers refused.<sup>129</sup> Travelers explained to Palm-Aire that it was no longer obligated to defend it because it had already tendered its primary policy limits to National Union in the first case.<sup>130</sup> The Maryland court then entered a default order against Palm-Aire.<sup>131</sup> The Florida state court litigation settled eighteen months later for \$5 million, including Travelers' \$1 million policy limits.<sup>132</sup> Thereafter, the Maryland court entered a \$1.7 million default judgment against Palm-Aire.<sup>133</sup> National Union paid \$1.4 million of the Maryland default judgment, that being the amount of Choice Hotels' recovery on its indemnification claim.<sup>134</sup>

National Union sued Travelers in a Florida federal court in an effort to recover the amount of the default judgment and its attorneys' fees and costs. National Union alleged that Travelers had a duty to defend Palm-Aire in the Maryland litigation and that its breach of this duty precipitated the default judgment.<sup>135</sup> National Union moved for partial summary judgment to preclude Travelers from arguing at trial that National Union had a concurrent duty to defend Palm-Aire in the Florida state court litigation.<sup>136</sup> The district court ruled that under Florida law National Union had a duty to "drop down" and assist Travelers in Palm-Aire's defense when it learned that the primary policy would likely be exhausted before the Florida state court litigation was concluded.<sup>137</sup> National Union took an interlocutory appeal to the Eleventh Circuit.<sup>138</sup>

Importantly, the district court rejected Travelers' argument that tendering its \$1 million policy limits to National Union was tantamount to paying them, thereby exhausting its coverage and terminating its duty to defend.<sup>139</sup> The district court found that Travelers was obligated to defend Palm-Aire in both the Florida and the Maryland litigation until it paid its policy limits in satisfaction of an actual judgment or settlement.<sup>140</sup> Travelers did not cross-appeal that ruling.<sup>141</sup> Accordingly, the Eleventh Cir-

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128. *See id.*

129. *See id.*

130. *See id.*

131. *See id.*

132. *See Nat'l Union Fire Ins. Co. v. Travelers Ins. Co.*, 214 F.3d 1269, 1271 (11th Cir. 2000).

133. *See Nat'l Union Fire Ins. Co.*, 214 F.3d at 1271.

134. *See id.*

135. *See id.*

136. *See id.*

137. *See id.*

138. *See Nat'l Union Fire Ins. Co. v. Travelers Ins. Co.*, 214 F.3d 1269, 1272 (11th Cir. 2000).

139. *See Nat'l Union Fire Ins. Co.*, 214 F.3d at 1272.

140. *See id.*

141. *See id.*

cuit focused exclusively on the district court's further holding that National Union had a concurrent duty to defend Palm-Aire.<sup>142</sup>

The Eleventh Circuit began its analysis by looking at the language of the National Union excess policy. Within a section entitled "Defense" the policy stated:

The provisions of this section apply solely to occurrences covered under this policy but not covered by any underlying policies ... or any other underlying insurance providing coverage to the Insured. This section shall also apply to occurrences not covered by any underlying insurance due to exhaustion of any aggregate limits due to any losses paid there under.<sup>143</sup>

This language obviously manifested National Union's intent that its policy only applied after the complete exhaustion of coverage under all underlying policies. National Union's duty to defend was consecutive to, rather than concurrent with, any primary insurer's duty to defend.<sup>144</sup> The *National Union* court held that because Travelers was still obligated to defend Palm-Aire at the time Choice Hotels amended its complaint in the Maryland litigation,<sup>145</sup> National Union's duty to defend had not yet been triggered.<sup>146</sup>

The *National Union* court also rejected the district court's conclusion that National Union had a duty to drop down and assume Palm-Aire's defense once it learned that potential damages in the Florida state court litigation would exceed the limits of the Travelers primary policy.<sup>147</sup> Such a duty could flow only from specific language in the National Union policy.<sup>148</sup> The court finally rejected Travelers' argument that National Union had assumed a duty to defend by participating in settlement negotiations in the Florida suit.<sup>149</sup> The court reasoned that (1) National Union's duty to indemnify Palm-Aire was distinct from its duty to defend, and it was its duty to indemnify that drove its participation in the settlement negotiations; and (2) National Union's voluntary participation

142. *See id.*

143. *Id.* (quoting the National Union policy).

144. *See Nat'l Union Fire Ins. Co. v. Travelers Ins. Co.*, 214 F.3d 1269, 1272-73 (11th Cir. 2000).

145. *Nat'l Union Fire Ins. Co.*, 214 F.3d at 1273. As explained in the text accompanying *supra* note 140, the district court had held that Travelers was obligated to continue Palm-Aire's defense until it actually paid its policy limits in settlement or in satisfaction of a judgment. *See id.* at 1272. In other words, the district court did not absolve Travelers of its duty to defend (although Travelers argued that the mere tender of its policy limits extinguished all of its duties). Rather, the district court held that National Union and Travelers had a *concurrent* duty to defend Palm-Aire on the facts. *See id.*

146. *See id.* at 1273.

147. *See id.* at 1273.

148. *See id.* at 1273-74.

149. *See id.*

in settlement negotiations did not relieve Travelers of its contractual duty to defend Palm-Aire, nor could it create for National Union a duty to defend a separate, albeit related, lawsuit (the Maryland litigation).<sup>150</sup>

The Eleventh Circuit reversed the district court and remanded the case.<sup>151</sup> In doing so, it left open the questions of whether National Union breached its duty of good faith and fair dealing in not settling the Florida state court litigation, and whether such a breach would defeat its indemnification claim.<sup>152</sup>

An excess insurer should have no duty to defend its insured even if the primary insurer wrongfully refuses to defend.<sup>153</sup> A primary insurer's refusal to defend does not mean that its policy limits are exhausted. So long as the primary insurer's policy limits are "payable," i.e., they are not actually paid, the excess insurer's defense obligations lie dormant.<sup>154</sup> If an excess insurer assumes its insured's defense because the primary insurer fails to do so, it should be entitled to recoup its defense costs from the primary carrier.<sup>155</sup>

## 2. Reservation of Rights

At the outset of a case, coverage issues are commonly unresolved or are the subject of unanswered questions. In order to avoid claims that it has waived coverage defenses or should be estopped from asserting them, a primary insurer that undertakes its insured's defense in a case of questionable coverage typically does so under a reservation of rights.<sup>156</sup> An insurer's reservation of rights letter is simply a unilateral declaration that it may later deny coverage notwithstanding its initial decision to defend.<sup>157</sup>

Because an excess insurer has no duty to defend its insured, it cannot later be estopped from raising coverage defenses, or be said to have waived those defenses, if it fails to reserve its rights when notified of a

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150. See *Nat'l Union Fire Ins. Co. v. Travelers Ins. Co.*, 214 F.3d 1269, 1274 (11th Cir. 2000).

151. See *Nat'l Union Fire Ins. Co.*, 214 F.3d at 1274.

152. See *id.* at 1274 n.10.

153. Whether a primary insurer's wrongful refusal to defend obligates an excess insurer to drop down and defend the insured in the primary insurer's place may turn on the language of the subject excess policy. Compare *Hocker v. N.H. Ins. Co.*, 922 F.2d 1476, 1481-83 (10th Cir. 1991) (applying Wyoming law and holding that excess insurer had duty to drop down and defend), with *Ticor Title Ins. Co. v. Employers Ins. of Wausau*, 48 Cal. Rptr. 2d 368, 374 (Ct. App. 1995) (holding that excess insurer was not obligated to drop down and defend).

154. See *Nat'l Union*, 214 F.3d at 1272-73; *Ticor Title*, 48 Cal. Rptr. 2d at 374.

155. See, e.g., *Kitchnefsky v. Nat'l Rent-A-Fence of Am., Inc.*, 88 F. Supp. 2d 360, 370-71 & n.16 (D.N.J. 2000) (applying New Jersey law).

156. See Douglas R. Richmond, *Reimbursing Insurers' Defense Costs: Restitution and Mixed Actions*, 35 SAN DIEGO L. REV. 457, 469-70 (1998).

157. See *id.* at 469.

claim or suit potentially implicating its coverage.<sup>158</sup> It is, after all, an insurer's duty to defend which compels it to reserve its rights, and without a duty to defend, an excess insurer has no obligation to issue a reservation of rights letter.<sup>159</sup> An excess insurer is of course free to issue a reservation of rights letter, and it may wish to do so out of an abundance of caution when it engages in settlement negotiations.<sup>160</sup>

Excess and primary insurers have no duty to reserve their rights against one another,<sup>161</sup> as *National Union Fire Insurance Co. v. American Motorists Insurance Co.*<sup>162</sup> illustrates. In *American Motorists*, the excess insurer National Union accepted the primary insurer's tender of its insured's defense. The primary insurer American Motorists had issued two policies that applied to the loss. National Union settled the underlying litigation and then sued American Motorists to recover a portion of the settlement under one of the American Motorists policies that had not been exhausted. American Motorists contended that National Union had waived its right to recover or should be estopped from asserting its right because it failed to reserve its rights to deny coverage when American Motorists tendered the defense.<sup>163</sup> The Georgia Court of Appeals sided with American Motorists and National Union appealed to the Georgia Supreme Court.

As an initial matter, the supreme court stated that American Motorists' attempt to label National Union's actions below as a denial of coverage was a mischaracterization.<sup>164</sup> Regardless of the label attached to the claim, the fact that National Union was attempting to recoup its outlay did not mean that it was denying coverage.<sup>165</sup> National Union accepted American Motorists' tender of their insured's defense, assumed the defense, and settled the lawsuit. Because National Union did not attempt to deny coverage, it was not required to reserve its rights to do so.<sup>166</sup>

The court further reasoned that even if National Union were denying coverage, its failure to reserve its rights would not bar its recovery

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158. See *Interstate Fire & Cas. Co. v. Archdiocese of Portland*, 899 F. Supp. 498, 501 (D. Or. 1995), *aff'd sub nom. Interstate Fire & Cas. Co. v. Underwriters at Lloyd's, London*, 139 F.3d 1234 (9th Cir. 1998); *Philadelphia Indem. Ins. Co. v. Barrera*, 998 P.2d 1064, 1069 (Ariz. Ct. App. 1999); *State Farm Fire & Cas. Co. v. Jioras*, 29 Cal. Rptr. 2d 840, 844 (Ct. App. 1994); *Int'l Ins. Co. v. Sargent & Lundy*, 609 N.E.2d 842, 855 (Ill. App. Ct. 1993).

159. See *Sargent & Lundy*, 609 N.E.2d at 855.

160. See, e.g., *Interstate Fire & Cas. Co.*, 139 F.3d at 1237-38 (9th Cir. 1998) (deciding case under Oregon law).

161. See, e.g., *St. Paul Mercury Ins. Co. v. Lexington Ins. Co.*, 78 F.3d 202, 207-08 (5th Cir. 1996) (applying Texas law).

162. *Nat'l Union Fire Ins. Co. v. Am. Motorists Ins. Co.*, 504 S.E.2d 673 (Ga. 1998).

163. See *Nat'l Union Fire Ins. Co.*, 504 S.E.2d at 674.

164. See *id.*

165. See *id.*

166. See *id.*

from American Motorists.<sup>167</sup> National Union had a contract only with its insured. Accordingly, only the insured could complain about the excess carrier's failure to reserve its rights.<sup>168</sup>

Finally, the *American Motorists* court considered whether public policy considerations might require an excess insurer to reserve its rights vis-à-vis a primary insurer in the absence of a contract between them. The court concluded that there was no public policy basis for imposing such a requirement on excess insurers.

The public policy interest in situations where insurance companies are arguing over which insurer should cover a claim rests with neither insurer, but with the insured. By requiring an excess insurer to investigate and notify a primary carrier of any claim for subrogation, we would be placing the insurer's interest ahead of the insured because the excess insurer would be required to delay action until it completed an investigation. We conclude that the better policy is to encourage insurers to promptly protect their insureds' interests and to hold disputes among themselves in abeyance. Therefore, we decline to impose a notice requirement.<sup>169</sup>

The supreme court thus reversed the appellate court.

It does not matter for reservation of rights purposes whether excess insurance is provided by way of a true excess policy or whether it is afforded under an umbrella policy.<sup>170</sup> So long as the primary coverage is not exhausted, an insurer providing excess coverage by way of an umbrella policy can have no defense obligations.<sup>171</sup> An umbrella carrier that has no duty to defend has no obligation to issue a reservation of rights letter in the event it later wants to disclaim coverage.<sup>172</sup>

### 3. The Duty to Reimburse Defense Costs

A few excess policies provide that in certain circumstances the insurer may be obligated to reimburse the insured for its defense costs.<sup>173</sup> The duty to reimburse defense costs and the duty to defend are not equivalent.<sup>174</sup> An excess insurer may incur a duty to reimburse defense

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167. *See id.*

168. *See Nat'l Union Fire Ins. Co. v. Am. Motorists Ins. Co.*, 504 S.E.2d 673, 675 (Ga. 1998).

169. *Nat'l Union Fire Ins. Co.*, 504 S.E.2d 675.

170. *See, e.g., State Farm Fire & Cas. Co. v. Jioras*, 29 Cal. Rptr. 2d 840, 844 (Ct. App. 1994).

171. *See State Farm Fire & Cas. Co.*, 29 Cal. Rptr. 2d at 844 ("[A]n umbrella policy has no duty of defense until the primary policy is exhausted.").

172. *See id.*

173. *See Seaman & Kittredge, supra* note 20, at 663.

174. *See Am. Cas. Co. of Reading v. Rahn*, 854 F. Supp. 492, 504 (W.D. Mich. 1994) (quoting case for the proposition that duty to defend clauses and reimbursement clauses are two different things); *See also Save Mart Supermarkets v. Underwriters at Lloyd's London*, 843 F. Supp. 597, 603 (N.D. Cal. 1994) (stating that an insurer's obligation to reimburse defense costs is not determinative of its duty to defend).



costs without assuming a duty to defend.<sup>175</sup> Indeed, a policy provision granting an excess insurer the explicit *option* to participate in its insured's defense clearly contradicts any possible *duty* to do so.<sup>176</sup> From a broader perspective, an excess insurer's duty to reimburse its insured's defense costs is more akin to its duty to indemnify than it is to a primary insurer's duty to defend. This is because an excess insurer's duty to reimburse does not arise until coverage is established.<sup>177</sup>

#### 4. The Equitable Allocation of Defense Costs to Excess Insurers

As noted previously, there are cases in which the insured's potential exposure clearly exceeds the primary insurer's policy limits, but the primary carrier cannot avoid what will surely be an expensive defense because the plaintiff will not settle and the excess carrier will not accept the primary carrier's tender of the defense.<sup>178</sup> In such cases, the primary insurer is forced to defend for the excess insurer's benefit. Should not the excess carrier be required to bear some portion of the defense costs on equitable grounds? The answer to this question may depend on the language of the excess policy at issue. If the excess policy at issue is a following form policy, or includes language that arguably suggests a duty to defend, the excess insurer may be required to share in the defense costs on some pro rata basis.<sup>179</sup>

The forced sharing of defense costs by an excess insurer absent exhaustion of the primary insurer's policy limits is a minority position,<sup>180</sup> as it should be. Here the doctrine of equitable contribution does not apply to disputes between primary and excess insurers over defense costs.<sup>181</sup> A true excess insurance policy is specifically intended to come into play only when the limits of underlying primary coverage are exhausted.<sup>182</sup> This principle or purpose is in no way altered by the fact that an excess policy follows form. Excess insurance is priced on the assumption that

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175. See *Seaman & Kittredge*, *supra* note 20, at 664.

176. See *Save Mart Supermarkets*, 843 F. Supp. at 603.

177. See *Stonewall Ins. Co. v. Asbestos Claims Mgmt. Corp.*, 73 F.3d 1178, 1219 (2d Cir. 1995), *modified on denial of reh'g on other grounds*, 85 F.3d 49 (2d Cir. 1996); *In re Celotex Corp.*, 152 B.R. 661, 666 (Bankr. M.D. Fla. 1993); *accord In re Kenai Corp.*, 136 B.R. 59, 64 (S.D.N.Y. 1992) (discussing similar language in a D&O liability policy).

178. See *supra* notes 116-19 and accompanying text.

179. See, e.g., *Gen. Accident Ins. Co. of Am. v. Am. Ins. Co.*, No. Civ. A. 99-3869, 2000 WL 92097, at \*\*3-5 (E.D. Pa. Jan. 27, 2000); *Builders Transp., Inc. v. Ford Motor Co.*, 25 F. Supp. 2d 739, 741-42, 44-47 (E.D. Tex. 1998); *Gen. Accident Ins. Co. of Am. v. Safety Nat'l Cas. Corp.*, 825 F. Supp. 705, 707-11 (E.D. Pa. 1993).

180. See *Tex. Employers Ins. Co. v. Underwriting Members of Lloyds*, 836 F. Supp. 398, 405 (S.D. Tex. 1993) (quoting 14 COUCH ON INSURANCE § 51:36, at 446 (2d ed. 1982)).

181. See *Home Indem. Co. v. Gen. Accident Ins. Co. of Am.*, 572 N.E.2d 962, 963 (Ill. App. Ct. 1991).

182. See *Guar. Nat'l Ins. Co. v. Am. Motorists Ins. Co.*, 981 F.2d 1108, 1109 (9th Cir. 1992) (affirming district court's prediction of how Montana Supreme Court would rule on issue of first impression).

the duty to defend rests with the primary insurer no matter how a particular excess policy is written. More importantly, a primary insurer's duty to defend, once triggered, exists without regard for the value or economic magnitude of the claims made against the insured.<sup>183</sup>

*Texas Employers Insurance Ass'n v. Underwriting Members of Lloyds*<sup>184</sup> reflects the better-reasoned majority approach. *Texas Employers* grew out of a wrongful death action against Monsanto. Texas Employers Insurance Association (TEIA) insured Monsanto under a \$1 million primary policy, which included standard duty to defend language.<sup>185</sup> Monsanto also had two layers of excess coverage written by Lloyds of London, with the first policy providing \$5 million in coverage and the second policy providing an additional \$10 million in coverage. The Lloyds policies provided that they would pay Monsanto's ultimate net loss, that being either the excess of the limits of the underlying insurance, or \$100,000 per occurrence not covered by the underlying insurance. The excess policies further provided that Lloyds "shall not be called upon" to assume Monsanto's defense, though Lloyds had the right to associate in Monsanto's defense.<sup>186</sup> Finally, the excess policies provided that Lloyds' liability did not attach until the underlying policies were exhausted by the payment of their policy limits.<sup>187</sup>

TEIA defended the wrongful death action, which ultimately settled for \$7.25 million. TEIA paid its \$1 million policy limits toward the settlement, the first level excess policy paid its full \$5 million limits, and the second level excess policy paid \$1.25 million. TEIA then demanded that Lloyds reimburse it for its attorneys' fees and costs incurred in Monsanto's defense, which exceeded \$4 million. Lloyds refused and TEIA sued for contribution.<sup>188</sup>

The *Texas Employers* court found no ambiguities in the Lloyds excess policies that would support imposing a duty to defend on the excess carriers,<sup>189</sup> and noted the majority rule that "excess or umbrella carriers are responsible for defense costs only after exhaustion of the primary policy limits."<sup>190</sup> TEIA argued that prorating the defense costs attributable to the wrongful death action was "more equitable" and that the excess insurers would be unjustly enriched if they were not required to

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183. See *Keck, Mahin & Cate v. Nat'l Union Fire Ins. Co.*, 20 S.W.3d 692, 701 (Tex. 2000) (stating that a primary insurer's duty to defend "extends to covered claims without regard to their amount"); See also ALLAN D. WINDT, *INSURANCE CLAIMS AND DISPUTES* § 411, at 195 (3d ed. 1995 & Supp. 1999).

184. 836 F. Supp. 398 (S.D. Tex. 1993).

185. See *Texas Employers Ins. Ass'n*, 836 F. Supp. at 401.

186. *Id.* at 402.

187. See *id.* at 402-03.

188. See *id.* at 403.

189. See *id.* at 406-07.

190. *Texas Employers Ins. Ass'n v. Underwriting Members of Lloyds*, 836 F. Supp. 398, 407 (S.D. Tex. 1993).

share the cost of defense.<sup>191</sup> The court, however, found no equitable principles supporting any departure from the express contractual obligations embodied in the primary and excess policies.

Where, as in this case, an insured purchases one policy specifically as primary coverage and another as excess coverage, to require the excess insurer to reimburse a primary carrier for amounts that were paid before exhaustion of the underlying policy limits would overturn the reasonable expectations of the parties.<sup>192</sup>

It was irrelevant that the exhaustion of the primary limits and the settlement of the wrongful death action occurred simultaneously, inasmuch as the defense costs at issue were incurred before the settlement, and the timing of TEIA's exhaustion did not change the language of the respective insurance policies.<sup>193</sup> To equitably apportion defense costs between the primary and excess policies would fly in the face of their unambiguous language. The coverage provided by the excess policies began only where coverage under the primary policy ended. As the primary insurer, it was TEIA's responsibility to defend Monsanto.<sup>194</sup>

Finally, none of the policies provided any guidance as to how defense costs should be apportioned. The court reasoned that the absence of related language was further evidence that apportionment was never contemplated.<sup>195</sup> The *Texas Employers* court therefore awarded the excess insurers summary judgment.<sup>196</sup>

An excess insurer may be compelled in equity to incur defense costs paid by a primary insurer where the excess carrier wrongfully refuses to defend the insured after the primary carrier's limits are exhausted, and the primary carrier continues to defend until it can obtain a declaration that its duty to defend has been fulfilled.<sup>197</sup> Because a primary insurer generally cannot withdraw its defense until it proves its entitlement to do so, an excess carrier that "shirks its duty to defend" between the time of exhaustion and the primary carrier's proof thereof potentially profits from its wrongful conduct.<sup>198</sup> Such behavior by excess insurers should be discouraged, which courts seek to do by holding that "principles of equity compel the excess carrier to reimburse the primary carrier for the excess

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191. *Texas Employers Ins. Ass'n*, 836 F. Supp. at 407.

192. *Id.* (citing *Hartford Accident & Indem. Co. v. Cont'l Nat'l Am. Ins. Cos.*, 861 F.2d 1184, 1187 (9th Cir. 1989) and *Guar. Nat'l Ins. Co. v. Am. Motorists Ins. Co.*, 981 F.2d 1108, 1109 (9th Cir. 1992)).

193. *See id.* at 407-08.

194. *See id.* at 408.

195. *See id.* at 409.

196. *See Texas Employers Ins. Ass'n v. Underwriting Members of Lloyds*, 836 F. Supp. 398, 410-11 (S.D. Tex 1993).

197. *See Hartford Accident & Indem. Co. v. Super. Ct.*, 29 Cal. Rptr. 2d 32, 34-35 (Ct. App. 1994).

198. *See Hartford Accident & Indem. Co.*, 29 Cal. Rptr. 2d at 35.

carrier's share of defense costs."<sup>199</sup> The primary carrier's duty to defend is only a contingent duty in the interim period after an exhaustion dispute arises.<sup>200</sup>

### 5. Umbrella Carriers' Duty to Defend Suits Not Covered by Primary Insurance

Unlike true excess policies, umbrella policies typically provide that the umbrella policy will afford primary coverage for certain claims or occurrences that are not within the ambit of the insured's primary policy.<sup>201</sup> With primary coverage comes a primary insurer's duty. Thus, an umbrella insurer may have a duty to defend its insured where a true excess carrier would not.<sup>202</sup> Of course, there must be a potential for coverage under the umbrella policy in order for the umbrella carrier to have a duty to defend.<sup>203</sup>

There is nothing remarkable about umbrella carriers' occasional duty to defend suits that primary policies do not cover. The point is that excess and umbrella policies are different, and the two types of carriers might have different obligations requiring case-specific scrutiny.

## III. GOOD FAITH AND FAIR DEALING

An insured may sue an excess insurer that breaches an express duty to the insured for breach of contract.<sup>204</sup> However, an excess insurer's duties to its insured go beyond those that are expressly stated in its policy. It is well settled that insurance policies contain an implied duty of good faith and fair dealing.<sup>205</sup> The implied duty of good faith and fair dealing

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199. *Id.*

200. *See id.* at 36.

201. *See Am. States Ins. Co. v. Md. Cas. Co.*, 628 A.2d 880, 886-88 (Pa. Super. Ct. 1993) (explaining that an umbrella carrier includes primary coverage in addition to claims not included in the insured's basic general liability coverage).

202. *See Nat'l Union Fire Ins. Co. v. Glenview Park Dist.*, 594 N.E.2d 1300, 1306-08 (Ill. App. Ct. 1992) (implying that umbrella policies are subject to broader exposure than excess policies), *aff'd in part, rev'd in part on other grounds*, 632 N.E.2d 1039 (Ill. 1994).

203. *See, e.g., Super. Equip. Co. v. Md. Cas. Co.*, 986 S.W.2d 477, 483-85 (Mo. Ct. App. 1998); *Am. States Ins. Co.*, 628 A.2d at 887 (applying standard duty to defend analysis to umbrella policy).

204. *See Bituminous Cas. Corp. v. Commercial Union Ins. Co.*, 652 N.E.2d 1192, 1195 (Ill. App. Ct. 1995).

205. *See Mora v. Phoenix Indem. Ins. Co.*, 996 P.2d 116, 120 (Ariz. Ct. App. 1999); *PPG Indus. v. Transam. Ins. Co.*, 975 P.2d 652, 655 (Cal. 1999); *Clausen v. Nat'l Grange Mut. Ins. Co.*, 730 A.2d 133, 140 (Del. Super. Ct. 1997); *Best Place, Inc. v. Penn. Am. Ins. Co.*, 920 P.2d 334, 337-38 (Haw. 1996); *Simper v. Farm Bureau Mut. Ins. Co. of Idaho*, 974 P.2d 1100, 1103 (Idaho 1999); *Greenvall v. Me. Mut. Fire Ins. Co.*, 715 A.2d 949, 955 (Me. 1998); *Dairyland Ins. Co. v. Herman*, 954 P.2d 56, 60 (N.M. 1997); *Smith v. Gen. Accident Ins. Co.*, 697 N.E.2d 168, 170 (N.Y. 1998); *Peterson v. West Am. Ins. Co.*, 518 S.E.2d 608, 614 (S.C. Ct. App. 1999); *Harter v. Plains Ins. Co.*, 579 N.W.2d 625, 631 (S.D. 1998); *Levine v. Selective Ins. Co. of Am.*, 462 S.E.2d 81, 84 (Va. 1995); *Mahler v. Szucs*, 957 P.2d 632, 641 (Wash. 1998); *Elmore v. State Farm Mut. Auto. Ins. Co.*,

essentially requires that neither party to a contract do anything to impair or injure the other's right to receive the benefits of their agreement.<sup>206</sup> An insurer that breaches its duty of good faith and fair dealing to its insured breaches its contract, and also may be said to be guilty of the tort of "bad faith."<sup>207</sup> The prototypical bad faith claim in the liability insurance context is a situation in which a primary insurer with exclusive control over the settlement of a claim against its insured fails or refuses to settle within its policy limits because it places its financial self-interest ahead of its insured's interests.<sup>208</sup> In other words, the insurer is seen as gambling with the insured's money.

An insurer's duty of good faith and fair dealing, like all contractual duties, has limits. Most fundamentally, an insurer's duty runs only to its insured.<sup>209</sup> Only the insurer and the insured are parties to the contract in which the duty is implied.<sup>210</sup> An insurer's duty of good faith and fair dealing does not extend to every person arguably entitled to payment from policy proceeds.<sup>211</sup>

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504 S.E.2d 893, 899 (W. Va. 1998); *Long v. Great W. Life & Annuity Ins. Co.*, 957 P.2d 823, 829 (Wyo. 1998).

206. See *Burkons v. Tigor Title Ins. Co.*, 813 P.2d 710, 720 (Ariz. 1991); *PPG Indus.*, 975 P.2d at 655; *Habetz v. Condon*, 618 A.2d 501, 505 (Conn. 1992); *Best Place*, 920 P.2d at 337-38; *Bourgeois v. Horizon Health Care Corp.*, 872 P.2d 852, 856 (N.M. 1994); *Harter*, 579 N.W.2d at 631 (quoting *Helmbolt v. LeMars Mut. Ins. Co.*, 404 N.W.2d 55, 57 (S.D. 1987)); *Carmichael v. Adirondack Bottled Gas Corp.*, 635 A.2d 1211, 1216 (Vt. 1993); *State Farm Mut. Auto. Ins. Co. v. Shrader*, 882 P.2d 813, 825 (Wyo. 1994).

207. "Bad faith" defies uniform definition or description. The majority rule appears to be that there must be some level of intentional wrongdoing by the insurer in order to support a bad faith claim. The insurer must do more than simply breach its contract with its insured. The Arkansas Supreme Court observed in *State Auto Property & Casualty Insurance Co. v. Swaim*, 991 S.W.2d 555 (Ark. 1999) that "[a]n insurance company commits the tort of bad faith when it affirmatively engages in dishonest, malicious or oppressive conduct in order to avoid a just obligation to its insured." *Id.* at 559. "Mere negligence or bad judgment is insufficient so long as the insurer is acting in good faith." *Id.* This sort of high standard is not universal, however. Some states allow bad faith recovery for an insurer's mere negligence. See Douglas R. Richmond, *An Overview of Insurance Bad Faith Law and Litigation*, 25 SETON HALL L. REV. 74, 98 (1994). "While it appears to be the majority rule that there must be some level of intentional wrongdoing by an insurer in order to support a bad faith claim, a significant minority of states apply a negligence standard." Richmond, 25 SETON HALL L. REV. at 98.

208. See *Yonkers Contracting Co. v. Gen. Star Nat'l Ins. Co.*, 14 F. Supp. 2d 365, 371 (S.D.N.Y. 1998).

209. See *Sperry v. Sperry*, 990 P.2d 381, 383 (Utah 1999).

210. See *Sperry*, 990 P.2d at 383.

211. For example, a liability insurer generally does not owe a third-party claimant a duty of good faith. See *Hand v. Farmers Ins. Exch.*, 29 Cal. Rptr. 2d 258, 264 (Ct. App. 1994); *Dunn v. Nat'l Sec. Fire & Cas. Co.*, 631 So. 2d 1103, 1106-07 (Fla. Dist. Ct. App. 1993); *Owens v. Allstate Ins. Co.*, 455 S.E.2d 368, 369 (Ga. Ct. App. 1995); *Dvorak v. Am. Family Mut. Ins. Co.*, 508 N.W.2d 329, 331 (N.D. 1993); *McWhirter v. Fire Ins. Exch.*, 878 P.2d 1056, 1058-59 (Okla. 1994); *Johnson v. Beane*, 664 A.2d 96, 99 n.3 (Pa. 1995); *Kleckley v. N.W. Nat'l Cas. Co.*, 526 S.E.2d 218, 219-20 (S.C. 2000); *Transp. Ins. Co. v. Faircloth*, 898 S.W.2d 269, 279-80 (Tex. 1995); *Larocque v. State Farm Ins. Co.*, 660 A.2d 286, 288 (Vt. 1995); *Planet Ins. Co. v. Wong*, 877 P.2d 198, 201 (Wash. Ct. App. 1994).

While it generally makes perfect sense to limit an insurer's duty of good faith to its insured, excess insurance presents a special need. A primary insurer may decline to settle a claim within its policy limits secure in the knowledge that it cannot be held liable for bad faith to its insured because any verdict or judgment that exceeds its limits will be paid by the excess carrier. Here the primary insurer is gambling with the excess insurer's money instead of the insured's. Moreover, because the excess insurer does not have any contractual relationship with the primary insurer it has no apparent contractual protections, whether express or implied.

The unusual relationship between primary and excess insurers, and the attending potential for strain and abuse, has long drawn judicial attention. As the Third Circuit observed in *Puritan Insurance Co. v. Canadian Universal Insurance Co.*:<sup>212</sup>

The relationship between the primary and excess carrier is an unusual one; each has a separate contract with the insured, but they have none with each other. Conflicts of interest invariably arise when the underlying tort injury is of such severity that a recovery over the limits of the primary policy is possible. In that circumstance, the excess carrier wishes the primary insurer to dispose of the case within its limits and is not unduly impressed with the primary insurer's desire to save some or all of its policy limits by a favorable verdict at trial. Conversely, the primary carrier is unlikely to have such paternalistic feelings as will induce it to concede its limits when there is some chance of obtaining a favorable verdict. In each instance, one carrier is to some extent gambling with the other's money.<sup>213</sup>

Understanding bad faith when excess insurance is involved may require different lines of analysis. First, what implied duties does an excess insurer owe its insured? Second, what duties flow between primary and excess insurers, if any, and how are those duties enforced in the absence of a direct contractual relationship? Insureds' obligations must be considered in both analyses, both because the duty of good faith and fair dealing is a two-way street and because a self-insured entity might assume a primary insurer's duties.

#### A. *Excess Insurers' Duty of Good Faith to Their Insureds*

Excess insurance policies, including those that provide only for indemnity, impose a duty of good faith on the insurer.<sup>214</sup> An insured therefore may sue its excess carrier for bad faith. Among the more complex

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212. 775 F.2d 76 (3d Cir. 1985).

213. *Puritan Ins. Co.*, 775 F.2d at 78.

214. See *N. Am. Van Lines, Inc. v. Lexington Ins. Co.*, 678 So. 2d 1325, 1330-31 (Fla. Dist. Ct. App. 1996), cert. denied, 692 So. 2d 185 (Fla. 1997); *Associated Wholesale Grocers, Inc. v. Americold Corp.*, 934 P.2d 65, 93 (Kan. 1997); *Rummel v. Lexington Ins. Co.*, 945 P.2d 970, 983-84 (N.M. 1997).

and interesting cases challenging an excess carrier's good faith is *Associated Wholesale Grocers, Inc. v. Americold Corp.*<sup>215</sup>

*Americold* arose out of a prolonged fire in a massive underground warehouse built inside a former limestone mine.<sup>216</sup> The fire began in December 1991 and burned until March 1992.<sup>217</sup> Smoke spread throughout the facility, invading space leased by customers and allegedly contaminating the tenants' stored food products with toxic residue.<sup>218</sup> Americold Corporation and its subsidiary, which owned and managed the warehouse, were insured under a \$1 million primary liability policy issued by National Union, a \$25 million excess policy issued by Northwest Pacific Indemnity (NPIC), and a top-layer \$15 million excess policy issued by TIG Insurance.<sup>219</sup> Americold's customers (or their subrogated property insurers) sued for the contamination of their property by smoke from the fire.<sup>220</sup> These cases were filed in both federal and state court.<sup>221</sup> National Union assumed Americold's defense as it was obligated to do under its policy, albeit under a reservation of rights.<sup>222</sup>

The fire litigation proceeded at an intense pace throughout 1992 and 1993.<sup>223</sup> By June 1993, the NPIC claims professional responsible for the many cases, David Bissell, concluded that the absolute pollution exclusion in the NPIC policy probably foreclosed coverage for claims attributable to smoke damage to property stored in the Americold facility.<sup>224</sup> Relying on the advice of counsel, however, Bissell resolved that he was not obligated to reveal NPIC's coverage position to Americold unless NPIC took control of the defense.<sup>225</sup>

In January 1994, TIG, whose following form policy was excess to NPIC's policy, demanded a coverage position from NPIC.<sup>226</sup> In response, NPIC's coverage counsel, Paul Hasty, told TIG that its request for a coverage position was premature.<sup>227</sup> Hasty based his reply on the fact that

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215. *Americold*, 934 P.2d at 65.

216. *See id.* at 70, 71.

217. *See id.* at 71.

218. *See id.*

219. *See id.* at 70-71.

220. *See Associated Wholesale Grocers, Inc. v. Americold Corp.*, 934 P.2d 65, 72 (Kan. 1997).

221. *See Americold*, 934 P.2d at 72.

222. *See id.* at 70.

223. *See id.* at 73.

224. *See id.* My firm having been engaged as defense counsel by National Union, I defended Americold in the underlying fire litigation. I did not participate in the negotiations leading to the consent judgments. I have previously has criticized insurers' attempts to invoke pollution exclusions to deny coverage where the pollutant is smoke from a hostile fire. This position was forged in part by the *Americold* fire litigation. *See Douglas R. Richmond, Where There's Smoke, There's Fire: The Absolute Pollution Exclusion and Hostile Fires*, 45 FED'N INS. & CORP. COUNS. Q. 157 (1995).

225. *See Americold*, 934 P.2d at 73.

226. *See Associated Wholesale Grocers, Inc. v. Americold Corp.*, 934 P.2d 65, 74 (Kan. 1997).

227. *See Americold*, 934 P.2d at 74.

National Union was still defending Americold, as well as the fact that because the primary policy limits had not been exhausted, NPIC's duties under its policy had not been triggered.<sup>228</sup>

The many plaintiffs claimed damages in the fire litigation exceeding all of Americold's available liability insurance coverage, both primary and excess.<sup>229</sup> On February 7, 1994, the district judge handling the federal cases announced that trial would be bifurcated, trying liability before damages.<sup>230</sup> The liability phase of the trial was scheduled to start April 12, 1994.<sup>231</sup> On February 10, 1994, Americold's personal counsel, Paul Niewald, demanded that National Union, NPIC, and TIG settle the many plaintiffs' claims within their combined policy limits.<sup>232</sup> Then, for the first time, NPIC stated its coverage position.<sup>233</sup> Hasty wrote Niewald telling him, among other things, that the absolute pollution exclusion in the NPIC excess policy barred coverage, that underlying coverage had to be exhausted before liability would attach under the NPIC policy, and that Americold's potential breach of the NPIC policy by not seeking coverage under its tenants' liability policies might excuse coverage.<sup>234</sup> Hasty's letter did not expressly state that NPIC was denying coverage.<sup>235</sup>

Niewald responded by informing Bissell that if NPIC denied coverage, Americold would seek indemnification from NPIC for any judgment against Americold.<sup>236</sup> Niewald also sent Bissell a copy of a brief addressing the absolute pollution exclusion in the NPIC policy.<sup>237</sup> "The brief emphasized that [the] exclusion was never intended to apply to smoke damage from a hostile fire."<sup>238</sup>

Court-ordered settlement conferences were held a little more than a month before the federal trial was to start.<sup>239</sup> The settlement conferences lasted five days, ending on March 8, 1994.<sup>240</sup> All plaintiffs offered to settle within Americold's total policy limits.<sup>241</sup> On March 9, National Union offered to pay the balance of its policy limits.<sup>242</sup> Neither NPIC nor

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228. *See id.*

229. *See id.*

230. *See id.*

231. *See id.*

232. *See* Associated Wholesale Grocers, Inc. v. Americold Corp., 934 P.2d 65, 74 (Kan. 1997).

233. *See* Americold, 934 P.2d at 74-75.

234. *See id.* More particularly, NPIC claimed that because Americold may have waived compulsory counterclaims for coverage under some of its customers' liability policies on which it would be an additional insured, that waiver could constitute a breach of the NPIC policy. *See id.*

235. *See id.* at 75.

236. *See id.*

237. *See id.*

238. *See* Associated Wholesale Grocers, Inc. v. Americold Corp., 934 P.2d 65, 75 (Kan. 1997).

239. *See* Americold, 934 P.2d at 75.

240. *See id.*

241. *See id.*

242. *See id.*



TIG offered any settlement amount.<sup>243</sup> On March 10, Americold repeated its demand that its insurers settle the cases within their policy limits.<sup>244</sup> NPIC then acknowledged that National Union's policy limits had been exhausted, but it would neither admit nor deny coverage.<sup>245</sup> "NPIC offered to defend Americold under a reservation of rights (although no reservation of rights letter had yet been issued), which Americold declined."<sup>246</sup> Niewald advised NPIC and TIG that he intended to negotiate a global settlement with the plaintiffs without NPIC's or TIG's involvement.<sup>247</sup> Americold and the plaintiffs then began negotiating outside of NPIC's and TIG's presence, and settled the plaintiffs' claims for consent judgments totaling \$58,754,574.<sup>248</sup> As part of the settlement, Americold assigned its breach of contract and bad faith claims against NPIC and TIG to the plaintiffs in exchange for a covenant not to execute against Americold.<sup>249</sup> That settlement was completed in the summer of 1994.<sup>250</sup>

On March 15, 1994, NPIC filed a declaratory judgment against the plaintiffs and Americold in a Kansas state court.<sup>251</sup> On April 11, 1994 (one day before the federal trial had been scheduled to start), NPIC "formally offered to defend [Americold] under a lengthy reservation of rights."<sup>252</sup> In September 1994, after registering their consent judgments, the plaintiffs instituted garnishment proceedings against NPIC and TIG.<sup>253</sup> The garnishment proceedings were consolidated with NPIC's declaratory judgment action. All parties moved for summary judgment.<sup>254</sup>

The trial court denied the excess insurers' motions and granted the plaintiffs' summary judgment motions. The court entered judgment against NPIC for its \$25 million policy limits. The court further held NPIC and TIG jointly and severally liable for the remaining amount of the consent judgments, that being just over \$33.6 million, plus interest.<sup>255</sup> TIG settled with the plaintiffs for its \$15 million policy limits. NPIC appealed to the Kansas Supreme Court.<sup>256</sup>

The *Americold* court easily rejected NPIC's arguments that the absolute pollution exclusion barred coverage,<sup>257</sup> and that some of Ameri-

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243. *See id.*

244. *See* Associated Wholesale Grocers, Inc. v. Americold Corp., 934 P.2d 65, 75 (Kan. 1997).

245. *See Americold*, 934 P.2d at 75.

246. *Id.*

247. *See id.*

248. *See id.*

249. *See id.*

250. *See* Associated Wholesale Grocers, Inc. v. Americold Corp., 934 P.2d 65, 75 (Kan. 1997).

251. *See Americold*, 934 P.2d at 75.

252. *Id.*

253. *See id.* at 75-76.

254. *See id.* at 76.

255. *See id.*

256. *See* Associated Wholesale Grocers, Inc. v. Americold Corp., 934 P.2d 65, 76 (Kan. 1997).

257. *See Americold*, 934 P.2d at 76-79.

cold's insurance policies were underlying insurance that had to be exhausted before implicating NPIC's policy.<sup>258</sup> The issue then became the enforceability of Americold's consent judgments.<sup>259</sup>

Viewing "the impact of the Americold settlement agreement on NPIC through the procedural lens of summary judgment," the court concluded that material issues of fact remained "concerning the reasonableness and good faith of the agreement."<sup>260</sup> In reaching this early conclusion, the court noted excess insurers' duties of good faith in the settlement context:

Before National Union tendered its policy limits, NPIC was not obligated to defend Americold or to take charge of settlement efforts on behalf of Americold. National Union had assumed Americold's defense. However, an excess insurer owes an implied good faith obligation regarding settlement negotiations . . . Even when [the excess insurer] has not assumed the defense or control of settlement negotiations, [it] has the right under the policy to consent to any settlement reaching its coverage level. The excess insurer has an implied obligation to exercise that right in good faith.<sup>261</sup>

The court then went on to examine several aspects of the challenged settlement agreement that supported its conclusion that genuine issues of material fact remained to be resolved.<sup>262</sup>

The *Americold* court first addressed NPIC's argument that its refusal to consent to the allegedly collusive settlements released it from liability.<sup>263</sup> The court observed "[a]n insured does not lose rights against the insurer by entering into a settlement after the insurer's bad faith denial of coverage and refusal of a reasonable settlement offer within policy limits."<sup>264</sup> NPIC's denial of coverage was wrongful and, if its refusal to settle were the product of either bad faith or negligence, then its lack of consent to the settlement would be no bar to its enforceability against it.<sup>265</sup> Of course, the settlement amount would have to be reasonable.<sup>266</sup>

NPIC tried to distinguish its implied duty to settle from that of a primary insurer, arguing that it did not have time to evaluate its potential settlement obligation.<sup>267</sup> This argument failed as a matter of fact. Although less than a day passed between National Union's March 9, 1994 tender of its policy limits and Americold's settlement with the plaintiffs,

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258. *See id.* at 80.

259. *See id.* at 80-81.

260. *Id.* at 80-81.

261. *Id.* at 81 (citation omitted).

262. *See Associated Wholesale Grocers, Inc. v. Americold Corp.*, 934 P.2d 65, 82 (Kan. 1997).

263. *See Americold*, 934 P.2d at 82.

264. *See id.* at 82-83.

265. *See id.* at 83.

266. *See id.*

267. *See id.*

NPIC had known of the plaintiffs' policy limits settlement offer since November 1993.<sup>268</sup> Americold gave NPIC an opportunity to reconsider its position before settling with the plaintiffs.<sup>269</sup> NPIC "never suggested that it needed more time" to consider the plaintiffs' settlement offer.<sup>270</sup>

NPIC also claimed that Americold breached its duty to cooperate by entering into the consent judgments.<sup>271</sup> NPIC claimed that it was prejudiced by the settlement because it was precluded from defending the case.<sup>272</sup> The *Americold* court was not persuaded.

NPIC was not obligated to assume the defense until the primary insurance was exhausted. When exhaustion occurred, the litigation had been pending for some 18 months, discovery had taken place, trial on the liability issues was a month away in federal court, and the parties had been involved in court-ordered settlement discussions over the previous 3 weeks. All during this time, NPIC had the right to participate in the investigation and litigation. NPIC's claim of prejudice in being foreclosed from defending Americold, in view of its refusal to offer any settlement amount, is questionable.<sup>273</sup>

Moving on, the court asked: "[w]hat effect should Americold's refusal of NPIC's offer to defend subject to a reservation of rights have on the enforceability of the settlement against NPIC?"<sup>274</sup> The court was not surprised by Americold's rejection of NPIC's defense under reservation in light of NPIC's wrongful denial of coverage and refusal to participate in settlement.<sup>275</sup> Accepting NPIC's defense under reservation would have exposed Americold to a ruinous jury verdict and additional litigation with NPIC over coverage.<sup>276</sup>

The Court found that NPIC's offer to defend under an oral reservation of rights did not cure its wrongful denial of coverage. While its offer of a defense under reservation did not absolve it of liability, it was relevant to its good faith and negligence surrounding the settlement of the fire litigation.<sup>277</sup>

The court next discussed NPIC's challenge to the reasonableness of the plaintiffs' policy limits settlement offer and, ultimately, to the reasonableness of the consent judgment amounts.<sup>278</sup> NPIC argued that the set-

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268. See *Associated Wholesale Grocers, Inc. v. Americold Corp.*, 934 P.2d 65, 83 (Kan. 1997).

269. *Americold*, 934 P.2d at 83.

270. *Id.*

271. See *id.*

272. See *id.* at 84.

273. *Id.*

274. *Associated Wholesale Grocers, Inc. v. Americold Corp.*, 934 P.2d 65, 84 (Kan. 1997).

275. See *Americold*, 934 P.2d at 84-85.

276. See *id.* at 85.

277. See *id.*

278. See *id.*

tlement was collusive because Americold negotiated it in secret.<sup>279</sup> Again, Americold's reluctance to share its thoughts and settlement strategies with NPIC was unremarkable.

NPIC chose not to be involved in the settlement discussions by refusing to contribute anything toward settlement. Once NPIC denied coverage and offered nothing toward settlement, the relationship with Americold became adversarial. NPIC knew the negotiations were taking place. Under those circumstances, Americold's efforts to keep the final settlement negotiations and agreement confidential from NPIC may or may not raise concerns of collusion.<sup>280</sup>

The court did conclude, however, that the trial court erred by not independently evaluating the reasonableness of the settlement amount.<sup>281</sup> On remand the plaintiffs would be required to substantiate their damages and, in doing so, provide the trial court with a basis to evaluate the reasonableness of the settlement.<sup>282</sup>

The crucial and final issue decided by the court was NPIC's liability for damages in excess of its policy limits.<sup>283</sup> The *Americold* court observed that because an insured's cause of action against an insurer for breach of its implied duty of good faith in settlement is contractual, "the term 'extra-contractual damages' is a misnomer."<sup>284</sup> The damages awarded should place the insured in the same position it would have enjoyed had the insurance company's breach never occurred.<sup>285</sup>

Kansas does not recognize the tort of bad faith, holding instead that in defending and settling claims a liability insurer owes the insured a "duty to act in good faith and without negligence."<sup>286</sup> The *Americold* court acknowledged that the distinction between the Kansas "bad faith" and "negligence" standards is blurry, and that the insurer's duty to act in good faith and without negligence arises out of the policy.<sup>287</sup> The duty to act in good faith without negligence also encompasses a liability insurer's coverage decision when used as the reason for rejecting a reasonable settlement offer within policy limits.<sup>288</sup> An insurer is not required to settle a claim when there is a good faith question as to whether there is coverage under its policy.<sup>289</sup> The court was thus required to decide

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279. *See id.* at 86.

280. *Associated Wholesale Grocers, Inc. v. Americold Corp.*, 934 P.2d 65, 86-87 (Kan. 1997).

281. *See Americold*, 934 P.2d at 87.

282. *See id.* at 87, 94.

283. *See id.* at 87.

284. *Id.* at 88.

285. *Id.*

286. *Associated Wholesale Grocers, Inc. v. Americold Corp.*, 934 P.2d 65, 89 (Kan. 1997).

287. *See Americold*, 934 P.2d at 89-90.

288. *See id.* at 90.

289. *See id.* (citing *Snodgrass v. State Farm Mut. Auto. Ins. Co.*, 804 P.2d 1012 (Kan. Ct. App. 1991)).

whether material issues of fact remained concerning NPIC's bad faith in declining to settle because it believed that its absolute pollution exclusion barred coverage.<sup>290</sup>

The *Americold* court concluded that material issues of fact remained to be resolved for several reasons.<sup>291</sup> First, NPIC offered to defend under a reservation of rights shortly after National Union's tender.<sup>292</sup> NPIC's obligations, if any, were not triggered until Americold's primary coverage was exhausted,<sup>293</sup> and National Union's coverage position was unclear (by virtue of its reservation of rights) until it tendered its policy limits at the March 1994 settlement conference.<sup>294</sup> Second, NPIC's brinkmanship may or may not have prejudiced Americold.<sup>295</sup> Although NPIC may not have had an express contractual obligation to reveal its coverage position before National Union's tender of its policy limits, its implied good faith obligation could have required a more prompt disclosure of its coverage position after the initial policy limits settlement offer.<sup>296</sup> Third, NPIC's claim that tenant policies provided coverage primary to NPIC's "lacked substance."<sup>297</sup> Fourth, NPIC did not take some steps necessary to perfect its exhaustion argument until two years after it first became aware of facts suggesting the possibility of this coverage defense.<sup>298</sup> Fifth, "NPIC made no effort to settle."<sup>299</sup>

The Kansas Supreme Court remanded the case to the trial court for a factual determination as to whether NPIC denied coverage in bad faith.<sup>300</sup> If the district court were to find that NPIC did not act in bad faith, the insurer's liability would be fixed at \$25 million, that being its policy limit.<sup>301</sup> If NPIC were found on remand to have acted in bad faith and the consent judgments were found to be reasonable, then NPIC would be liable for the full value of those judgments.<sup>302</sup>

*Americold* is a complex and confusing case, and the opinion is not a model of clarity. The case does illustrate the predicament in which an excess insurer can find itself when it slumbers on its rights and arguably plays coy with its insured. NPIC's entire policy limits clearly were at risk and, accordingly, it could have demanded that National Union tender its

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290. *See id.*

291. *See id.* at 90-91.

292. *See Associated Wholesale Grocers, Inc. v. Americold Corp.*, 934 P.2d 65, 90 (Kan. 1997).

293. *See Americold*, 934 P.2d at 90.

294. *See id.*

295. *See id.* at 91.

296. *See id.*

297. *Id.*

298. *See Associated Wholesale Grocers, Inc. v. Americold Corp.*, 934 P.2d 65, 91 (Kan. 1997).

299. *Americold*, 934 P.2d at 91.

300. *See id.*

301. *See id.* at 93-94.

302. *See id.*

policy limits months earlier so that it could take control of the defense. It did not. It could have announced its coverage position as soon as it knew that it would be relying on its absolute pollution exclusion. It instead concealed its coverage position from its insured and from TIG, the excess carrier above. It could have filed a declaratory judgment action to determine the applicability of its exclusion long before it did. There was no apparent reason for that delay. Whether NPIC will ultimately bear the \$33 million in bad faith liability remains to be seen.

In *Rocor International, Inc. v. National Union Fire Insurance Co.*,<sup>303</sup> an excess insurer, National Union, assumed control of settlement negotiations in a high-exposure case that clearly implicated its policy limits.<sup>304</sup> Although National Union ultimately settled the case within its policy limits, it delayed in doing so.<sup>305</sup> Shortly after National Union took control of settlement negotiations, the case could have been settled for \$6.3 million.<sup>306</sup> National Union finally settled the case almost a year later for \$6.4 million.<sup>307</sup> In the meantime, Rocor, which was self-insured up to \$1 million, had to continue to prepare for trial in the event the case did not settle.<sup>308</sup> Rocor thus sued National Union to recover its defense costs incurred because of National Union's delay.<sup>309</sup>

Rocor alleged that National Union violated the Texas Insurance Code by not attempting in good faith to settle on fair terms once Rocor's liability was reasonably clear.<sup>310</sup> The Texas Court of Appeals agreed that Rocor had pleaded a cause of action under the applicable statute, stating that:

While Rocor had no right to expect that [National Union] would settle blindly, it certainly had a right to expect that, once all parties agreed on liability and damages, settlement would follow with reasonable promptness, and thus Rocor's financial interests would be protected. This is especially true in this case, because National Union took over settlement negotiations and negotiated with Rocor's funds and those of Rocor's primary carrier.<sup>311</sup>

Rocor also alleged National Union's negligence in handling the settlement. National Union argued in response that it had no duty to defend Rocor, and that absent a duty to defend it owed Rocor no duty to settle within policy limits.<sup>312</sup> The *Rocor* court rejected National Union's argu-

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303. 995 S.W.2d 804 (Tex. Ct. App. 1999).

304. See *Rocor Int'l, Inc.*, 995 S.W. 2d at 807.

305. See *id.*

306. See *id.*

307. See *id.* at 808.

308. See *id.* at 807-808.

309. See *Rocor Int'l, Inc. v. Nat'l Union Fire Ins. Co.*, 995 S.W.2d 804, 808 (Tex. App. 1999).

310. See *Rocor Int'l, Inc.*, 995 S.W. 2d at 808.

311. *Id.* at 809.

312. See *id.* at 812.

ments.<sup>313</sup> While National Union clearly had no duty to defend Rocor under the express terms of its policy, it “assumed a duty to fairly settle the underlying tort litigation when it took over settlement negotiations, especially negotiations involving funds that it did not control” (Rocor’s SIR and its primary policy limits).<sup>314</sup> The court reasoned that National Union could not have it both ways: “it [could not] take exclusive control of the handling of claims against its insured” and then claim that it could not be liable for related missteps because it had no contractual duty to defend.<sup>315</sup> National Union’s assumption of exclusive control over settlement negotiations gave rise to a special relationship upon which liability could be premised.<sup>316</sup>

The court acknowledged that National Union did settle the case, such that Rocor was not exposed to excess liability.<sup>317</sup> Nevertheless, the fact that this was not a typical third-party bad faith case did not mean that National Union should escape responsibility; National Union owed Rocor a duty to handle claims in such a way as to minimize Rocor’s financial hardship.<sup>318</sup> The *Rocor* court reasoned that National Union should not be allowed to drag out settlement free from a duty to defend while Rocor paid what were essentially unnecessary defense costs.<sup>319</sup>

*Rocor* teaches that excess insurers, just like primary insurers, can assume duties to their insureds that would not otherwise exist. The opinion should not be extended beyond its facts, however. The case is unusual in that the plaintiffs’ attorneys, Rocor’s defense counsel and National Union’s attorneys all evaluated the case as having nearly the same settlement value.<sup>320</sup> Had there not been that harmony, such that National Union’s delay in settlement was the product of hard negotiations required to close a significant gap between the plaintiffs’ initial offer and the true value of the case, no one reasonably could have accused the insurer of unfair business practices or negligence. That being the situation, Rocor’s defense costs would simply have been the price of self-insuring rather than being cast as damages.

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

Liability insurers regularly complain of insureds’ collusive and even fraudulent behavior in connection with allegedly unreasonable settle-

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313. *See id.*

314. *Id.*

315. *See Rocor Int’l, Inc. v. Nat’l Union Fire Ins. Co.*, 995 S.W.2d 804, 812 (Tex. App. 1999).

316. *See Rocor Int’l, Inc.*, 995 S.W. 2d at 812.

317. *See id.* at 813.

318. *See id.*

319. *See id.*

320. *See id.* at 808.

ments and consent judgments. Excess insurers also are targets of schemes by insureds to manipulate claims to the carrier's detriment.

The London underwriter serving as an excess insurer in *Andrade v. Jennings*,<sup>321</sup> Jennings, issued a policy to the owner of a fishing boat. The boat's owner, Jorge Fishing, also purchased a \$1 million primary policy from American Maritime.<sup>322</sup> Unfortunately, when Jorge's employee Andrade was injured in a shipboard accident, American Maritime was insolvent.<sup>323</sup> Thus, Wells Fargo Bank, the vessel's largest lien holder, engaged the law firm of Gray, Cary, Ames & Frye (Gray Cary) to defend Jorge against Andrade's lawsuit.<sup>324</sup> Another lien holder, PCA, also joined Jorge's defense.<sup>325</sup>

Gray Cary wrote counsel for Jorge's broker to enlist his aid in notifying Jennings that Jorge required a defense in light of American Marine's insolvency.<sup>326</sup> One thing led to another, and Jennings retained the law firm of Hancock, Rothert & Bunshoft (Hancock) to represent his syndicate's interests.<sup>327</sup> Gray Cary informed Hancock that Andrade's claim had a settlement value of \$200,000.<sup>328</sup> Hancock asked to be provided with any information indicating that Andrade's claim might exceed \$1 million, thereby implicating Jennings' coverage.<sup>329</sup>

Andrade's lawyer later made a \$950,000 settlement offer which Gray Cary did not report to Hancock.<sup>330</sup> PCA asked Gray Cary to quickly resolve Andrade's claim.<sup>331</sup> PCA also told Gray Cary to structure the settlement such that Andrade would not record a lien against the vessel.<sup>332</sup> Gray Cary then asked Andrade's lawyer to present an "immediate demand" and new settlement proposal.<sup>333</sup> The lawyers met to design a settlement.<sup>334</sup> Immediately after that meeting, Andrade's lawyer filed with the court an offer to compromise for a \$1.5 million stipulated judgment.<sup>335</sup> Gray Cary did not report either the settlement discussions or the \$1.5 million settlement demand.<sup>336</sup>

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321. 62 Cal. Rptr. 2d 787 (Ct. App. 1997).

322. See *Andrade*, 62 Cal. Rptr. 2d at 789.

323. See *id.* at 790.

324. See *id.*

325. See *id.*

326. See *id.*

327. See *Andrade v. Jennings*, 62 Cal. Rptr. 2d 787, 791 (Ct. App. 1997).

328. See *Andrade*, 62 Cal. Rptr. 2d at 791.

329. See *id.*

330. See *id.*

331. See *id.*

332. See *id.*

333. *Andrade v. Jennings*, 62 Cal. Rptr. 2d 787, 791 (Ct. App. 1997).

334. See *Andrade*, 62 Cal. Rptr. 2d at 791.

335. See *id.*

336. See *id.* at 792.



Settlement negotiations continued for months.<sup>337</sup> Gray Cary concealed these negotiations from Hancock.<sup>338</sup> Hancock eventually learned of the settlement negotiations and warned Gray Cary that such conduct was a breach of Jorge's duty to cooperate, thus voiding void coverage under Jennings' policy.<sup>339</sup> Hancock further warned Gray Cary against attempting to manufacture a claim in the excess layer where none would otherwise exist.<sup>340</sup> Gray Cary responded by telling Hancock that Andrade's attorney intended to seek court approval of a settlement ranging between \$1.5 million and \$2 million, and giving Hancock the date of the settlement hearing.<sup>341</sup> The Hancock attorney handling the case declined to attend the settlement hearing.<sup>342</sup>

The hearing went forward in Hancock and Jennings' absence.<sup>343</sup> Gray Cary appeared at the hearing for Jorge.<sup>344</sup> Andrade testified without objection and without being cross-examined.<sup>345</sup> "[Gray Cary] did not contest Jorge's liability or Andrade's damages."<sup>346</sup> The federal magistrate conducting the "prove-up hearing" entered a \$1,586,840.53 judgment for Andrade.<sup>347</sup>

Andrade settled with Jorge's insurance broker, who procured the worthless American Maritime primary policy, for somewhere between \$150,000 and \$175,000.<sup>348</sup> Jennings refused to pay Andrade that portion of the judgment within the excess policy's limits.<sup>349</sup> A trial court eventually entered a \$586,840.57 judgment against Jennings on claims brought by Andrade for breach of contract and declaratory relief.<sup>350</sup> After an appeal and remand, Jennings' collusion defense was tried to a jury.<sup>351</sup> The jury returned a verdict for Jennings and Andrade appealed.<sup>352</sup>

On appeal, Andrade argued that Jennings should be barred from attacking his judgment as collusive because he knew of his potential liability as an excess insurer and the prove-up hearing, but did nothing until after the hearing.<sup>353</sup> The *Andrade* court rejected this argument.<sup>354</sup>

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337. *See id.*

338. *See id.*

339. *See Andrade v. Jennings*, 62 Cal. Rptr. 2d 787, 793 (Ct. App. 1997).

340. *See Andrade*, 62 Cal. Rptr. 2d at 793.

341. *See id.*

342. *See id.*

343. *See id.*

344. *See id.*

345. *See Andrade v. Jennings*, 62 Cal. Rptr. 2d 787, 793 (Ct. App. 1997).

346. *Andrade*, 62 Cal. Rptr. 2d at 793.

347. *See id.*

348. *See id.* at 794 n. 7.

349. *See id.* at 794.

350. *See id.*

351. *See Andrade v. Jennings*, 62 Cal. Rptr. 2d 787, 795 (Ct. App. 1997).

352. *See Andrade*, 62 Cal. Rptr. 2d at 795.

353. *See id.* at 796.

Jennings' decision not to participate in the prove-up hearing had been but one factor considered by the jury in adjudicating his collusion defense.<sup>355</sup>

Andrade next attacked the verdict for Jennings as lacking substantial evidentiary support.<sup>356</sup> The court also rejected this argument.<sup>357</sup> "As the insured, Jorge owed its excess insurer Jennings the duty of good faith and fair dealing."<sup>358</sup> The court further stated that "[a]n insured may not manipulate claims to an excess carrier's detriment."<sup>359</sup> There was abundant evidence of Jorge's bad faith. Gray Cary violated the assistance and cooperation clauses in the excess policy "and thus committed a fraud on Jennings" by not providing him with a copy of Andrade's original \$950,000 settlement offer; by not conveying Andrade's \$1.5 million settlement offer; by concealing other evidence of Andrade's damages (an economist's report that Andrade's lost income approached \$1.2 million); by entering into the settlement agreement; and by not mounting a defense at the prove-up hearing.<sup>360</sup> Further, three witnesses who testified in the collusion case pegged the value of Andrade's claim at between \$150,000 and \$250,000, and one of the Gray Cary attorneys had twice told Hancock that Andrade's claim had a settlement value of \$200,000.<sup>361</sup> At the time of the settlement, there had been no local settlement or judgment exceeding \$1 million in a similar maritime case; the highest settlement had not exceeded \$350,000.<sup>362</sup> The largest prior jury verdict obtained by Andrade's attorney's law firm in a maritime case was \$900,000.<sup>363</sup> Finally, the court found that the jury could also "reasonably conclude" that defenses available to Jorge that were not raised at the prove-up hearing could have reduced Andrade's provable damages to below \$1 million.<sup>364</sup>

After reasoning that the settlement was unreasonable and the judgment was collusive, the *Andrade* court turned to the reasonableness of Jennings' absence at the prove-up hearing.<sup>365</sup> In light of Jorge's admission of liability in settlement documents, Jennings' appearance at the hearing would have been pointless.<sup>366</sup> Moreover, Hancock satisfied all duties of inquiry that Jennings might owe.<sup>367</sup> The Hancock attorney handling the matter (Booth) knew that Gray Cary was defending Jorge and had no

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354. See *id.* 796-97.

355. See *id.* at 797.

356. See *id.*

357. See *Andrade v. Jennings*, 62 Cal. Rptr. 2d 787, 797 (Ct. App. 1997).

358. *Andrade*, 62 Cal. Rptr. 2d at 798.

359. *Id.*

360. See *id.* at 798-99.

361. See *id.* at 799-800.

362. See *id.* at 800.

363. See *Andrade v. Jennings*, 62 Cal. Rptr. 2d 787, 800 (Ct. App. 1997).

364. See *Andrade*, 62 Cal. Rptr. 2d at 800.

365. See *id.*

366. See *id.* at 802.

367. See *id.*

reason to believe that it would cease its defense at any foreseeable time.<sup>368</sup> Nor did Booth have any reason to believe that Gray Cary was withholding information.<sup>369</sup> According to expert witnesses who testified at the trial of the collusion case, Booth was entitled to believe that the Gray Cary attorneys were truthful, and that they were providing complete and accurate information about the status of Andrade's case.<sup>370</sup>

Andrade also argued that even if Andrade did collude with Gray Cary and Jorge, Jennings was not damaged because Jennings had all the information needed to defend himself in the case in which the consent judgment was taken.<sup>371</sup> Again, the *Andrade* court rejected the plaintiff's argument.<sup>372</sup> Jennings' exposure arose when "he knew or should have known [that] the limits of Jorge's primary coverage would . . . become exhausted."<sup>373</sup> Gray Cary effectively concealed all such information from Jennings.<sup>374</sup> The settlement agreement with its unopposed judgment harmed Jennings because the liability issue was a "done deal" once Jorge agreed to give up all defenses it might assert against Andrade.<sup>375</sup> Jennings thus lacked "any meaningful opportunity to present a proper defense of the case, particularly with respect to issues of liability."<sup>376</sup>

Finally, Andrade argued that even if the court were to uphold the jury verdict of collusion, he should be entitled to pursue a direct claim against Jennings.<sup>377</sup> He reasoned that any collusion "voided only the settlement agreement and did not relieve Jennings of his contractual obligation to provide coverage for [his] injuries."<sup>378</sup> Jennings countered by arguing that, as Jorge's assignee, Andrade possessed only those remedies that Jorge had and he was subject to any defenses Jennings had against Jorge.<sup>379</sup> Thus, the jury's finding of collusion barred any direct claim by Andrade against Jennings.<sup>380</sup>

The *Andrade* court dodged this issue altogether.<sup>381</sup> The issue was not presented to the trial court, and accordingly, it could not be raised for the first time on appeal.<sup>382</sup>

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368. *See id.*

369. *See Andrade v. Jennings*, 62 Cal. Rptr. 2d 787, 802 (Ct. App. 1997).

370. *See Andrade*, 62 Cal. Rptr. 2d at 802.

371. *See id.*

372. *See id.*

373. *Id.*

374. *See id.* at 803.

375. *See Andrade v. Jennings*, 62 Cal. Rptr. 2d 787, 803 (Ct. App. 1997).

376. *Andrade*, 62 Cal. Rptr. 2d at 803.

377. *See id.*

378. *Id.*

379. *See id.*

380. *See id.*

381. *See Andrade v. Jennings*, 62 Cal. Rptr. 2d 787, 803 (Ct. App. 1997).

382. *See Andrade*, 62 Cal. Rptr. 2d at 803.

While an excess carrier may be able to sue a primary insurer for bad faith if it fails to settle a case within its policy limits, a subject discussed in detail in the next section,<sup>383</sup> it does not necessarily follow that an excess carrier may sue a self-insured policyholder for bad faith in failing to settle a lawsuit for an amount within its SIR.<sup>384</sup> As the court observed in *Employers Mutual Casualty Co. v. Key Pharmaceuticals, Inc.*:<sup>385</sup>

The simple fact of the matter is that policyholders, even partially self-insured policyholders, are not primary carriers. Policyholders pay premiums to excess carriers in order to have protection against the risk of litigation (which risks include that of guessing wrong in settlement negotiations); primary carriers do not, and therefore must be careful as to how they balance their own interests with the competing interests of the excess carriers in any given claim instance. We have found no basis in the law, nor have we been pointed to any, for concluding that, apart from the premiums it pays, an insured also assumes a fiduciary duty of care toward its insurer in the context of settlements.<sup>386</sup>

Thus, an excess insurer believing that its insured wrongly refused to settle a case within its SIR must raise policy defenses to coverage for the resulting judgment. A court might enforce a duty in contract for which the insured has bargained, even though the court might hesitate to enforce the duty in tort.<sup>387</sup>

### C. *Disputes Between Excess and Primary Insurers*

Disputes between primary and excess insurers often grow out of a primary carrier's failure to settle a case within its policy limits.<sup>388</sup> A primary insurer's failure to settle a case within its policy limits for which the facts should require it to do so, thereby exposing its insured to personal liability, is the essence of the third-party bad faith tort. A primary insurer's wrongful or unreasonable failure to settle a case within its policy limits is no less offensive when an excess insurer must bear liability for the resulting judgment above the primary carrier's limits. The issue then becomes how the excess carrier can call the primary insurer to account.<sup>389</sup>

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383. See *infra* notes 388-431.

384. See, e.g., *Int'l Ins. Co. v. Dresser Indus., Inc.*, 841 S.W.2d 437, 444-45 (Tex. Ct. App. 1992) (holding that insured had no common law duty to accept settlement offer that would avoid exposing excess insurer to liability).

385. 871 F. Supp. 657, 663 (S.D.N.Y. 1994) (predicting New Jersey law).

386. *Employers Mut.*, 871 F. Supp. at 666.

387. See *id.*

388. See, e.g., *Cal. Union Ins. Co. v. Liberty Mut. Ins. Co.*, 920 F. Supp. 908, 918 (N.D. Ill. 1996); *Galen Health Care v. Am. Cas. Co.*, 913 F. Supp. 1525, 1534 (M.D. Fla. 1996).

389. Allowing excess insurers a right of action against primary insurers for bad faith (whether direct or via equitable subrogation) encourages reasonable settlements, prevents primary insurers from obstructing settlement, prevents the unfair distribution of losses among primary and excess

A few courts hold that a primary insurer owes an excess insurer a direct duty of good faith and fair dealing.<sup>390</sup> These courts reason that when a primary insurer refuses to settle in bad faith, the excess insurer is in the same position as an insured.<sup>391</sup> Fairness dictates the imposition of a direct duty on the primary insurer, inasmuch as the excess carrier relies on the primary carrier to discharge any claims handling and defense obligations.<sup>392</sup> An excess insurer is entitled to rely on a primary insurer to not elevate its interests ahead of the excess insurer's interests, just as an insured can expect that a primary insurer will not subordinate the insured's interests to its own.<sup>393</sup> By treating an excess insurer and an insured as identical, direct duty jurisdictions avoid stumbling over the intellectual block posed by the absence of a contractual relationship between a primary and an excess insurer.<sup>394</sup>

Most courts reject the direct duty theory.<sup>395</sup> Under the majority rule, the duty to settle that a primary insurer owes an excess insurer derives from the primary insurer's duty to the insured, such that an aggrieved excess insurer may sue on an equitable subrogation theory.<sup>396</sup> In order for an excess insurer to sue a non-settling primary insurer via equitable subrogation the excess insurer must prove that the primary insurer failed to fulfill a duty owed to the insured,<sup>397</sup> and it must pay some portion of the

insurers, and reduces the cost of excess insurance. *See* *Truck Ins. Exch. v. Century Indem. Co.*, 887 P.2d 455, 458 (Wash. Ct. App. 1995).

390. *See, e.g.*, *RLI Ins. Co. v. Scottsdale Ins. Co.*, 691 So. 2d 1095, 1096 (Fla. Dist. Ct. App. 1997); *Frankenmuth Mut. Ins. Co. v. Cont'l Ins. Co.*, 537 N.W.2d 879, 881 n.6 (Mich. 1995); *Baen v. Farmers Mut. Ins. Co.*, 723 A.2d 636, 639 (N.J. Super. Ct. App. Div. 1999).

391. *See* *RLI*, 691 So. 2d at 1096; *Baen*, 723 A.2d at 639.

392. *See* *Am. Centennial Ins. Co. v. Warner-Lambert Co.*, 681 A.2d 1241, 1246 (N.J. Super. Ct. Law Div. 1995).

393. *See* *Gen. Accident Ins. Co. v. N.Y. Marine & Gen. Ins. Co.*, 727 A.2d 1050, 1054 (N.J. Super. Ct. App. Div. 1999).

394. The implied duty of good faith and fair dealing clearly is a contract law principle. *See* RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979).

395. *See* *Twin City Fire Ins. Co. v. Country Mut. Ins. Co.*, 23 F.3d 1175, 1178-1179 (7th Cir. 1994); *Greater N.Y. Mut. Ins. Co. v. N. River Ins. Co.*, 872 F. Supp. 1403, 1409 (E.D. Pa. 1995) (applying Pennsylvania law), *aff'd*, 85 F.3d 1088 (3d Cir. 1996).

396. *See* *Westchester Fire Ins. Co. v. Gen. Star Indem. Co.*, 183 F.3d 578, 583 (7th Cir. 1999) (interpreting Illinois law); *Evanston Ins. Co. v. Stonewall Surplus Lines Ins. Co.*, 111 F.3d 852, 858-59 (11th Cir. 1997) (applying Georgia and Wisconsin law); *Greater N.Y. Mut. Ins. Co. v. N. River Ins. Co.*, 85 F.3d 1088, 1095 (3d Cir. 1996) (deciding case under Pennsylvania law); *Hocker v. N.H. Ins. Co.*, 922 F.2d 1476, 1485 (10th Cir. 1991) (applying Wyoming law); *Cal. Cas. Ins. Co. v. State Farm Mut. Auto. Ins. Co.*, 913 P.2d 505, 510 (Ariz. Ct. App. 1996); *Pruyn v. Agric. Ins. Co.*, 42 Cal. Rptr. 2d 295, 307 (Ct. App. 1995); *Fireman's Fund Ins. Co. v. Maryland Cas. Co.*, 26 Cal. Rptr. 2d 762, 772 (Ct. App. 1994); *Hartford Cas. Ins. Co. v. New Hampshire Ins. Co.*, 628 N.E.2d 14, 17 n.7 (Mass. 1994); *Ins. Co. of N. Am. v. Travelers Ins. Co.*, 692 N.E.2d 1028, 1035-36 (Ohio Ct. App. 1997); *Am. Centennial Ins. Co. v. Canal Ins. Co.*, 843 S.W.2d 480, 482 (Tex. 1992); *First State Ins. Co. v. Kemper Nat'l Ins. Co.*, 971 P.2d 953, 957 (Wash. Ct. App.), *review denied*, 989 P.2d 1136 (Wash. 1999).

397. *See* *Gen. Star Indem. Co. v. Vesta Fire Ins. Corp.*, 173 F.3d 946, 949 (5th Cir. 1999) (applying Texas law).

verdict or judgment at issue.<sup>398</sup> Generally, the measure of damages in an equitable subrogation action is the difference between the amount the excess insurer would have contributed to the settlement that the primary insurer unreasonably refused, if anything, and the amount the excess insurer ultimately paid to satisfy the judgment.<sup>399</sup>

The equitable subrogation approach represents better contract law and insurance law than does the direct duty theory.<sup>400</sup> Though direct duty proponents may argue that their way avoids equitable defenses (such as estoppel) that might operate to deny an excess carrier redress, that simply is not so; equitable defenses work on legal claims as well as those in equity.<sup>401</sup> A primary insurer in a direct duty jurisdiction also may have perfectly valid defenses to an excess insurer's bad faith claim that do not sound in equity. For example, a primary insurer's implied duty to settle is excused where an excess insurer denies coverage.<sup>402</sup>

There are two situations, however, in which the recognition of a direct duty makes some sense, contract law hurdles aside. First, consider the situation in which the plaintiff is willing to settle only for an amount that exceeds the primary insurer's policy limits. An insurer generally does not owe an insured the implied duty to settle where no offer is made within its limits.<sup>403</sup> Under equitable subrogation theory, the absence of a policy limits settlement offer allows the primary insurer to try the case unencumbered by potential bad faith liability even though it is gambling with the excess insurer's money. The excess insurer can have rights against the primary carrier no greater than those enjoyed by the insured, which would be none.<sup>404</sup> Second, consider the situation where the insured insists on trying the case notwithstanding the risk of a verdict greater than the limits of its primary policy. Perhaps the insured is concerned about its reputation or about business interests that might be harmed by a decision in the case at bar. If the excess insurer's right to sue the primary carrier for bad faith or negligence is derivative, any claim the excess

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398. See *Cal. Union Ins. Co. v. Liberty Mut. Ins. Co.*, 920 F. Supp. 908, 923 (N.D. Ill. 1996).

399. See *Seaman & Kittredge*, *supra* note 20, at 703 (citing *Cont'l Cas. Co. v. Royal Ins. Co.*, 268 Cal. Rptr. 193, 198 (Ct. App. 1990)).

400. See *Twin City Fire Ins. Co. v. Country Mut. Ins. Co.*, 23 F.3d 1175, 1179-81 (7th Cir. 1994).

401. See *Twin City Fire Ins. Co.*, 23 F.3d at 1179.

402. See *Baen v. Farmers Mut. Fire Ins. Co.*, 723 A.2d 636, 639 (N.J. Super. Ct. App. Div. 1999).

403. See, e.g., *McLaughlin v. Nat'l Union Fire Ins. Co.*, 29 Cal. Rptr. 2d 559, 566-67 (Ct. App. 1994); *Motorists Mut. Ins. Co. v. Glass*, 996 S.W.2d 437, 453 (Ky. 1997); *Tex. Farmers Ins. Co. v. Soriano*, 881 S.W.2d 312, 314-15 (Tex. 1994).

404. See *M & B Apts., Inc. v. Teltser*, 745 A.2d 586, 591 (N.J. Super. Ct. App. Div. 2000) (observing that "[i]f the duty owed by a primary insurer to an excess insurer is identical to that owed to an insured, it follows that the rights of an excess insurer can rise no greater than those enjoyed by the assured").

insurer might have will be "barred by the insured's decision to roll the dice."<sup>405</sup>

Even these two scenarios, however, do not justify the recognition of a direct duty. As for the first, why should an excess insurer possess rights greater than those of an insured? There is no evidence of such a need. Moreover, the excess insurer bargained for this risk. The insurance industry maxim "there are no bad risks, only bad premiums," finds application here. As for the second scenario, an initial observation is that it will rarely happen. Standard primary liability insurance policies grant the insurer the right to settle as it deems expedient. Such provisions trump the insured's desire for vindication by a jury.<sup>406</sup> Additionally, if the insured irresponsibly insists on a trial, an excess insurer may avoid liability by asserting the insured's breach of its duty of good faith and fair dealing.<sup>407</sup> The excess carrier does not need to be able to sue the primary insurer in light of the defense the insured's conduct affords.<sup>408</sup>

Bad faith cases are often fact specific, but *California Union Insurance Co. v. Liberty Mutual Insurance Co.*<sup>409</sup> illustrates the burdens primary insurers may bear when trying to resolve a case short of an excess carrier's coverage. In *California Union*, a telephone company's (CTI) second-level excess insurer, California Union, sued its underlying insurer, Liberty Mutual, for negligence in bad faith in failing to settle a case within Liberty Mutual's policy limits. Liberty Mutual had issued CTI a \$1 million primary policy and a \$1 million first-level excess policy. California Union had issued a \$4 million excess policy immediately above the Liberty Mutual excess policy.<sup>410</sup>

The plaintiff in the underlying case, Hauck, suffered catastrophic injury while inspecting a roof. He retained the renowned Chicago plaintiffs' firm of Corboy & Demetrio to pursue his claims against several defendants.<sup>411</sup> Liberty Mutual provided CTI with a defense to Hauck's suit.

Hauck initially demanded \$37.5 million to settle.<sup>412</sup> Despite her belief that CTI's liability clearly exceeded the limits of Liberty Mutual's coverage, the Liberty Mutual claims handler primarily responsible for the

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405. *Twin City Fire Ins. Co.*, 23 F.3d at 1180.

406. *See, e.g., W. Polymer Tech., Inc. v. Reliance Ins. Co.*, 38 Cal. Rptr. 2d 78, 85 (Ct. App. 1995); *Shuster v. S. Broward Hosp. Dist. Physicians' Prof. Liab. Ins. Trust*, 591 So. 2d 174, 176-77 (Fla. 1992); *Miller v. Sloan, Listrom, Eisenbarth, Sloan & Glassman*, 978 P.2d 922, 928-29 (Kan. 1999).

407. *See Twin City Fire Ins. Co. v. Country Mut. Ins. Co.*, 23 F.3d 1175, 1180 (7th Cir. 1994).

408. *See Twin City Fire Ins. Co.*, 23 F.3d at 1180.

409. 920 F. Supp. 908 (N.D. Ill. 1996).

410. *See Cal. Union Ins. Co.*, 920 F. Supp. at 912.

411. *See id.*

412. *See id.*

case refused to offer the company's \$2 million policy limits toward settlement.<sup>413</sup> California Union reserved its entire \$4 million policy limits shortly thereafter based on the advice of the attorney it hired to monitor the defense of Hauck's case.

As discovery proceeded, the case got worse from the defendants' perspective. Nonetheless, Hauck reduced his settlement demand to \$16 million. Liberty Mutual's defense counsel asked for authority to settle the case and California Union formally demanded that Liberty Mutual do so. California Union was prepared to contribute to a settlement but would not do so until Liberty Mutual exhausted its \$2 million policy limits. At a meeting of all concerned on the defense side, Liberty Mutual advised that it had no plans to contribute to any settlement.<sup>414</sup>

Ultimately, all of the defendants except CTI settled for a combined \$4.4 million. Despite the fact that Liberty Mutual's defense counsel advised it to offer its \$2 million policy limits in settlement and another excess carrier above California Union urged Liberty Mutual to move quickly toward settlement, Liberty Mutual refused to offer more than \$400,000.<sup>415</sup> Liberty Mutual finally upped its offer to \$800,000. This offer was rejected. Even when it became apparent that Liberty Mutual could settle the case for \$1.6 million it refused to offer more than \$800,000.<sup>416</sup>

California Union ultimately became so concerned about the potential for a big verdict that it offered a "high-low agreement" governing the trial. The low was \$500,000 and the high was \$4 million, with the \$4 million divided equally between Liberty Mutual and California Union. While the parties still would have to try the case, the high-low agreement limited the risk of a bad verdict from either side's perspective.<sup>417</sup> California Union reserved its right to sue Liberty Mutual for bad faith in refusing to settle notwithstanding its participation in the high-low strategy.<sup>418</sup>

Hauck's lawyer Demetrio rejected the high-low agreement. Demetrio tried the case solely against CTI, which he called "the most culpable party."<sup>419</sup> The jury returned a \$16,038,737 verdict for Hauck, reduced by 40 percent for Hauck's comparative fault. One month after the verdict, California Union and Liberty Mutual settled with Hauck for \$5,723,242, with Liberty Mutual paying its \$2 million policy limits and California

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413. *See id.* at 914.

414. *See id.* at 915.

415. *See Cal. Union Ins. Co. v. Liberty Mutual Ins. Co.*, 920 F. Supp. 908, 916 (N.D. Ill. 1996).

416. *See Cal. Union Ins. Co.*, 920 F. Supp. at 917.

417. *See id.*

418. *See id.*

419. *Id.*



Union contributing \$3,723,242.<sup>420</sup> California Union then sued Liberty Mutual for bad faith in failing to settle the Hauck case.

Both carriers moved for summary judgment in the bad faith action, and the case was decided on their cross motions. Liberty Mutual first argued that California Union was equitably estopped from pursuing its claims. Liberty Mutual asserted that the presence of California Union's monitoring counsel at the settlement conferences in the Hauck case "'altered the negotiating landscape' because it signaled Hauck's attorney that the excess carrier was concerned by the case, and therefore that more money might be forthcoming."<sup>421</sup> The *California Union* court quickly dispatched this argument.

An excess insurer can be estopped from recovery if its own actions induced the defendant to try the case . . . . Likewise, if an excess insurance carrier participates in settlement negotiations and approves the settlement amount, it may have waived its right to challenge the settlement later . . . . Neither of those situations exists here, and the mere hiring of monitoring counsel does not create equitable estoppel.<sup>422</sup>

Liberty Mutual next asserted that California Union had suffered no harm because it had reserved its entire \$4 million policy limits. This unsupported argument failed easily. "Under Illinois law, if a primary insurer breaches its duty to its insured or an excess insurer, the excess verdict itself constitutes damages."<sup>423</sup>

Liberty Mutual did not dispute that it owed CTI (and thus California Union) a "general duty to use due care to avoid an excess judgment."<sup>424</sup> Liberty Mutual instead contended that it had no duty to initiate settlement negotiations. The *California Union* court cautiously observed that an insurer occasionally may have a duty to initiate settlement negotiations, though that is not the general rule and such a duty should be imposed sparingly, such as where potential excess liability is "glaring."<sup>425</sup> The court then made clear that so rare a duty was not directly implicated in this case.

The duty to initiate settlement does not directly apply here. Instead, this case involves the related *duty to continue ongoing settlement discussions* . . . . Here, Hauck's attorney began the negotiating process and demonstrated receptiveness to counter-offers. Although Hauck's demands were high, he never indicated that he was not prepared to

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420. *See id.*

421. *See* Cal. Union Ins. Co. v. Liberty Mutual Ins. Co., 920 F. Supp. 908, 919 (N.D. Ill. 1996).

422. *Cal. Union Ins. Co.*, 920 F. Supp. at 919 (citations omitted).

423. *See id.*

424. *See id.* at 920.

425. *Id.* at 920-21.

reduce them in order to settle; in fact, Hauck's demands became lower over time, a clear signal that he was willing to settle. *In this situation, Liberty Mutual's duty was not to initiate settlement but merely to act reasonably in continuing the negotiations, including making reasonable offers up to the limits of its policy if that was necessary and prudent.*<sup>426</sup>

After examining many factors bearing on the reasonableness of Liberty Mutual's conduct, the *California Union* court concluded that no reasonable trier of fact could find that Liberty Mutual's actions in pursuing settlement in the Hauck case were reasonable.<sup>427</sup> There was virtually no evidence that Liberty Mutual met its duty of care to CTI and, by way of equitable subrogation, its duty to California Union.<sup>428</sup> The court thus entered summary judgment for California Union, awarding the excess insurer \$3,723,242 (its portion of the settlement) plus interest and costs.<sup>429</sup>

Of course, there may be cases in which the primary insurer allegedly mishandles settlement negotiations or seriously misjudges the value of the case, but the primary insurer's blunders are meaningless because the plaintiff's damages are so great that the case could never be settled within the primary policy limits.<sup>430</sup> In such a case, an excess insurer that pays all or part of its policy limits will not be able to prevail on a bad faith claim against the primary insurer. This is because the primary insurer's failures or errors are not the cause of the excess insurer's claimed damages.<sup>431</sup> Indeed, the excess insurer has no damages. It paid under its policy not because of the primary insurer's bad faith, but because it realized the risk it insured.

#### IV. SPREADING THE RISK AND SHARING THE PAIN: EXHAUSTION OF COVERAGE AND LOSS ALLOCATION ISSUES

Generally, for an excess insurer to have any obligation to its insured, the primary insurer must pay its policy limits toward the satisfaction or settlement of the claim or judgment against the insured. A primary insurer that properly pays its policy limits is said to have "exhausted" its limits. Similarly, an excess insurance policyholder that self-insures instead of purchasing a primary policy must exhaust its SIR before the excess insurer is required to respond to a loss.<sup>432</sup>

426. *Id.* at 921 (emphasis added).

427. *See Cal. Union Ins. Co. v. Liberty Mutual Ins. Co.*, 920 F. Supp. 908, 921-23 (N.D. Ill. 1996).

428. *See Cal. Union Ins. Co.*, 920 F. Supp. at 923.

429. *See id.* at 924.

430. *See, e.g., RLI Ins. Co. v. Gen. Star Indem. Co.*, 997 F. Supp. 140 (D. Mass. 1998) (applying Massachusetts law).

431. *See RLI Ins. Co.*, 997 F. Supp. at 150.

432. *See, e.g., City of Oxnard v. Twin City Fire Ins. Co.*, 44 Cal. Rptr. 2d 177, 180 (Ct. App. 1995) (discussing duty to defend); *Mo. Pac. R.R. v. Int'l Ins. Co.*, 679 N.E.2d 801, 808-81 (Ill. App. Ct. 1997) (discussing duty to indemnify).

Problems arise in cases involving continuous or progressive injuries or losses spanning several policy periods. Asbestosis claims, silicosis claims, environmental or pollution claims, and cases involving construction defects and earth movement, are just a few examples of continuous losses that burden courts and insurers. Standard insurance policy provisions do not neatly fit the complex factual scenarios presented by losses that span years or even decades.<sup>433</sup>

A loss that spans years may "trigger" multiple insurance policies. Insurance policies do not contain the term "trigger," which is simply a term of convenience.<sup>434</sup> "Triggering" occurs when a loss implicates a policy's coverage, subject to the policy's terms and exclusions, and any other coverage defenses the insurer may raise.<sup>435</sup> Most courts now employ the so-called "continuous trigger" or "triple trigger."<sup>436</sup> Under this approach, any policy on the risk at any time during the continuing loss is triggered, meaning that the issuing insurer must be prepared to defend or pay up to its policy limits as the case may be.<sup>437</sup>

One of the most hotly contested issues in continuous loss cases, often referred to by insurers as "long-tail claims," is whether an insured is obligated to exhaust its liability coverage "vertically" or "horizontally." This issue arises when several primary policies or lower level excess policies are triggered, and a court must determine whether the limits of the underlying policies for one year (vertical exhaustion) or all years (horizontal exhaustion) must be exhausted before a particular excess policy must pay.<sup>438</sup> Special problems may arise when an underlying insurer becomes insolvent, or an excess insurer is otherwise required to

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433. See *Pub. Serv. Co. of Colo. v. Wallis & Cos.*, 986 P.2d 924, 939 (Colo. 1999).

434. See *Armstrong World Indus., Inc. v. Aetna Cas. & Sur. Co.*, 52 Cal. Rptr. 2d 690, 699 (Ct. App. 1996) (citing *Montrose Chem. Corp. v. Admiral Ins. Co.*, 913 P.2d 878 (Cal. 1995)); *Rubenstein v. Royal Ins. Co. of Am.*, 694 N.E.2d 381, 387 n.6 (Mass. App. Ct. 1998), *aff'd*, 708 N.E.2d 639 (Mass. 1999).

435. See *Pub. Serv. Co. of Colo.*, 986 P.2d at 937 n.11.

436. Courts can pick from several coverage triggers. Applying an "exposure" trigger, CGL coverage triggers each time a person is exposed to a harmful condition during a policy period. Regardless of when the injury actually occurs, courts deem the injury to have occurred at the time of exposure. The "actual injury" or "injury-in-fact" trigger implicates those policies in effect when the subject injury or damage actually occurs, even if it is not discovered during that policy period. Those courts employing the "manifestation" trigger hold that bodily injury or property damage occurs when a latent disease or defect manifests itself. The policy (or policies) that is in effect when the injury or damage is discovered, or reasonably should have been discovered, is thus triggered. The application of a "continuous" trigger or "triple trigger" affords the broadest coverage. The continuous trigger theory implicates all policies from the date of first exposure through manifestation. It is sometimes called the "triple trigger" because it embraces the three other possible triggers. See Douglas R. Richmond, *Issues and Problems in "Other Insurance," Multiple Insurance, and Self-Insurance*, 22 PEPP. L. REV. 1373, 1430-32 (1995).

437. See *Pub. Serv. Co. of Colo.*, 986 P.2d at 938 n.12; *Sentinel Ins. Co. v. First Ins. Co. of Haw.*, 875 P.2d 894, 915 (Haw. 1994).

438. See Mary K. Gogoel & Mitchell A. Orpett, *Allocation and Excess Insurance*, in UNDERSTANDING ALLOCATION 135, 138-39 (Def. Research Inst. 1999).

“drop down” to provide a level of coverage lower than that for which it bargained.

Long-tail claims are the bane of liability insurers.<sup>439</sup> They are horribly expensive, consuming untold insurance company dollars in defense costs, indemnity payments, and coverage litigation costs. Accordingly, disputes involving the allocation of losses between insurers and their insureds, and between insurers, are regular sights on the insurance litigation landscape. Should multiple insurers bear that portion of a loss attributable to their “time on the risk”? Are policyholders bound to pay “orphan shares” attributable to gaps in coverage, or must the other insurers on the risk bear that responsibility as well? Allocation disputes are often confusing, at least in part because insurance policies themselves are silent on the issue.<sup>440</sup>

#### A. *Exhaustion of Primary Insurance*

##### 1. Vertical Versus Horizontal Exhaustion

“Vertical exhaustion” allows an insured to select policy periods triggered by a continuous loss.<sup>441</sup> Under vertical exhaustion theory, “the first-in-time primary and excess policies will be exhausted before the next-in-time primary and excess policies will be tapped.”<sup>442</sup> Vertical exhaustion benefits the insured because it allows the insured to select the policy periods in which it has the most available coverage to respond to a loss, thereby maximizing indemnity dollars.<sup>443</sup> It also benefits the insured because it preserves coverage under successive primary policies, thereby ensuring the insured of a continued defense.<sup>444</sup>

“Horizontal exhaustion” means that the primary insurance must be exhausted across all of the triggered policy periods before the next layer of coverage, whether excess or umbrella, must respond to a continuous loss.<sup>445</sup> In other words, every primary policy triggered by a continuous loss must be exhausted before any excess insurer can be required to pay.<sup>446</sup> Horizontal exhaustion best comports with the continuous trigger theories favored in many jurisdictions.

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439. See Michael F. Aylward, *Sharing the Blame? Issues Arising Out of the Allocation of Indemnity in Long Tail Coverage Disputes*, in UNDERSTANDING ALLOCATION 221, 221 (Def. Research Inst. 1999).

440. See *Owens-Illinois, Inc. v. United Ins. Co.*, 650 A.2d 974, 990 (N.J. 1994).

441. See Donald C. Erickson, *Emerging Primary and Excess Coverage Issues in Continuous Trigger Regimes*, THE BRIEF, Summer 1999, at 18, 19.

442. Gogoel & Orpett, *supra* note 438, at 138.

443. See *id.*

444. See *id.*

445. See *Mo. Pac. R.R. v. Int'l Ins. Co.*, 679 N.E.2d 801, 809 (Ill. App. Ct. 1997).

446. See, *Gen. Refractories Co. v. Allstate Ins. Co.*, No. Civ. A. 89-7924, 1994 WL 246274 (E.D. Pa. June 8, 1994); *Cont'l Cas. Co. v. Armstrong World Indus., Inc.*, 776 F. Supp. 1296 (N.D.

[I]f "occurrences" are continuously occurring throughout a period of time, all of the primary policies in force during that period of time cover these occurrences, and all of them are primary to each of the excess policies; and if the limits of liability of each of these primary policies is adequate in the aggregate to cover the liability of the insured, there is no "excess" loss for the excess policies to cover.<sup>447</sup>

Horizontal exhaustion benefits excess insurers by increasing the insulation from loss that underlying insurance provides.

Whether a court will apply vertical or horizontal exhaustion principles in a continuing-loss case is a question that is sometimes answered by looking at the language of the excess policy (or policies) at issue. A court will typically require vertical exhaustion when the limits of a specifically scheduled primary policy are exhausted and the excess policy provides that it shall be excess only to that specific underlying policy.<sup>448</sup> Where excess policies are not so specific, horizontal exhaustion is preferred. *Community Redevelopment Agency of the City of Los Angeles v. Aetna Casualty & Surety Co.*<sup>449</sup> is a representative case.

In *Community Redevelopment*, developer Carley purchased two successive \$1 million primary policies from United Pacific Insurance (United).<sup>450</sup> A third \$1 million primary policy issued by United insured both Carley and another developer, Cal Coast.<sup>451</sup> Additionally, Cal Coast purchased its own primary policy from State Farm with \$1 million limits.<sup>452</sup> Finally, Cal Coast also purchased a \$5 million umbrella policy from Scottsdale Insurance that was specifically (but not exclusively) excess to the State Farm policy.<sup>453</sup> The Scottsdale umbrella policy provided in relevant part:

#### UNDERLYING LIMIT—RETAINED LIMIT

The Company shall be liable only for the ULTIMATE NET LOSS in excess of the greater of the INSURED'S: (A) Underlying Limit—An amount equal to the limits of liability indicated beside the underlying insurance listed in the Schedule of Un-

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Ill. 1991); *Stonewall Ins. Co. v. City of Palos Verdes Estates*, 54 Cal. Rptr. 2d 176 (Ct. App. 1996); *United States Gypsum Co. v. Admiral Ins. Co.*, 643 N.E.2d 1226 (Ill. App. Ct. 1994).

447. *City of Palos Verdes Estates*, 54 Cal. Rptr. 2d at 199.

448. *See Cmty. Redev. Agency of Los Angeles v. Aetna Cas. & Sur. Co.*, 57 Cal. Rptr. 2d 755, 761 (Ct. App. 1996).

449. 57 Cal. Rptr. 2d at 755.

450. *See id.* at 757.

451. *See id.*

452. *See id.* at 758.

453. *See id.*

derlying Insurance (Schedule A) . . . plus the applicable limits of any other underlying insurance collectible by the INSURED;<sup>454</sup>

The policy's Schedule A listed State Farm's \$1 million policy as the underlying insurance.<sup>455</sup>

The Scottsdale policy also included a provision headed "Limits of Liability," a section providing for defense and supplementary payments, and an "Other Insurance" clause.<sup>456</sup> The limits of liability provision stated:

In the event of reduction or exhaustion of the aggregate limits of liability under said underlying insurance by reason of the payment of damages . . . , which occur during each policy period, this policy, subject to the above limitations, shall:

(A) in the event of reduction pay in excess of the reduced underlying limits, or

(B) in the event of exhaustion continue in force as underlying insurance subject to all the terms and conditions of such underlying insurances.<sup>457</sup>

The policy's "Supplementary Payments" provision stated:

DEFENSE, SETTLEMENT AND SUPPLEMENTARY  
PAYMENTS

The company shall have the right and duty to defend any suit against the INSURED seeking damages which are payable under the above insuring Agreement, even if the allegations of the suit are groundless, false, or fraudulent, provided, however, that no other insurance affording a defense or indemnity against such a suit is available to the INSURED.<sup>458</sup>

The "Other Insurance" clause provided: "OTHER INSURANCE: the insurance afforded by this policy shall be excess insurance over any other valid and collectible insurance available to the INSURED, whether or not described in the Schedule of Underlying Insurance."<sup>459</sup>

Carley and Cal Coast designed and built a number of residential developments in the hills around Los Angeles in the late 1970s and early 1980s.<sup>460</sup> Unfortunately, their developments were built on unsuitable

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454. *Cmty. Redev. Agency of Los Angeles v. Aetna Cas. & Sur. Co.*, 57 Cal. Rptr. 2d 755, 758 (Ct. App. 1996) (quoting the Scottsdale policy).

455. *See Cmty. Redev. Agency of Los Angeles*, 57 Cal. Rptr. 2d at 758 n.4.

456. *See id.*

457. *Id.* (quoting Scottsdale's policy).

458. *Id.* (quoting Scottsdale's policy).

459. *Id.* (quoting Scottsdale's policy).

460. *See Cmty. Redev. Agency of Los Angeles v. Aetna Cas. & Sur. Co.*, 57 Cal. Rptr. 2d 755, 757 (Ct. App. 1996).

soils, resulting in continuing damage to many properties over a number of years.<sup>461</sup> Not surprisingly, affected homeowners and homeowners associations filed a number of lawsuits against Carley, Cal Coast and the CRA, a city agency that had promoted the developments.<sup>462</sup>

In 1988, State Farm settled many of the lawsuits, contributing its \$1 million policy limits to the settlement.<sup>463</sup> The remaining lawsuits were settled in 1990, with United serving as the primary insurer and defending Carley, Cal Coast and the CRA until those cases were settled.<sup>464</sup> A declaratory relief action followed.<sup>465</sup> The insureds and insurers all disputed how to share the settlement and defense costs.<sup>466</sup> United argued that Scottsdale had a duty to provide primary coverage in State Farm's place as soon as State Farm paid its policy limits as part of the earlier settlement.<sup>467</sup> Such a duty, if it existed, would obligate Scottsdale to equitably share the considerable expense that United incurred defending Carley, Cal Coast and the CRA.<sup>468</sup>

The trial court entered judgment for Scottsdale, holding in part that it had no duty to share in the defense costs because not *all* of the primary policies on the risk were exhausted.<sup>469</sup> In other words, it was not enough that the State Farm policy was exhausted; Scottsdale had duty until the United policies also were exhausted and they never were. United appealed.<sup>470</sup>

The *Community Redevelopment* court readily acknowledged that the Scottsdale policy was purchased as excess insurance above the State Farm policy; however, the Scottsdale policy further provided that it was excess to the applicable limits of any other collectible underlying insurance.<sup>471</sup> This express description of the scope of Scottsdale's excess coverage was entirely consistent with, and was reinforced by, other policy language addressing Scottsdale's duty to defend and the effect of other insurance.<sup>472</sup>

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461. See *Cnty. Redev. Agency of Los Angeles*, 57 Cal. Rptr. 2d at 757.

462. See *id.* at 756-58.

463. See *id.* at 758.

464. See *id.* 756 n.1.

465. See *id.*

466. See *Cnty. Redev. Agency of Los Angeles v. Aetna Cas. & Sur. Co.*, 57 Cal. Rptr. 2d 755, 756 & n.1 (Ct. App. 1996).

467. See *Cnty. Redev. Agency of Los Angeles*, 57 Cal. Rptr. 2d at 758-59.

468. See *id.* at 759.

469. See *id.* (emphasis added).

470. See *id.* at 756.

471. See *id.* at 760.

472. See *Cnty. Redev. Agency of Los Angeles v. Aetna Cas. & Sur. Co.*, 57 Cal. Rptr. 2d 755, 760 (Ct. App. 1996).

California courts generally favor “horizontal exhaustion.”<sup>473</sup> As the *Community Redevelopment* court explained:

[P]rimary policies may have defense and coverage obligations which make them underlying insurance to excess policies which were effective in entirely different periods and which may not have expressly described such primary policies as underlying insurance. *Absent a provision in the excess policy specifically describing and limiting the underlying insurance, a horizontal exhaustion rule should be applied in continuous loss cases . . .* In other words, all of the primary policies in force during the period of continuous loss will be deemed primary policies to each of the excess policies covering that same period. *Under the principle of horizontal exhaustion, all of the primary policies must exhaust before any excess [policy] will have coverage exposure.*<sup>474</sup>

Given the general California rule and the language of its policy, Scottsdale could have no duty to defend until all primary policies—including the United policies—were exhausted. Although State Farm's policy limits were exhausted, United's policy limits clearly were not, and therefore, Scottsdale's duty was never triggered.<sup>475</sup>

United argued that because Scottsdale's policy specifically provided that it was excess to the State Farm policy, its duty to participate in the defense arose as soon as State Farm's limits were exhausted.<sup>476</sup> The *Community Redevelopment* court rejected United's argument, stating:

First, as we have quoted above, the ‘drop down’ provisions of the Scottsdale policy are contained in the ‘Limits of Liability’ section. The relevant provision requires ‘exhaustion’ before the drop down obligation will arise. United's reliance on this language is misplaced. Indeed, United's argument necessarily begs the very question on which our resolution of this matter depends: has exhaustion occurred or not? What is required for exhaustion to occur is clearly set out in other portions of the Scottsdale policy's insuring clauses. Those other provisions do not limit the coverage of the Scottsdale policy to only the ‘excess’ over the State Farm limits, but expressly extends it to ‘the applicable limits of any other underlying insurance collectible by the [insureds].’ The only reasonable interpretation of this policy language is that the term ‘underlying insurance’ must be read to include all available primary insurance, not just the policy expressly listed on the Schedule of Underlying Insurance. This conclusion is confirmed and reinforced by the ‘Defense’ and ‘Other Insurance’ sections of the Scottsdale policy, which contain additional and consistent provisions that compel rejection of United's contention. The coverage provided by United clearly was ‘other underlying insurance’ within the mean-

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473. See *Cnty. Redev. Agency of Los Angeles*, 57 Cal. Rptr. 2d at 761.

474. *Id.* (emphasis added).

475. See *id.*

476. See *id.* at 758-59.



ing of Scottsdale's policy . . . . In other words, an excess insurer can require in its policy that all primary insurance be first exhausted. Consistent with the horizontal exhaustion rule, that is what Scottsdale effectively did in this case. Because exhaustion of all available primary (or underlying) insurance never occurred, Scottsdale's duty, under the terms of the policy, to 'drop down' and provide a defense never arose.<sup>477</sup>

The *Community Redevelopment* court thus affirmed the trial court's judgment for Scottsdale.

## 2. Special Exhaustion Problems

Exhaustion is not just an issue in connection with long-tail claims. There may be cases in which a primary insurer wants its policy limits to be deemed exhausted so that an excess insurer will take over the insured's defense. Of course, an excess insurer wants the primary insurer to actually exhaust its policy limits so that the excess carrier can avoid defense costs as well as minimize its indemnity obligations. These competing interests sometimes give rise to unusual exhaustion disputes, as in *County of Santa Clara v. United States Fidelity & Guaranty Co.*<sup>478</sup>

In *County of Santa Clara*, the county's primary insurer, USF&G, escrowed its policy limits for use by the county in executing a state ordered remediation plan.<sup>479</sup> The district court then ordered the county's excess insurer, Employers Reinsurance Corporation (ERC), to assume the county's defense.<sup>480</sup> ERC appealed.<sup>481</sup>

The Ninth Circuit reversed the district court, noting, "there was nothing in the record to indicate that the [c]ounty had actually incurred expenses on account of claims made against it that would not reimbursed by others."<sup>482</sup> The district court "failed to appreciate that actual, as opposed to anticipatory, exhaustion is required before a primary insurer's duty to defend is extinguished . . . ."<sup>483</sup> Because USF&G's full policy limits remained available to indemnify the county, even if the company held them in escrow, they were not exhausted and ERC could not be compelled to take over the county's defense.

Because its duty to defend (if any) and duty to indemnify are not triggered until underlying coverage is properly exhausted, an excess insurer may need to discover into settlements within the limits of underlying coverage or within an insured's SIR in order to evaluate its potential

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477. *Id.* at 762.

478. No. 97-16759, 1999 U.S. App. LEXIS 7623 (9th Cir. Apr. 19, 1999).

479. *See County of Santa Clara*, 1999 U.S. App. LEXIS 7623 at \*2, 3.

480. *See id.* at \*3 n.3.

481. *See id.*

482. *Id.* at \*3.

483. *Id.* at \*4 (McKeown, C.J., concurring).

obligations. At least one court had held, however, that a non-settling excess insurer has no right to know the terms of a settlement between a plaintiff and a primary insurer.<sup>484</sup> The court in *UMC/Stamford, Inc. v. Allianz Underwriters Insurance Co.*<sup>485</sup> reasoned that an excess insurer was not entitled to discover the amount of settlements within the underlying primary coverage because that information was irrelevant to the excess insurer's obligations.<sup>486</sup>

As long as the underlying liability exceeds the primary limits in a vertical exhaustion, it does not matter how much the primary [insurer] paid plaintiffs. If there is any dollar difference between the primary layer of coverage and the amount of the settlement, plaintiffs will have to pay that difference before expecting to obtain any reimbursement from excess insurance companies since plaintiffs do not contend that these are 'drop down' policies. It is therefore irrelevant what the exact dollar figure was in the settlement.<sup>487</sup>

The better reasoned position holds that an excess insurer is entitled to discover the amounts of settlements below its limits and, in the cases of continuing losses or multiple occurrences, to have those amounts correctly allocated among policy periods.<sup>488</sup> This is a right the carrier needs to determine whether coverage obligations have been triggered.<sup>489</sup> An excess insurer certainly should be allowed to determine if and when underlying primary insurance is properly exhausted. Any reasons that an insured might have for attempting to conceal such information ought to be subordinate to "the parties' contractual rights to pay and be paid only on the terms and conditions to which they agreed."<sup>490</sup>

Insureds sometimes purchase liability policies variously described as "defense within limits" policies, "self-liquidating" policies, or "eroding limits" policies. Under these policies, defense costs reduce the limits of liability. In other words, every dollar spent on defense is one less dollar available to indemnify the insured.

A key issue is whether payment of defense costs exhausts a self-liquidating primary policy for excess insurance purposes. Though there are few cases on point, the answer appears to be "it depends." Where an umbrella policy or a following form excess policy, provide the excess coverage, the payment of defense costs may exhaust the primary policy

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484. See *UMC/Stamford, Inc. v. Allianz Underwriters Ins. Co.*, 647 A.2d 182, 191 (N.J. Super. Ct. Law. Div. 1994).

485. 647 A.2d 182 (N.J. Super. Ct. Law Div. 1994).

486. See *id.* at 190-91.

487. *Id.* at 190 (quoting plaintiff's brief).

488. See *Home Ins. Co. v. Super. Ct.*, 54 Cal. Rptr. 2d 292, 295 (Ct. App. 1996).

489. See *Home Ins. Co.*, 54 Cal. Rptr. 2d at 295.

490. *Id.* at 296.

and accelerate the excess insurer's potential obligations.<sup>491</sup> Where a true excess policy that stands alone is involved, the payment of defense costs does not occur until the first, i.e., "primary" policy's full sum has been paid out.<sup>492</sup>

As a matter of principle, defense costs paid under a self-liquidating primary policy should not count toward exhaustion unless the excess carrier knew that its underlying primary policy provided for defense costs within limits at the time the excess carrier accepted the risk. This is because self-liquidating policies are a rare exception rather than the rule.<sup>493</sup> An excess carrier that is not specifically told by the insured or its broker that the underlying primary coverage is self-liquidating rightly assumes that defense costs will be paid in addition to the primary policy limits as is industry custom, and prices its policy accordingly.<sup>494</sup> Contrary to some courts' belief,<sup>495</sup> an excess insurer may not always be able to review the actual primary policy before accepting the risk and calculating its premium. The insured wants seamless primary and excess coverage. Were an excess insurer to take the time to study a primary policy before issuing its own policy, the insured would face a coverage gap. A loss exceeding the insured's primary coverage and occurring before the excess policy was bound could be devastating; it certainly would defeat the insured's purpose for purchasing excess coverage.

### 3. Requiring An Excess Carrier to "Drop Down" in the Face of An Underlying Insurer's or Self-Insured's Insolvency

It is common for a primary policy to cover a loss fully, such that excess coverage is never triggered. Similarly, a loss might consume the insured's primary coverage and even trigger a first layer of excess coverage, but not encroach on upper layers of excess coverage. But what if a primary insurer or an intermediate excess insurer is insolvent? May an excess carrier be forced to "drop down" and fill the coverage gap created by the underlying insurer's insolvency?

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491. See *Coleman Co. v. California Union Ins. Co.*, 960 F.2d 1529, 1530-37 (10th Cir. 1992) (applying Kansas law).

492. See *Harnischfeger Corp. v. Harbor Ins. Co.*, 927 F.2d 974, 974-77 (7th Cir. 1991) (interpreting Wisconsin law).

493. See *Coleman Co.*, 960 F.2d at 1536. This point is lost in those jurisdictions that consider the excess insurer's subjective intent to be irrelevant. See *id.*

494. Of course, this argument has no force where the same insurance company writes both the primary and excess policies. There the insurer ought to know the terms of its respective policies. Additionally, an insurer that bears all of the risk (both primary and excess) ought not to fight itself over what must be its obligation in any event.

495. See *Coleman Co.*, 960 F.2d at 1536-37.

The answers to "drop down" questions may be answered by the terms of the subject excess policy.<sup>496</sup> Unfortunately, many excess policies do not address whether they drop down to the next lowest level of liability when underlying insurers become insolvent.<sup>497</sup> The focus then shifts to potentially related policy language, and courts and litigants often find themselves searching for ambiguities that might require an excess insurer to drop down.<sup>498</sup> It is apparently the majority rule that absent obligatory policy language, an excess insurer is not required to drop down and cover that portion of a loss once within an insolvent primary insurer's coverage,<sup>499</sup> nor must it drop down to provide the defense that an insolvent primary insurer was obligated to fund.<sup>500</sup>

The insured in *Hoffman Construction Co. v. Fred S. James & Co.*<sup>501</sup> had three layers of coverage: a \$50,000 Seaboard Surety primary policy, a \$450,000 intermediate layer of excess coverage provided by Holland-America, and an umbrella liability policy with Century Insurance.<sup>502</sup> The plaintiffs suffered a covered loss of \$375,000.<sup>503</sup> Seaboard paid the first \$50,000, but Holland-America became insolvent and could not pay the

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496. See Ala. Ins. Guar. Ass'n v. Kinder-Care, Inc., 551 So. 2d 286, 287 (Ala. 1989); Denny's Inc. v. Chicago Ins. Co., 286 Cal. Rptr. 507, 510 (Ct. App. 1991); Domingue v. Reliance Ins. Co., 619 So.2d 1220, 1223 (La. Ct. App. 1993). See, e.g., Atkinson Dredging Co. v. St. Paul Fire & Marine Ins. Co., 836 F. Supp. 341, 347 (E.D. Va. 1993).

497. See, e.g., Newton v. United States Fire Ins. Co., 391 S.E.2d 837, 839-40 (N.C. Ct. App. 1990); See Metro. Leasing, Inc. v. Pacific Employers Ins. Co., 633 N.E.2d 434, 436 (Mass. App. Ct. 1994). Insurers have recognized the problem, such that many policies now include provisions precluding drop-down coverage. See, e.g., Louisiana Ins. Guar. Ass'n v. Interstate Fire & Cas. Co., 630 So. 2d 759, 769 n.18 (La. 1994) (stating "[t]he current policies now often expressly include anti-drop down provisions") (citation omitted).

498. See Ala. Ins. Guar. Ass'n v. Magic City Trucking Serv. Inc., 547 So. 2d 849, 853-56 (Ala. 1989); Mass. Bay Transp. Auth. v. Allianz Ins. Co., 597 N.E.2d 439, 441-43 (Mass. 1992).

499. See Hartford Accident & Indem. Co. v. Chicago Hous. Auth., 12 F.3d 92, 95, 97 (7th Cir. 1993); Revco D.S., Inc. v. Gov't Employees Ins. Co., 791 F. Supp. 1254, 1265 (N.D. Ohio 1991), *aff'd*, 984 F.2d 154 (6th Cir. 1992); Alaska Elec. Rural Coop. Ass'n, Inc. v. INSCO Ltd., 785 P.2d 1193, 1193-94 (Alaska 1990); Maricopa County v. Fed. Ins. Co., 757 P.2d 112, 113 (Ariz. Ct. App. 1988); Wells Fargo Bank v. California Ins. Guar. Ass'n, 45 Cal. Rptr. 2d 537, 538 (Ct. App. 1995); Playtex FP, Inc. v. Columbia Cas. Co., 622 A.2d 1074, 1074 (Del. Super. Ct. 1992); S.E. Atl. Cargo Operators, Inc. v. First State Ins. Co., 398 S.E.2d 264, 266 (Ga. Ct. App. 1990); Hendrix v. Fireman's Fund Ins. Co., 823 S.W.2d 937, 941 (Ky. Ct. App. 1991); Vickodil v. Lexington Ins. Co., 587 N.E.2d 777, 779 (Mass. 1992); Am. Hoist & Derrick Co. v. Employers' of Wausau, 454 N.W.2d 462, 467 (Minn. Ct. App. 1990) (citation omitted); Fred Weber, Inc. v. Granite State Ins. Co., 829 S.W.2d 589, 590-91, 593 (Mo. Ct. App. 1992); Cent. Waste Sys., Inc. v. Granite State Ins. Co., 437 N.W.2d 496, 498-500 (Neb. 1989); Werner Indus., Inc. v. First State Ins. Co., 548 A.2d 188, 189 (N.J. 1988); Ambassador Assocs. v. Corcoran, 562 N.Y.S.2d 507 (N.Y. App. Div. 1990), *aff'd*, 589 N.E.2d 1258 (N.Y. 1992); N.C. Ins. Guar. Ass'n v. Century Indem. Co., 444 S.E.2d 464, 467, 471 (N.C. Ct. App. 1994); J. Kinderman & Sons, Inc. v. United Nat'l Ins. Co., 593 A.2d 857, 860 (Pa. Super. Ct. 1991), *aff'd*, 619 A.2d 1058 (Pa. 1993); Rapid City Reg'l Hosp., Inc. v. S.D. Ins. Guar. Ass'n, 436 N.W.2d 565, 567 (S.D. 1989); Emcor, Inc. v. Alliance Ins. Group, 804 S.W.2d 195, 198-99 (Tex. Ct. App. 1991).

500. See Emcor Mfg., Inc. v. Alliance Ins. Group, 879 S.W.2d 894, 903 (Tex. App. 1994).

501. 836 P.2d 703 (Or. 1992).

502. See *Hoffman Constr. Co.*, 836 P.2d at 704.

503. See *id.*

next \$325,000.<sup>504</sup> The plaintiffs then demanded that Century pay the \$325,000 that could not be recovered from Holland-America.<sup>505</sup>

The Century excess policy provided that the company would only be liable for the ultimate net loss of "the amount recoverable under the underlying insurances" specifically declared.<sup>506</sup> The plaintiffs argued that the phrase "amount recoverable under the underlying insurances" required the umbrella carrier to pay that portion of the loss not recoverable from insolvent Holland-America.<sup>507</sup> Century argued that the phrase meant that the plaintiffs were entitled to recover only for any portion of the net loss exceeding the limits of the underlying policies.<sup>508</sup> The plaintiffs argued essentially that "amount recoverable" meant the amount "able to be recovered," while the insurer argued that the phrase meant the "amount capable of recovery."<sup>509</sup>

The *Hoffman* court embraced the insurer's urged interpretation.<sup>510</sup> The court drew support from the "Limit of Liability" section in the Century umbrella policy, which specified the circumstances under which the umbrella policy would drop down.<sup>511</sup> The policy provided for drop down coverage where there was reduced primary coverage because of the payment of claims.<sup>512</sup> By holding that Holland-America's insolvency did not create drop down coverage, the court was able to give effect to both provisions, consistent with basic rules of contract interpretation.<sup>513</sup>

The court next rejected the plaintiffs' interpretation based on the "Loss Payable" provision in the Century policy.<sup>514</sup> The Loss Payable provision stated that "[l]iability under this policy with respect to any occurrence shall not attach unless and until the Insured, or the Insured's underlying insurer, shall have paid the amount of the underlying limits on account of such occurrence."<sup>515</sup> Again, to accept the plaintiffs' insolvency argument would render this provision meaningless and redundant. The *Hoffman* court concluded that the parties could not have intended such a result.<sup>516</sup>

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504. *See id.*

505. *See id.*

506. *Id.*

507. *See Hoffman Constr. Co. v. Fred S. James & Co.*, 836 P.2d 704, 705 (Or. 1992).

508. *See Hoffman Constr. Co.*, 836 P.2d at 705.

509. *Id.* at 706.

510. *See id.* at 709.

511. *See id.* at 707.

512. *See id.*

513. *See Hoffman Constr. Co. v. Fred S. James & Co.*, 836 P.2d 704, 707 (Or. 1992).

514. *See Hoffman Constr. Co.*, 836 P.2d at 708.

515. *Id.* at 707-08.

516. *See id.* at 708.

Finally, the plaintiffs asserted that the language in the Century policy's "other insurance" clause required drop down coverage.<sup>517</sup> Like most "other insurance" clauses, the Century policy provided that it would be excess over other "valid and collectible" insurance.<sup>518</sup> That condition, the plaintiffs argued, demonstrated the insurer's intent to cover all losses except where other valid and collectible insurance is available to the insured.<sup>519</sup> The court rejected this argument, as well.<sup>520</sup>

The problem with the plaintiffs' argument was that the use of the word "collectible" demonstrated that the parties were aware of that consideration—that concurrent insurance was collectible—and chose not to separately connect it with the phrase "amount recoverable under the underlying insurances."<sup>521</sup> The *Hoffman* court reasoned that the omission was designed.<sup>522</sup> The "amount recoverable" provision was expressly intended to recognize the underlying policies specifically stated in the declarations, while the "other insurance" clause was intended to limit the umbrella carrier's liability in the event other insurance was *available*.<sup>523</sup>

A slightly different situation was present in *Playtex FP, Inc. v. Columbia Casualty Co.*<sup>524</sup> In *Playtex*, Mission National Insurance, one of several excess carriers, became insolvent.<sup>525</sup> All of the excess insurers employed following form policies.<sup>526</sup>

Like the *Hoffman* plaintiffs, the *Playtex* plaintiffs argued that "amount recoverable" meant "real money."<sup>527</sup> Because Mission was insolvent, the coverage purportedly provided by the Mission policy was not an amount recoverable.<sup>528</sup> The excess carriers, on the other hand, argued that the terms "amount recoverable" and "limits of liability" were synonymous.<sup>529</sup> As did the *Hoffman* court, the *Playtex* court concluded that "amount recoverable" referred to specifically scheduled underlying insurance. The Mission policy did not meet this definition.<sup>530</sup>

The plaintiffs next turned their attention to the "Maintenance of Underlying Insurances" requirement in the Mission policy.<sup>531</sup> This provi-

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517. *See id.*

518. *See id.* (emphasis in original).

519. *See Hoffman Constr. Co. v. Fred S. James & Co.*, 836 P.2d 704, 708 (Or. 1992).

520. *See Hoffman Constr. Co.*, 836 P.2d at 708.

521. *Id.*

522. *See id.*

523. *See id.* (emphasis added).

524. 622 A.2d 1074 (Del. Super. Ct. 1992).

525. *See Playtex FP*, 622 A.2d at 1075-76.

526. *See supra* notes 11-13 (explaining that "following form" excess policies are subject to all agreements, conditions, exclusions and limitations in the underlying policies).

527. *See Playtex FP, Inc.*, 622 A.2d at 1081.

528. *See id.*

529. *See id.*

530. *See Playtex FP, Inc. v. Columbia Cas. Co.*, 622 A.2d 1074, 1083 (Del. Super. Ct. 1992).

531. *See Playtex FP, Inc.*, 622 A.2d at 1083.

sion required the insured to maintain the scheduled underlying policies in full force and effect for the duration of the excess policies, except for any reduction in applicable limits or the aggregate limit.<sup>532</sup> If the insured failed to maintain the underlying policies, Mission agreed to be bound only to the extent of its obligation were the underlying policies kept in force.<sup>533</sup>

The plaintiffs contended that Mission's insolvency caused a reduction in the underlying limits beyond the insured's control or which was not the insured's fault.<sup>534</sup> Because the excess carriers' policy followed Mission's form, the excess carriers were obligated to drop down.<sup>535</sup> The insurers contended that any reduction had to be by way of payment of claims.<sup>536</sup> Were that not so, the insurers argued, the condition's purpose would be eliminated.<sup>537</sup> The *Playtex* court rejected the plaintiffs' argument.<sup>538</sup> The condition in the Mission policy requiring the insured to maintain its underlying insurance was simply that; it was "clear that the provision [was] not intended to expand the insured's coverage and force the excess insurers to drop down."<sup>539</sup>

The positions taken by the *Hoffman* and *Playtex* courts make sense. Excess insurance and umbrella policies are relatively inexpensive because excess insurers are only obligated to pay claims to the extent they exceed primary coverage.<sup>540</sup> Insureds' expectations that excess carriers drop down in the event of a primary insurer's insolvency are objectively unreasonable. Insofar as liability insurance is concerned, the purpose of an excess policy is to protect against third-party claims, not to insure the solvency of a primary carrier.<sup>541</sup> An underlying primary insurer's insolvency is not an "occurrence."<sup>542</sup> Additionally, because the insured presumably selected the primary carrier, it is fair to ask the insured to bear the risk of insolvency. Excess insurers should not bear the risk of the insolvency of primary insurers they do not select.<sup>543</sup> Finally, the term "collectible," when used in an "other insurance" clause, should never be held to create an ambiguity as to an excess insurer's coverage in the case

532. *See id.*

533. *See id.*

534. *See id.* at 1085.

535. *See id.*

536. *See Playtex FP, Inc. v. Columbia Cas. Co.*, 622 A.2d 1074, 1085 (Del. Super. Ct. 1992).

537. *See Playtex FP, Inc.*, 622 A.2d at 1085.

538. *See id.*

539. *Id.*

540. *See Alaska Rural Elec. Coop. Ass'n, Inc. v. INSCO Ltd.*, 785 P.2d 1193, 1194 (Alaska 1990); *Rivere v. Heroman*, 688 So. 2d 1293, 1295 (La. Ct. App. 1997).

541. *See Safety Nat'l Cas. Corp. v. Pacific Employers Ins. Co.*, 927 P.2d 748, 750-51 (Alaska 1996).

542. *See Zurich-Am. Ins. Co. v. Mead Reinsurance Corp.*, 555 N.Y.S.2d 333, 334 (App. Div. 1990).

543. *See Alaska Rural*, 785 P.2d at 1195.

of a primary insurer's insolvency. In the excess insurance context, an "other insurance" clause serves to limit the company's liability in the event insurance other than the scheduled underlying insurance is available. Where a primary insurer is insolvent there is no "other insurance," and the clause never comes into play.<sup>544</sup>

While *Hoffman* and *Playtex* reflect the majority position, *Coca Cola Bottling Co. of San Diego v. Columbia Casualty Co.*<sup>545</sup> reflects the other side of the insolvency coin. *Coca Cola Bottling* also involved the Mission insolvency and following form policies. As did *Playtex*, the case hinged on the "Maintenance of Underlying Insurances" provision in Section III of the Mission policy.

Columbia argued that because it was excess of the Mission policy, and therefore was not scheduled as underlying insurance in the Mission policy, Section III of the Mission policy could not define the coverage provided by the Columbia policy.<sup>546</sup> The court succinctly disposed of this argument:

The fundamental difficulty with Columbia's argument is that it requires that Mission bear risks without imposing similar risks on insurers whose coverage is in excess of Mission's coverage. Such a disparate risk allocation between primary and excess carriers is inconsistent with the "followed form" nature of the insurance Columbia provided. 'An excess policy generally follows the form of the underlying primary coverage and is called >following form' excess coverage, *i.e.*, *the excess had the same scope of coverage as the primary policy.*<sup>547</sup>

The court next looked to Columbia's policy definition of its lower limits.<sup>548</sup> The policy provided coverage "where applicable excess of primaries."<sup>549</sup> Because the Columbia policy did not fully define the lower limits of its coverage, the court returned to the underlying Mission policy.<sup>550</sup> Of course, the Mission policy provided that the lower limit of coverage was the "amount recoverable,"<sup>551</sup> a phrase previously determined by California courts to be ambiguous.<sup>552</sup> The *Coca Cola Bottling* court thus concluded that Columbia was obligated to drop down.<sup>553</sup>

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544. *See id.* at 1196.

545. 14 Cal. Rptr. 2d 643 (Ct. App. 1992).

546. *Coca Cola Bottling Co. of San Diego*, 14 Cal. Rptr. 2d at 645-46.

547. *Id.* at 646-47 (citation omitted).

548. *See id.* at 647.

549. *See id.*

550. *See id.*

551. *See Coca Cola Bottling Co. of San Diego v. Columbia Cas. Co.*, 14 Cal. Rptr. 2d 643, 647 (Ct. App. 1992).

552. *See Coca Cola Bottling Co. of San Diego*, 14 Cal. Rptr. 2d at 645-46.

553. *See id.* at 647.



In *Rummel v. Lexington Insurance Co.*,<sup>554</sup> one of the issues was whether an excess carrier, Lexington, was obligated to indemnify a bankrupt self-insured entity, Circle K, which claimed that it had satisfied its \$250,000 SIR by granting a plaintiff a \$500,000 unsecured claim in its Chapter 11 reorganization.<sup>555</sup> The Lexington policy provided that the company's liability did not attach "unless and until the Insured's Underlying Insurance has been paid or has been held liable to pay the total applicable underlying limits."<sup>556</sup> The policy further provided that Lexington would indemnify Circle K against "loss" exceeding the total limits of all underlying insurance, defining "loss" to include the amounts owed by the underlying insurance "whether recoverable or not."<sup>557</sup>

Lexington contended that its coverage was not triggered until Circle K paid the limit of its SIR in cash.<sup>558</sup> The *Rummel* court disagreed. The language in the excess policy providing that Lexington's obligation kicked in where an underlying policy "has been held liable to pay" refuted any claim that an actual cash payment was required to implicate Lexington's coverage.<sup>559</sup> Indeed, to interpret the Lexington excess policy to require actual cash payment in light of the "has been held liable to pay" language in its insuring agreement would be "absurd."<sup>560</sup>

The *Rummel* court also looked to the policy definition of "loss" in rejecting Lexington's argument. Again, the policy defined "loss" to include amounts owed by underlying insurance "whether recoverable or not."<sup>561</sup> This phrase "would most logically be construed by the reasonably intelligent layperson as acknowledging the possibility that recovery from the underlying insurers may never happen."<sup>562</sup> The same reasoning applied with equal force to Circle K's SIR.

The court noted that other courts might disagree with its holding, but reasoned that:

[P]ublic policy supported this construction of Lexington's policy. The debtor in need of financial relief receives the protections granted by the bankruptcy process. Such benefits were never intended to absolve third parties of debts they share in common with the debtor. To conclude otherwise would be to grant insurers a windfall.<sup>563</sup>

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554. 945 P.2d 970 (N.M. 1997).

555. *Rummel*, 945 P.2d at 974.

556. *See id.* at 977.

557. *See id.* at 978.

558. *See id.* at 976.

559. *See id.* at 977.

560. *See Rummel v. Lexington Ins. Co.*, 945 P.2d 970, 978 (N.M. 1997).

561. *See Rummel*, 945 P.2d at 978.

562. *See id.*

563. *Id.*

### B. *Allocating Losses*

When a loss triggers multiple policies, allocating responsibility for the loss is important for obvious financial reasons. Allocation disputes can involve concurrent insurers, consecutive insurers, insurers and insureds, and tortured combinations of them all. Insurers contend that allocation is mandated by the terms of their policies, which specify coverage periods (typically one year). Thus, in the case of a continuing loss, an insurer should be allowed to limit its indemnity obligation to damage occurring during its policy period.<sup>564</sup> Insureds argue strenuously against allocation, fearing that their obligations under SIRs and other gaps in coverage will leave them responsible for portions of a continuing loss (so-called "orphan shares").

Insureds generally make two arguments against allocation. The first involves the standard language in most primary policies by which the insurer promises to pay "all sums [the insured] should become obligated to pay [as damages] by reason of specified liabilities,"<sup>565</sup> or "those sums that the insured becomes legally obligated to pay as damages."<sup>566</sup> Insureds argue that because standard policies do not specify that they will pay "all sums" or "those sums" attributable to damage caused during the policy period, if any portion of a continuing loss is covered the insurer must pay the entire loss up to the limits of its coverage. As the Washington Supreme Court explained in *American National Fire Insurance Co. v. B&L Trucking and Construction Co.*:<sup>567</sup>

[O]nce a policy is triggered, the policy language requires that the insurer to pay all sums for which the insured becomes legally obligated, up to the policy limits. Once coverage is triggered in one or more policy periods, those policies provide full coverage for all continuing damage, without any allocation between insurer and insured.<sup>568</sup>

The "all sums" approach makes an insurer liable for damages and defense costs attributable to harm outside its policy period.<sup>569</sup> "Under any given policy, the insurer contracted to pay all sums which the insured becomes legally obligated to pay, not merely some pro rata portion

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564. See *Mo. Pac. R.R. v. Int'l Ins. Co.*, 679 N.E.2d 801, 805-07 (Ill. App. Ct. 1997); See also Aylward, *supra* note 439, at 223.

565. See *FMC Corp. v. Plaisted & Cos.*, 72 Cal. Rptr. 2d 467, 475, 497 (Ct. App. 1998); *Domtar, Inc. v. Niagara Fire Ins. Co.*, 563 N.W.2d 724, 731 (Minn. 1997); *Am. Nat'l Fire Ins. Co. v. B&L Trucking and Constr. Co.*, 951 P.2d 250, 253 (Wash. 1998).

566. See *Am. Nat'l Fire Ins. Co.*, 951 P.2d at 253; 1 MILLER & LEFEBVRE, *supra* note 1, at 409.

567. 951 P.2d 250 (Wash. 1998).

568. *Nat'l Union Fire Ins. Co.*, 951 P.2d at 256.

569. See *Aerojet-General Corp. v. Transport Indem. Co.*, 948 P.2d 909, 919 (Cal. 1997); *Arco Indus. Corp. v. Am. Motorists Ins. Co.*, 594 N.W.2d 61, 69-70 (Mich. Ct. App.), *appeal granted*, 603 N.W.2d 780 (Mich. 1999).

thereof.”<sup>570</sup> Each insurer on the risk during a continuing loss thus becomes a primary insurer, and the insured is free to select the policy period under which it is to be indemnified.<sup>571</sup> The “all sums” approach is justified, some courts reason, because the allocation of a loss among insurers is irrelevant to each individual insurer’s obligation to the insured under the terms of its policy,<sup>572</sup> and because insurers surely negotiate their premiums with the possibility of such expansive liability in mind.<sup>573</sup>

Policyholders’ second argument against allocation is cloaked in terms of joint and several liability. This argument has two variations. First, an insured may argue that because each of several consecutive insurers provides coverage at relevant times, each has an independent obligation to insure the entire loss.<sup>574</sup> Second, an insured may argue that because it faces joint and several tort liability for the loss for which coverage is sought (as in environmental cases), its insurer’s liability is also joint and several.<sup>575</sup> This second approach is unsupported by any rationale.<sup>576</sup>

Though the “all sums” and “joint and several” approaches have been commonly applied,<sup>577</sup> they make little sense. Among other things, they require an incorrect presumption that all damage occurred in one policy period.<sup>578</sup> Insurers are wrongly held liable for damages occurring outside their policy periods, while insureds, who purposely reduce their insurance costs at different times by way of SIRs and varying limits, receive coverage for which they did not bargain.

### 1. Allocation Formulas or Methods

Because of the scientific complexities that characterize many continuing losses, as well as the extended period of time that damages may go undiscovered and the many parties potentially involved, it often is impractical to allocate damages “as proven,” i.e., to hold each insurer responsible only for those damages occurring during its policy period.<sup>579</sup>

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570. *J.H. France Refractories Co. v. Allstate Ins. Co.*, 626 A.2d 502, 507 (Pa. 1993).

571. *See J.H. France Refractories Co.*, 626 A.2d at 508.

572. *See FMC Corp. v. Plaisted & Cos.*, 72 Cal. Rptr. 2d 467, 499-500 (Ct. App. 1998).

573. *See FMC Corp.*, 72 Cal. Rptr. 2d at 500.

574. *See Aylward*, *supra* note 439, at 223.

575. *See, e.g., Outboard Marine Corp. v. Liberty Mut. Ins. Co.*, 670 N.E.2d 740, 750 (Ill. App. Ct. 1996).

576. *See Outboard Marine Corp.*, 670 N.E.2d at 750 (“We can find no rationale to support the imposition of joint and several liability upon the insurers simply because [the insured’s] liability arose under CERCLA.”).

577. *See Monsanto Co. v. C.E. Health Comp. & Liab. Ins. Co.*, 652 A.2d 30, 35 n.6 (Del. 1994) (citing cases).

578. *See Hercules Inc. v. Aetna Cas. & Sur. Co.*, Nos. 92C-10-105, 90C-FE-195-1-CV, 1998 WL 962089, at \*4 (Del. Super. Ct. Sept. 30, 1998).

579. *See generally N. States Power Co. v. Fid. & Cas. Co.*, 523 N.W.2d 657, 663 (Minn. 1994).

Some courts therefore allocate losses based on insurers' "time on the risk." Under the time on the risk method of allocation, a loss is allocated in proportion to the amount of time that an insurer's policies were in effect (the numerator) as a percentage of the total years during which the loss occurred (the denominator).<sup>580</sup> Allocation according to an insurer's time on the risk is relatively simple, as the Minnesota Supreme Court explained in *Northern States Power Co. v. Fidelity & Casualty Co.*:<sup>581</sup>

If, for example, contamination occurred over a period of 10 years, 1/10th of the damage would be allocable to the period of time that a policy in force for 1 year was on the risk and 3/10ths of the damage would be allocable to the period of time a 3-year policy was in force.<sup>582</sup>

Factoring in the triggered insurer's policy limits sometimes modifies the time on the risk method.<sup>583</sup> Prorating insurer's indemnity obligations on the basis of policy limits multiplied by years of coverage is best understood by way of example: Assume a loss spanning nine years and \$27 million in available insurance and self-insurance. The policies in effect for years one to three have \$2 million limits; the policies in effect for years four to six have \$3 million limits; and in years seven to nine, the insured has a \$4 million SIR. In the case of a loss spanning those nine years, carriers during the first three years would bear 6/27ths of the loss, the carriers insuring the next three years would bear 9/27ths of the loss, and the insured would bear 12/27ths of the loss.<sup>584</sup> Allocating the uninsured portion of the loss to the policyholder is fair because the insurers only agreed to indemnify the policyholder during their respective policy periods, and an entity that chooses to self-insure or "go bare" ought to share responsibility for a loss rather than shift responsibility for its choice to the insurers.<sup>585</sup>

## 2. Allocation and Excess Insurance

An excess policy typically provides that the insurance company "will indemnify the insured for the ultimate net loss in excess of the applicable underlying limit which the insured shall become legally obligated to pay as damages."<sup>586</sup> An excess policy usually defines "ultimate net loss" as "the sum actually paid" to settle a claim or suit, or to satisfy

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580. Courts may allocate liability based on the months insurers were on the risk, rather than years. *See, e.g., Sentinel Ins. Co. v. First Ins. Co. of Haw.*, 875 P.2d 894, 919 (Haw. 1994).

581. *See N. States Power Co.*, 523 N.W.2d at 657.

582. *Id.* at 664.

583. *See, e.g., Armstrong World Indus., Inc. v. Aetna Cas. & Sur. Co.*, 52 Cal. Rptr. 2d 690, 707-10 (Ct. App. 1996); *Owens-Illinois, Inc. v. United Ins. Co.*, 650 A.2d 974, 993-94 (N.J. 1994); *Sharon Steel Corp. v. Aetna Cas. & Sur. Co.*, 931 P.2d 127, 140 (Utah 1997).

584. *See Owens-Illinois*, 650 A.2d at 994.

585. *See Outboard Marine Corp. v. Liberty Mut. Ins. Co.*, 670 N.E.2d 740, 748-49 (Ill. App. Ct. 1996).

586. 1 MILLER & LEFEBVRE, *supra* note 1, at 623.

a judgment.<sup>587</sup> In these ways excess insurers' indemnity obligations are different from those of primary insurers. But differences in the language of an excess policy's insuring agreement from that found in a standard primary policy do not significantly alter courts' approaches to allocation. Courts prefer to allocate liability to excess insurers according to their time on the risk and the relative degree of risk assumed,<sup>588</sup> although allocation methods may vary.

The New Jersey Supreme Court examined allocation involving excess insurance policies in *Carter-Wallace, Inc. v. Admiral Insurance Co.*<sup>589</sup> In *Carter-Wallace*, the court expanded on the time on the risk/relative degree of risk method involving primary insurance it adopted some four years earlier in *Owens-Illinois, Inc. v. United Insurance Co.*,<sup>590</sup> using the same example it employed in *Owens-Illinois* to explain its holding.<sup>591</sup> That example assumed a nine-year continuous trigger and \$27 million in available indemnity dollars.<sup>592</sup> The insurers in years 1-3 provided \$2 million in annual coverage, the insurers in years 4-6 provided annual coverage of \$3 million, and in each of the last three years the policyholder was self-insured up to \$4 million.<sup>593</sup> Carriers in the first three years would thus bear 6/27ths of the burden (2/27ths per year), the carriers in the next three years would bear 9/27ths of the burden (3/27ths per year), and the insured would bear 12/27ths of the burden (4/27ths per year).<sup>594</sup>

The *Carter-Wallace* court's approach to excess allocation added a vertical exhaustion component to the time on the risk allocation method exemplified in *Owens-Illinois*. That is, after using the time on the risk method illustrated above to reach a figure for each year, the *Carter-Wallace* court embraced the idea of vertically allocating each policy in effect for a given year, beginning with the primary policy and proceeding upward through each succeeding excess layer.<sup>595</sup> The court again explained its holding by way of example:

Assume that primary coverage for one year was \$100,000, first-level excess insurance totaled \$200,000, and second-level excess coverage was \$450,000. If the loss allocated to that specific year was \$325,000,

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587. *Id.* at 626.

588. *See, e.g.*, *Pub. Serv. Co. of Colo. v. Wallis & Cos.*, 986 P.2d 924 (Colo. 1999); *Outboard Marine Corp. v. Liberty Mut. Ins. Co.*, 670 N.E.2d 740 (Ill. App. Ct. 1996), *appeal denied*, 675 N.E.2d 634 (Ill. 1996); *Carter-Wallace, Inc. v. Admiral Ins. Co.*, 712 A.2d 1116 (N.J. 1998).

589. 712 A.2d 1116 (N.J. 1998).

590. 650 A.2d 974 (N.J. 1994).

591. *See Carter-Wallace, Inc.*, 712 A.2d at 1124.

592. *See id.*

593. *See id.*

594. *See id.*

595. *See id.* at 1123-24 (citing *Chem. Leaman Tank Lines, Inc. v. Aetna Cas. & Sur. Co.*, 978 F. Sup. 589, 606 (D.N.J. 1997)).

the primary insurer would pay \$100,000, the first-level excess policy would be responsible for \$200,000, and the second-level excess policy would pay \$25,000.<sup>596</sup>

The court believed that its approach to allocation involving excess insurance was appropriate for several reasons. First, it efficiently used available resources because it neither minimized nor maximized the liability of either primary or excess insurance, thereby promoting cost efficiency by spreading costs.<sup>597</sup> Second, it promoted "simple justice" by differentiating between primary and excess insurance while not permitting excess insurers to avoid their obligations in continuous losses.<sup>598</sup> Third, it introduced "a degree of certainty and predictability into the complex world" of continuous trigger cases.<sup>599</sup>

The Colorado Supreme Court recently took up allocation in the excess insurance context in *Public Service Co. of Colorado v. Wallis & Cos.*<sup>600</sup> In *Public Service*, the insured, PSC, sued a London market insurer, Wallis, to recover its costs associated with environmental cleanup of a scrap yard and a landfill.<sup>601</sup> The issue ultimately became the allocation of liability across policy years.<sup>602</sup> PSC's insurance structure spanning the forty-five years at issue was complex.<sup>603</sup> All of the Wallis policies at issue were excess policies; however, for 22 years PSC did not carry primary insurance, such that the Wallis policies were excess to SIRs.<sup>604</sup> PSC also had several different layers of excess coverage. Thus, some Wallis policies were excess to other Wallis policies.<sup>605</sup> Finally, some years PSC had more than one excess policy insuring the same layer of risk, such that in any given year Wallis and another excess insurer issued concurrent policies at the same level.<sup>606</sup> The proportion of the risk borne by each concurrent insurer was expressed as a percentage in the policies.<sup>607</sup>

The *Public Service* court employed a continuous trigger,<sup>608</sup> leaving PSC and Wallis to argue over the method of allocation. PSC argued that it should be allowed to "pick and choose" which of its many triggered policies may be held liable for the entire cost of remediation of the environmental damage at a particular site, reasoning that such an approach

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596. *Carter-Wallace, Inc. v. Admiral Ins. Co.*, 712 A.2d 1116, 1124 (N.J. 1998).

597. *See Carter-Wallace, Inc.*, 712 A.2d at 1124.

598. *See id.* (citing *Owens-Illinois, Inc. v. United Ins. Co.*, 650 A.2d 974 (N.J. 1994)).

599. *See id.*

600. 986 P.2d 924 (Colo. 1999).

601. *See Pub. Serv. Co. of Colo.*, 986 P.2d at 927-28.

602. *See id.* at 930.

603. *See id.* at 935.

604. *See id.*

605. *See id.*

606. *See Pub. Serv. Co. of Colo. v. Wallis & Cos.*, 986 P.2d 924, 935 (Colo. 1999).

607. *See Pub. Serv. Co. of Colo.*, 986 P.2d at 935-36.

608. *See id.* at 939.

was required by Wallis' promise in its policies to pay "any and all sums" that PSC was obligated to pay as damages.<sup>609</sup> PSC also argued that because the "all sums" or "pick and choose" approach implicates only one policy period, it could only be required to exhaust one SIR.<sup>610</sup>

Wallis argued that the "all sums" approach was inadequate because it would make it liable for harm occurring outside its policy periods, contrary to the language of its policies.<sup>611</sup> Wallis urged the court to adopt a time on the risk method of calculation, whereby the ultimate net loss for each site would be allocated across all years from the onset of environmental damage until its discovery.<sup>612</sup> Once the amount of liability was determined for each year, the applicable SIR would be deducted.<sup>613</sup> Wallis would bear any remaining liability up to its policy limit.<sup>614</sup> Where both Wallis and another insurer issued concurrent excess policies to PSC at the same layer or level, they would share the liability attributable to that level of risk in proportion to the degree of risk that each accepted.<sup>615</sup>

The *Public Service* court rejected the "all sums" approach urged by PSC because it "creates a false equivalence between an insured that has purchased insurance coverage continuously for many years and an insured that has purchased only one year of insurance coverage."<sup>616</sup> In contrast, time on the risk allocation treats such hypothetical insureds differently, in accordance with the vastly different insurance protection they purchased.<sup>617</sup> The court further rejected PSC's argument that the "all sums" approach was appropriate because the Wallis policies were ambiguous, because the "all sums" or "pick and choose" approach did not represent a reasonable interpretation of the policies.<sup>618</sup> A policy can only be ambiguous when both the competing interpretations are reasonable. Finally, the court rejected PSC's argument that applications of the "all sums" or "pick and choose" approach was necessary to protect its reasonable expectations under its policies.

At the time PSC purchased each individual insurance policy, we doubt that PSC could have had a reasonable expectation that each single policy would indemnify PSC for liability related to property damage occurring due to events taking place years before and years after the term of each . . . [T]here is no logic to support the notion one single insurance policy among 20 or 30 years worth of policies could

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609. *See id.* at 937.

610. *See id.*

611. *See id.*

612. *See Pub. Serv. Co. of Colo. v. Wallis & Cos.*, 986 P.2d 924, 937 (Colo. 1999).

613. *See Pub. Serv. Co. of Colo.*, 986 P.2d at 937.

614. *See id.*

615. *See id.*

616. *See id.* at 939-40.

617. *See id.* at 940.

618. *See Pub. Serv. Co. of Colo. v. Wallis & Cos.*, 986 P.2d 924, 940 (Colo. 1999).

be expected to be held liable for the entire time period. Nor is it reasonable to expect that a single-year policy would be liable, for example, if the insured carried no insurance at all for the other years covered by the occurrence.<sup>619</sup>

The *Public Service* court thus held that:

[W]here property damage is gradual, long-term, and indivisible, [a] trial court should make a reasonable estimate of the . . . “occurrence” that is fairly attributable to each year by dividing the total amount of liability by the number of years at issue. The court should then allocate liability to each policy year, taking into account primary and excess coverage, SIRs, policy limits, and other insurance on the risk . . .

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Because it was remanding the case for retrial, the *Public Service* Court did not apply time on the risk allocation to the jury verdicts below. Rather, it presented some general guidelines for the trial court to follow, emphasizing that they were flexible standards that the trial court had the discretion to adapt and modify depending on the circumstances of a particular case.<sup>621</sup>

In the court's view, the most equitable method of time on the risk allocation also takes into account the degree of risk that insurers assume.<sup>622</sup> Thus, where damages cannot be precisely attributed to successive insurance policies:

[T]he total amount of damages should be divided by the total number of years to yield the amount of damage that is fairly attributable to each year. For example, if an insured's liability for a decade of pollution is one million dollars, then one tenth of the total liability, or \$100,000, is attributable to each policy-year.

Within each policy-year, the allocation of that \$100,000 of liability depends on the structure of the insurance. Primary insurance, or alternatively, any SIRs, must first be exhausted. If liability remains after that, then policies in the first layer of excess for that year are required to respond, then policies in the second layer of excess, and so on.<sup>623</sup>

When there are two or more policies within the same layer of excess, the *Public Service* court reasoned, the carriers should share the loss according to the degree of risk they assumed.<sup>624</sup> Returning to its ten year, \$1 million loss example, the court again illustrated its approach.

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619. *Pub. Serv. Co. of Colo.*, 986 P.2d at 940 (citation omitted).

620. *Id.*

621. *See id.* at 941.

622. *See id.*

623. *Id.*

624. *See Pub. Serv. Co. of Colo. v. Wallis & Cos.*, 986 P.2d 924, 941 (Colo. 1999).



[S]uppose the insured in the above example has an SIR of \$20,000 and then two excess insurance policies from different insurers in the first layer of excess. Each of these excess policies indemnifies the insured for losses in excess of \$20,000 and up to a \$50,000 limit of total loss, with one insurer assuming 70% of the risk in that excess layer and the other insurer assuming 30% of the risk. Under these circumstances, the insured would absorb the first \$20,000 of the total \$100,000 liability. Of the remaining \$80,000, only \$30,000 would be covered by the two insurers in this first layer of excess. The insurer who had assumed 70% of the risk would pay \$21,000, while the insurer who had assumed 30% of the risk would pay \$9,000. The remaining \$50,000 of liability would be allocated to the subsequent layers of excess, or would be absorbed by the insured if the insured were only insured up to a total loss of \$50,000 for that year.<sup>625</sup>

In allocating liability between concurrent excess insurers as it did, the court held that the carriers were required to indemnify the insured for their policy limits minus the insured's SIR, based upon the ultimate net-loss language in the Wallis policies.<sup>626</sup>

In offering the example it did, the court did not mean that the degree of risk should not be taken into account when successive policies have different liability limits, as some courts have done.<sup>627</sup> Rather, the amount of liability that is initially attributed to each year is independent of the policy limits that may be in effect for any given year.<sup>628</sup> Once the policy limits are reached in any given year, the insured must bear the remaining loss in accordance with its business decision to purchase that particular amount of coverage.<sup>629</sup>

### C. Applying "Other Insurance" Principles to Allocation Disputes

"Other insurance" refers only to two or more policies insuring the same risk and the same interest, for the benefit of the same person, during the same period.<sup>630</sup> "Other insurance" clauses in policies only operate when there is concurrent coverage.<sup>631</sup> Such clauses are not intended to

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625. *Pub. Serv. Co. of Colo.*, 986 P.2d at 941-42.

626. *See id.* at 942 n.19.

627. *See id.* at 942 (citing as an example *Owens-Illinois, Inc. v. United Ins. Co.*, 650 A.2d 974, 993-94 (N.J. 1994)).

628. *See id.*

629. *See id.*

630. *See* *Nationwide Mut. Ins. Co. v. Hall*, 643 So. 2d 551, 561 (Ala. 1994); *Nolt v. United States Fid. & Guar. Co.*, 617 A.2d 578, 579-84 (Md. 1993); *Merch. & Bus. Men's Mut. Ins. v. Savemart, Inc.*, 624 N.Y.S.2d 623, 625 (App. Div. 1995); *Harstead v. Diamond State Ins. Co.*, 723 A.2d 179, 182 (Pa. 1999); *S.C. Ins. Co. v. Fid. & Guar. Ins. Underwriters, Inc.*, 489 S.E.2d 200, 202 (S.C. 1997); *State Farm Fire & Cas. Co. v. Griffin*, 888 S.W.2d 150, 155 (Tex. Ct. App. 1994).

631. *See* *Richmond*, *supra* note 436, at 1376.

allocate liability among successive insurers.<sup>632</sup> Consecutive policies cannot constitute "other insurance" because while they may, insure the same *type* of risk, they do not insure the same risk.<sup>633</sup> Moreover, to enforce "other insurance" clauses among consecutive policies would unfairly make insurers liable for damages occurring outside their policy periods.<sup>634</sup>

Concurrent policies insuring a person for the same risk and interest can be the product of design or coincidence. For example, a business may insist that it be named as an additional insured on a contractor's CGL policy. It is therefore covered under its own policy and under the contractor's policy. A general contractor typically requires a subcontractor to make it an additional insured on the subcontractor's liability policy, thereby making at least two insurers potentially responsible for a loss.<sup>635</sup> A health care professional may carry malpractice coverage and at the same time be insured under a hospital's liability policy.<sup>636</sup> A person who is involved in an accident while driving the automobile of another is covered as a named insured under a personal automobile policy, as well as being insured under the policy of the owner.<sup>637</sup> Of course, concurrent coverage can exist at both primary and excess levels.<sup>638</sup>

When two or more concurrent insurers cover the same interest and the same risk, and one insurer is compelled to pay an entire loss, the paying insurer may be entitled to recover some portion of its expenditure from the other insurers.<sup>639</sup> "Each insurer has an individual right to recovery."<sup>640</sup> An insurer's right to recover from another carrier on the same risk cannot be contractual, because there is no contractual relationship between them.<sup>641</sup> "Other insurance" clauses in concurrent policies do not create a contractual right allowing insurers to recover from one

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632. See *Arco Indus. Corp. v. Am. Motorists Ins. Co.*, 594 N.W.2d 61,70 (Mich. Ct. App. 1998), *appeal granted*, 603 N.W.2d 780 (Mich. 1999); *Owens-Illinois, Inc. v. United Ins. Co.*, 650 A.2d 974, 991 (N.J. 1994).

633. See *Richmond*, *supra* note 436, at 1376 (emphasis added).

634. See *Outboard Marine Corp. v. Liberty Mut. Ins. Co.*, 670 N.E.2d 740, 750 (Ill. App. Ct. 1996); *Cont'l Cas. Co. v. Medical Protective Co.*, 859 S.W.2d 789, 791 (Mo. Ct. App. 1993).

635. See, e.g., *Nat'l Union Fire Ins. Co. v. Hartford Ins. Co.*, 677 N.Y.S.2d 105 (App. Div. 1998), *aff'd*, 717 N.E.2d 1077 (N.Y. 1999).

636. See, e.g., *Am. Cont'l Ins. Co. v. Am. Cas. Co.*, 86 Cal. Rptr. 2d 560 (Ct. App. 1999); *Am. Cas. Co. v. PHICO Ins. Co.*, 643 A.2d 91 (Pa. 1994).

637. See, e.g., *Ryan v. Knoller*, 695 A.2d 990 (R.I. 1997).

638. See, e.g., *Bosco v. Bauermeister*, 571 N.W.2d 509 (Mich. 1997).

639. See *Aetna Cas. & Sur. Co. v. James J. Benes & Assocs., Inc.*, 593 N.E.2d 1087, 1090 (Ill. App. Ct. 1992). It logically follows that if the insured interests and risks are not identical, there is no right to contribution. See *Hall v. Country Cas. Ins. Co.*, 562 N.E.2d 640, 644 (Ill. App. Ct. 1990).

640. *Am. Cont'l Ins. Co. v. Am. Cas. Co.*, 86 Cal. Rptr. 2d 560, 563 (Cal. Ct. App. 1999) (discussing contribution).

641. See *N. Ins. Co. v. Allied Mut. Ins. Co.*, 955 F.2d 1353, 1360 (9th Cir. 1992); *Gould, Inc. v. Cont'l Cas. Co.*, 585 A.2d 16, 18 (Pa. Super. Ct. 1991); *Church Mut. Ins. Co. v. Smith*, 509 N.W.2d 274, 275-76 (S.D. 1993).

another.<sup>642</sup> Courts apportioning a loss among or between concurrent insurers therefore rely on the equitable principle that “[o]ne who pays money for the benefit of another is entitled to be reimbursed.”<sup>643</sup> Some jurisdictions allow concurrent insurers to recover from one another under contribution theory,<sup>644</sup> while others apply equitable subrogation.<sup>645</sup> Still other courts apparently mix contribution and subrogation, or allow recovery on either approach.<sup>646</sup>

Concurrent insurers' contribution or subrogation rights are not purely equitable. The specific means by which liability is allocated between or among concurrent insurers is determined “not by an adjustment of equities, but by the provisions of the contracts which [the insurers] made.”<sup>647</sup> Hence, “other insurance” clauses in liability policies are significant.

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642. See *State Farm Ins. Co. v. Atl. Mut. Ins. Co.*, 672 N.E.2d 708, 713 (Ohio Ct. App. 1996). See also *Allstate Ins. Co. v. TIG Ins. Co.*, 711 So. 2d 84, 86 (Fla. Dist. Ct. App. 1998) (refusing to enforce method of sharing contained in one carrier's "other insurance" clause on the other concurrent insurer).

643. *Carolina Cas. Ins. Co. v. Oregon Auto. Ins. Co.*, 408 P.2d 198, 203 (Or. 1965); See also *Fire Ins. Exch. v. Am. States Ins. Co.*, 46 Cal. Rptr. 2d 135, 141 (Ct. App. 1995) (quoting *N. Ins. Co.*, 955 F.2d at 1360).

644. See *MIC Prop. & Cas. Ins. Corp. v. Int'l Ins. Co.*, 990 F.2d 573, 576-77 (10th Cir. 1993) (applying Oklahoma law); *Gulf Ins. Co. v. Am. Fam. Mut. Ins. Co.*, 962 F.2d 834, 835-36 (8th Cir. 1992) (applying Missouri law); *Nationwide Mut. Ins. Co. v. Hall*, 643 So. 2d 551, 561-62 (Ala. 1994); *Am. Cont'l Ins. Co. v. Am. Cas. Co.*, 903 P.2d 609, 610-11 (Ariz. Ct. App. 1995); *Fireman's Fund Ins. Co. v. Md. Cas. Co.*, 77 Cal. Rptr. 2d 296, 301 (Ct. App. 1998); *Colonial Ins. Co. v. Am. Hardware Mut. Ins. Co.*, 969 P.2d 796, 801 (Colo. Ct. App. 1998); *Cincinnati Cos. v. W. Am. Ins. Co.*, 701 N.E.2d 499, 502 (Ill. 1998) (quoting cases); *Jefferson Ins. Co. v. Health Care Ins. Exch.*, 588 A.2d 1275, 1277-78 (N.J. Super. Ct. App. Div. 1991); *Cont'l Cas. Co. v. Rapid-Am. Corp.*, 609 N.E.2d 506, 513-14 (N.Y. 1993); *Nationwide Mut. Ins. Co. v. State Farm Mut. Auto. Ins. Co.*, 470 S.E.2d 556, 559 (N.C. Ct. App. 1996); *J. H. France Refractories Co. v. Allstate Ins. Co.*, 626 A.2d 502, 509 (Pa. 1993); *TRW-Title Ins. Co. v. Stewart Title Guar. Co.*, 832 S.W.2d 344, 346 (Tenn. Ct. App. 1991).

645. See *Hartford Accident & Indem. Co. v. Aetna Cas. & Sur. Co.*, 792 P.2d 749, 752-54 (Ariz. 1990); *State v. Cont'l Cas. Co.*, 879 P.2d 1111, 1114-15 (Idaho 1994); *Nat'l Union Fire Ins. Co. v. Hartford Ins. Co.*, 677 N.Y.S.2d 105, 110 (App. Div. 1998), *aff'd*, 717 N.E.2d 1077 (N.Y. 1999); *N.C. Ins. Guar. Ass'n v. Century Indem. Co.*, 444 S.E.2d 464, 472 (N.C. Ct. App. 1994); *Unisun Ins. Co. v. Hertz Rental Corp.*, 436 S.E.2d 182, 186 (S.C. Ct. App. 1993); *CNA Lloyds of Tex. v. St. Paul Ins. Co.*, 902 S.W.2d 657, 661 (Tex. Ct. App. 1995); *Sharon Steel Corp. v. Aetna Cas. & Sur. Co.*, 931 P.2d 127, 137-38 (Utah 1997); *Jefferson Ins. Co. v. Travelers Ins. Co.*, 614 A.2d 385, 387 (Vt. 1992).

646. See, e.g., *Nat'l Cas. Co. v. Great S.W. Fire Ins. Co.*, 833 P.2d 741, 747-48 (Colo. 1992); *Hanover Ins. Co. v. Fireman's Fund Ins. Co.*, 586 A.2d 567, 569-70 (Conn. 1991).

647. *W. Cas. & Sur. Co. v. Trinity Universal Ins. Co.*, 764 P.2d 1256, 1259 (Kan. Ct. App. 1988), *aff'd*, 775 P.2d 176 (Kan. 1989); *accord* *Isler v. Federated Guar. Mut. Ins. Co.*, 567 So. 2d 1264, 1265 (Ala. 1990); *Shade Foods, Inc. v. Innovative Prods. Sales & Marketing, Inc.*, 93 Cal. Rptr. 2d 364, 400 (Cal. Ct. App. 2000); *Am. Econ. Ins. Co. v. Motorists Mut. Ins. Co.*, 593 N.E.2d 1242, 1246 (Ind. Ct. App.), *aff'd in part, vacated in part on other grounds*, 605 N.E.2d 162 (Ind. 1992); *State Auto. Prop. & Cas. Ins. Co. v. Gibbs*, 444 S.E.2d 504, 507 (S.C. 1994); *Am. Concept Ins. Co. v. Certain Underwriters at Lloyds of London*, 467 N.W.2d 480, 482 (S.D. 1991).

### 1. Excess Insurance Versus Primary Policies with Excess "Other Insurance" Clauses

Liability insurance policies may contain any one of several "other insurance" clauses,<sup>648</sup> one of which is an "excess clause." An excess "other insurance" clause provides that the insurer's liability is limited to the amount of the loss exceeding all other valid and collectible insurance,<sup>649</sup> up to the insurer's policy limits. A typical excess clause reads: "This insurance is excess over any other valid and collectible insurance, except insurance written specifically to cover as excess over the limits of liability that apply in this policy."<sup>650</sup> When two policies both contain an excess "other insurance" clause, most courts treat the excess clauses as mutually repugnant and prorate the loss between the competing insurers.<sup>651</sup>

Excess policies clearly differ in purpose from primary policies containing excess "other insurance" clauses, such that a prorated loss between an excess insurer and a primary insurer seeking excess status by virtue of its "other insurance" clause is improper.<sup>652</sup> The nature or purpose of excess and umbrella policies, and their relationship with primary policies containing excess "other insurance" clauses, are succinctly described in *Oelhafen v. Tower Insurance Co.*:<sup>653</sup>

Umbrella carriers are not primary insurers that attempt to limit a portion of their risk by describing it as "excess." Umbrella policies are not devices for an insurer to escape responsibility . . .

We also note that the intent of umbrella policies to serve a different function from primary policies with excess clauses is reflected in the rate structures of the two types of policies. In general, umbrella policy premiums are relatively small in relation to the amount of risk "so that the company cannot be expected to prorate with other excess coverages; and public policy should not demand that this be done."<sup>654</sup>

Excess and umbrella policies are therefore regarded as true excess coverage over and above all primary policies, including those with excess

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648. See generally Richmond, *supra* note 436, at 1379-87.

649. See *O'Brien v. United States Fid. & Guar. Co.*, 669 A.2d 1221, 1224 (Conn. 1996) (discussing excess clause in context of uninsured motorist coverage).

650. See *Ill. Nat'l Ins. Co. v. Farm Bureau Mut. Ins. Co.*, 578 N.W.2d 670, 671 (Iowa 1998) (quoting Farm Bureau "other insurance" clause).

651. See Richmond, *supra* note 436, at 1389.

652. See *Commerce & Indus. Ins. Co. v. Chubb Custom Ins. Co.*, 88 Cal. Rptr. 2d 464, 467-68 (Cal. Ct. App. 1999); *Cont'l Ins. Co. v. Lexington Ins. Co.*, 64 Cal. Rptr. 2d 116, 121 (Cal. Ct. App. 1997).

653. 492 N.W.2d 321 (Wis. Ct. App. 1992).

654. *Oelhafen* 492 N.W.2d. at 324 (citations omitted); See also *Reliance Nat'l Indem. Co. v. Gen. Star Indem. Co.*, 85 Cal. Rptr. 2d 627, 639 (Ct. App. 1999).

"other insurance" clauses.<sup>655</sup> The presence of an excess "other insurance" clause in a primary policy does not transform that policy into an excess policy vis-à-vis a second carrier providing true excess or umbrella coverage.<sup>656</sup>

Although a primary policy with an excess "other insurance" clause and a true excess policy are not equivalents, and an excess carrier in that situation should not be required to share in the primary insurer's defense or indemnity obligations, primary insurers routinely argue for excess insurers' participation at a primary level for the obvious economic advantage that comes with sharing a loss pro rata instead of bearing it alone. If there is a landmark case in this area, it is *Liberty Mutual Insurance Co. v. United States Fire Insurance Co.*,<sup>657</sup> in which a Texas court applied basic excess insurance principles to complex facts.

*Hillyer* involved an automobile accident in which Elizabeth Hillyer was injured.<sup>658</sup> She was a passenger in a jeep driven by Steve Kennedy and owned by Henry Taub. Liberty Mutual insured Kennedy, with policy limits of \$100,000 per person per accident.<sup>659</sup> Taub had two policies: American General Insurance Company provided a family automobile policy with \$100,000 limits, and he had a \$1,000,000 umbrella policy with United States Fire.<sup>660</sup> There was no dispute that the United States Fire policy was excess over the American General policy. The United States Fire policy expressly provided that it was excess above a scheduled \$100,000 automobile policy.<sup>661</sup>

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655. See *Argonaut Ins. Co. v. U.S. Fire Ins. Co.*, 728 F. Supp. 298, 300-03 (S.D.N.Y. 1990) (applying New York law); *Ins. Co. of N. Am. v. Am. Econ. Ins. Co.*, 746 F. Supp. 59, 62-64 (W.D. Okla. 1990) (applying Arkansas law) (citing 8A APPLEMAN, INS. LAW & PRACTICE § 4904.85 (1981)); *Cont'l Ins. Co. v. Lexington Ins. Co.*, 64 Cal. Rptr. 2d 116, 121 (Ct. App. 1997) (citing 8A APPLEMAN, INS. LAW & PRACTICE § 4904.85 (1981)); *Cincinnati Ins. Co. v. St. Paul Fire & Marine Ins. Co.*, 474 S.E.2d 78, 80 (Ga. Ct. App. 1996); *Am. Country Ins. Co. v. Hanover Ins. Co.*, 689 N.E.2d 186, 188-91 (Ill. App. Ct. 1998); *N.H. Ins. Co. v. Hanover Ins. Co.*, 696 N.E.2d 22, 25 (Ill. App. Ct. 1998); *Vigilant Ins. Co. v. Allied Prop. & Cas. Ins. Co.*, 609 N.W.2d 538, 540-41 (Iowa 2000); *Rivere v. Heroman*, 688 So. 2d 1293, 1295 (La. Ct. App. 1997); *Bosco v. Bauermeister*, 571 N.W.2d 509, 519 (Mich. 1997); *Smith v. Wausau Underwriters Ins. Co.*, 977 S.W.2d 291, 293-95 (Mo. Ct. App. 1998); *Liberty Mut. Ins. Co. v. Harbor Ins. Co.*, 603 A.2d 300, 302-303 (R.I. 1992); *Oelhafen*, 492 N.W.2d at 324 (citing 8A APPLEMAN, INS. LAW & PRACTICE § 4904.85 (1981)).

656. See *LeMars Mut. Ins. Co. v. Farm & City Ins. Co.*, 494 N.W.2d 216, 219 (Iowa 1992) ("A primary insurance provider cannot hide behind an excess insurance clause in its other insurance' provision to require an umbrella insurer to cover liability for its insured."); *Smith*, 977 S.W.2d at 294 ("A primary insurer cannot use an other insurance' clause to require an umbrella carrier to share in its liability.").

657. 590 S.W.2d 783 (Tex. App. 1979).

658. *Liberty Mut. Ins. Co.*, 590 S.W.2d at 784.

659. See *id.*

660. See *id.*

661. See *id.* at 784-85.

Hillyer's personal injury claim was settled for \$250,000.<sup>662</sup> American General and Liberty Mutual each paid \$100,000, and United States Fire paid the remaining \$50,000.<sup>663</sup> Liberty Mutual then sued United States Fire to determine their respective obligations.<sup>664</sup> The trial court held that Liberty Mutual was entitled to recover none of its settlement expenditure from United States Fire, and Liberty Mutual appealed.<sup>665</sup>

The Liberty Mutual policy was not declared underlying insurance in the United States Fire policy schedules.<sup>666</sup> The only provision in the United States Fire policy applicable to Liberty Mutual, therefore, was its "other insurance" clause statement that it was excess over any other valid and collectible insurance, and would not contribute with such other insurance.<sup>667</sup> The Liberty Mutual policy, however, contained an "other insurance" clause making its coverage excess in the event its insured was involved in an accident while driving a non-owned automobile.<sup>668</sup> The subject accident thus fell squarely within Liberty Mutual's excess "other insurance" clause.<sup>669</sup>

Liberty Mutual argued that its excess clause and the excess clause in the United States Fire policy were mutually repugnant.<sup>670</sup> Accordingly, the two policies provided concurrent second-layer coverage and Hillyer's loss should be prorated based on their respective policy limits.<sup>671</sup> The court rejected this superficially appealing argument:

It is true that each of the policies has an "other insurance" clause that apparently limits coverage in the fortuitous circumstance of the presence of other validly subsisting coverage, but an examination of the purpose of the policies dictates the resolution of this dispute. Liberty Mutual's policy generally affords primary coverage; its coverage becomes excess only because of the presence of a non-owned vehicle. United States Fire's policy remains excess in all events. Thus it is apparent that the intent of all parties to the policies is for United States Fire's policy to remain an umbrella policy, and for Liberty Mutual's coverage to underlie it . . . Had Liberty Mutual issued its policy as it did, and United States Fire had issued its policy to Kennedy instead

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662. See *id.* at 784.

663. See *Liberty Mut. Ins. Co. v. United States Fire Ins. Co.*, 590 S.W.2d 783, 784 (Tex. Ct. App. 1979).

664. See *Liberty Mut. Ins. Co.*, 590 S.W.2d at 784.

665. See *id.*

666. See *id.* at 785.

667. See *id.*

668. See *id.*

669. See *Liberty Mut. Ins. Co. v. United States Fire Ins. Co.*, 590 S.W.2d 783, 785 (Tex. Ct. App. 1979).

670. See *Liberty Mut. Ins. Co.*, 590 S.W.2d at 785.

671. See *id.*

of to Taub, there would be no question that Liberty would be liable to the full extent of its limits.<sup>672</sup>

The Michigan Supreme Court carefully and correctly resolved a dispute between concurrent primary and umbrella insurers in *Bosco v. Bauermeister*.<sup>673</sup> *Bosco* arose out of a truck-bicycle accident in which Eric Bosco was killed.<sup>674</sup> Defendant Chris Bauermeister was driving a truck owned by Kenneth Cook while in the course of his employment with Flint Canvas Company.<sup>675</sup> The *Bosco* estate's suit resulted in a damage award exceeding \$1,000,000.<sup>676</sup> That led to a dispute between the insurers involved.<sup>677</sup> Four insurers had written five liability policies covering the various defendants.<sup>678</sup> Those included: (1) a Continental Insurance policy with \$500,000 limits issued to Cook; (2) a USAA automobile policy with \$100,000 limits insuring Bauermeister; (3) a \$1,000,000 USAA personal umbrella policy insuring Bauermeister; (4) a Frankenmuth Mutual policy with \$250,000 limits issued to Flint Canvas; and (5) an Auto-Owners Insurance executive umbrella policy with \$1,000,000 limits issued to Cook.<sup>679</sup>

The Continental policy issued to Cook was previously determined to be primary and was not at issue in *Bosco*.<sup>680</sup> Frankenmuth settled with the plaintiff for \$55,000 of its \$250,000 policy limits, thereby extinguishing its potential liability for the remaining \$195,000.<sup>681</sup> USAA voluntarily paid the full \$100,000 limits of its primary automobile liability policy insuring Bauermeister.<sup>682</sup> The plaintiff then pursued a garnishment action against USAA and Auto-Owners with respect to their obligations under their umbrella policies issued to Bauermeister and Cook, respectively.<sup>683</sup> All parties to the garnishment action moved for summary judgment.<sup>684</sup>

The trial court held that there were three layers of coverage: (1) the primary coverage afforded by Continental in the amount of \$500,000; (2) excess "other insurance" coverage provided by Frankenmuth (\$250,000) and USAA (\$100,000); and (3) the true excess or umbrella policies is-

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672. *Id.* (citation omitted).

673. 571 N.W.2d 509 (Mich. 1997).

674. *See Bosco*, 571 N.W.2d at 511.

675. *See id.*

676. *See id.*

677. *See id.*

678. *See id.*

679. *See Bosco v. Bauermeister*, 571 N.W.2d 509, 511 (Mich. 1997).

680. *See Bosco*, 571 N.W.2d at 511 (citing *Frankenmuth Mut. Ins. Co. v. Cont'l Ins. Co.*, 537 N.W.2d 879 (Mich. 1995)).

681. *See id.*

682. *See id.*

683. *See id.*

684. *See id.*

sued by USAA and Auto-Owners (each with \$1,000,000 limits).<sup>685</sup> Thus, there was \$850,000 in primary insurance that had to be exhausted before the indemnity provisions of the umbrella policies were triggered. The trial court also held that the plaintiff could not recover the \$195,000 portion of the Frankenmuth policy that he did not exhaust by agreement.<sup>686</sup>

The trial court required that the primary coverage be exhausted before the umbrella policies would be required to contribute to the loss.<sup>687</sup> It then prorated liability between Auto-Owners and USAA under their umbrella policies for the portion of the judgment exceeding the limits of the three liability policies.<sup>688</sup> A lower appellate court reversed the trial court.<sup>689</sup> The Michigan Court of Appeals held that the Frankenmuth policy, which contained an excess "other insurance" clause, was similar to the USAA and Auto-Owners umbrella policies, such that the three policies "were responsible pro rata" for that portion of the loss not paid under the Continental and USAA primary policies.<sup>690</sup> The case then made its way to the Michigan Supreme Court.

The *Bosco* court was required to differentiate between the Frankenmuth policy, which was a primary policy with an excess "other insurance" clause, and the concurrent umbrella policies. The court first contrasted the Frankenmuth policy with the Auto-Owners umbrella policy.<sup>691</sup> In doing so, it rejected the plaintiff's argument that the Auto-Owners policy should operate on the same level with the Frankenmuth policy because the "other insurance" clause in the Auto-Owners policy did not specifically make its coverage excess over other excess policies.<sup>692</sup> The court reasoned that "the fact that a policy is issued as an umbrella policy at rates reflecting the reduced risk insured indicates the intent that the policy is excess over other excess policies."<sup>693</sup> The Frankenmuth policy was a primary policy with an excess "other insurance" clause that operated in limited circumstances.<sup>694</sup> The presence of that excess clause did not change the Frankenmuth policy's nature and function.<sup>695</sup>

With respect to the USAA umbrella policy, the plaintiff argued that the Frankenmuth policy should prorate with it because the USAA policy defined primary insurance as those policies listed in the declarations, and

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685 See *Bosco v. Bauermeister*, 571 N.W.2d 509, 511 (Mich. 1997).

686. See *Bosco*, 571 N.W.2d at 511.

687. See *id.*

688. See *id.* at 512.

689. See *id.*

690. See *id.* at 513.

691. See *Bosco v. Bauermeister*, 571 N.W.2d 509, 512 (Mich. 1997).

692. See *Bosco*, 571 N.W.2d at 514.

693. See *id.* (citing *State Farm Fire & Cas. Co. v. LiMauro*, 482 N.E.2d 13 (N.Y. 1985)).

694. See *id.*

695. See *id.*



the only policy listed there was the USAA primary policy.<sup>696</sup> The *Bosco* court disagreed, again based on the policies' differing nature.

Plaintiff's analysis is inherently flawed because the Frankenmuth policy is not written as a "true" excess policy. Only the existence of the Continental policy triggers the Frankenmuth policy "coincidental" excess coverage clause. Its basic nature (a primary automobile policy) does not change . . . The basic purpose and nature of an insurance policy does not change, even if its coverage may change under certain limited circumstances.<sup>697</sup>

The court further distinguished between primary policies with excess "other insurance" insurance clauses (i.e., the Frankenmuth policy), which it described as "coincidental excess" coverage, and true excess policies (i.e., the USAA and Auto-Owners umbrella policies).

The Frankenmuth policy excess coverage availability in certain circumstances does not make it "true" excess coverage like an umbrella policy because the Frankenmuth policy excess coverage is triggered only upon the circumstances of the accident, while the umbrella policies are written to be excess over any underlying coverage. If there had been no other primary policy, the Frankenmuth policy would have been primary, regardless of the "coincidental" excess insurance clause, unlike the USAA and Auto-Owners umbrella policies.<sup>698</sup>

The court observed that the "defining character" of a primary policy even one with an excess "other insurance" clause is that the insurer's obligation attaches immediately upon the occurrence of an insured event.<sup>699</sup> Under an umbrella policy, on the other hand, liability does not immediately attach upon an occurrence. Rather, liability under a true excess or umbrella policy attaches only after the limits of all underlying primary policies have been exhausted.<sup>700</sup>

The *Bosco* court next looked at the disparity in the premiums charged by Frankenmuth, and USAA and Auto-Owners.<sup>701</sup> An examination of the respective insurers' premiums reflected the intent that the umbrella policies served a different function.<sup>702</sup> The premiums charged for the USAA and Auto-Owners umbrella policies were significantly lower than the Frankenmuth policy premium.<sup>703</sup> While not dispositive, the dis-

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696. *See id.*

697. *Bosco v. Bauermeister*, 571 N.W.2d 509, 514-15 (Mich. 1997) (citation omitted).

698. *Bosco*, 571 N.W.2d at 516.

699. *See id.*

700. *See id.*

701. *See id.* at 517.

702. *See id.*

703. *See Bosco v. Bauermeister*, 571 N.W.2d 509, 517-18 (Mich. 1997).

parity in premiums was evidence that the USAA and Auto-Owners umbrella policies were intended to insure a more remote level of risk.<sup>704</sup>

Finally, the court examined the parties' reasonable expectations. Because the dispute was one between insurers, the court focused on the *insurers'* reasonable expectations rather than on the reasonable expectations of the insureds.<sup>705</sup> The Auto-Owners and USAA policies were written to be excess over any underlying insurance under all circumstances.<sup>706</sup> Moreover, the Frankenmuth policy was not written to be prorated with true excess policies.<sup>707</sup> Thus, the insurers' reasonable expectations compelled the conclusion that there should be three tiers of coverage: primary, "coincidental" excess and "true" excess.<sup>708</sup>

The *Bosco* court concluded that a primary policy with an excess "other insurance" clause must be exhausted before a true excess policy can be applied to a loss.<sup>709</sup> The Michigan Supreme Court therefore reversed the court of appeals and reinstated the trial court judgment.<sup>710</sup>

## 2. Allocating Liability Between Concurrent Excess Insurers

Courts must seldom prorate liability between concurrent excess insurers. Generally, courts should attempt to reconcile competing "other insurance" clauses in excess and umbrella policies just as though the policies were primary.<sup>711</sup> The fact that concurrent policies are excess rather than primary does not change the fact that they are operating on the same plane or at the same level.

In *Mission Insurance Co. v. United States Fire Insurance Co.*,<sup>712</sup> Mission Insurance issued a \$1,000,000 umbrella policy to the lessor of a vehicle.<sup>713</sup> A lessee's employee wrecked the vehicle.<sup>714</sup> The lessee was insured under a "Commercial Comprehensive Catastrophe Liability Pol-

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704. See *Bosco*, 571 N.W.2d at 518.

705. See *id.*

706. See *id.*

707. See *id.*

708. See *id.* at 519.

709. See *Bosco v. Bauermeister*, 571 N.W.2d 509, 519 (Mich. 1997).

710. See *Bosco*, 571 N.W.2d at 519-20.

711. See, e.g., *Fire Ins. Exch. v. Am. States Ins. Co.*, 46 Cal. Rptr. 2d 135, 141 (Ct. App. 1995) (deeming excess "other insurance" clauses in umbrella policies mutually repugnant and ordering proration); *Aetna Cas. & Sur. Co. v. Home Ins. Co.*, 689 N.E.2d 1355, 1358-59 (Mass. App. Ct. 1998) (same); *Am. Cas. Co. v. PHICO Ins. Co.*, 702 A.2d 1050, 1053-65 (Pa. 1997) (deeming "other insurance" clauses in excess policies mutually repugnant and prorating loss by equal shares); *United Servs. Auto. Ass'n v. Underwriters at Interest*, No. 14-98-00234-CV, 2000 WL 332718, at \*2 (Tex. Ct. App. Jan. 13, 2000) (holding that excess "other insurance" clauses in umbrella policies were mutually repugnant).

712. 517 N.E.2d 463 (Mass. 1988).

713. See *Mission Ins. Co.*, 517 N.E.2d at 468.

714. See *id.* at 464.

icy" issued by U.S. Fire with \$3,000,000 limits.<sup>715</sup> Both policies contained excess "other insurance" clauses which stated that they provided coverage in excess of all other valid and collectible insurance.<sup>716</sup> Neither company's policy was identified in the other's schedule of underlying policies.<sup>717</sup> There was no dispute that, in the absence of "other insurance," each of the policies covered the loss.<sup>718</sup>

Mission and two primary insurers settled a tort claim arising out of the accident.<sup>719</sup> Mission then sued U.S. Fire seeking a declaration that U.S. Fire had to contribute to the settlement.<sup>720</sup> U.S. Fire won summary judgment, asserting that its coverage was excess to Mission's policy, and that it need contribute nothing until Mission's policy was exhausted. The Massachusetts Supreme Court reversed.<sup>721</sup>

The *Mission* court determined that both policies created "umbrella-type excess insurance,"<sup>722</sup> rather than the owner's policy being primary, as U.S. Fire contended.<sup>723</sup> The court then turned to the conflict between the two competing excess "other insurance" clauses, adopting the majority approach that excess clauses are mutually repugnant.<sup>724</sup> The court required both insurers to prorate the loss by equal shares.<sup>725</sup>

In reaching this conclusion, the *Mission* court rejected U.S. Fire's argument that Mission's failure to state in its limit of liability clause that its coverage was excess of all other collectible insurance, as it provided in its "other insurance" clause, created a fatal ambiguity.<sup>726</sup> The court reasoned that it would be clear to Mission's insured that the policy provided excess coverage.<sup>727</sup> The only colorable ambiguity resulted from a comparison of the Mission limit of liability clause with the corresponding clause in the U.S. Fire policy. Creating an "ambiguity" by comparing Mission's policy with a separate unrelated document (the U.S. Fire policy) did not justify construing Mission's policy other than as written.<sup>728</sup>

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715. *See id.* at 468.

716. *See id.* at 464.

717. *See id.*

718. *See Mission Ins. Co. v. United States Fire Ins. Co.*, 517 N.E.2d 463, 464 (Mass. 1988).

719. *See Mission Ins. Co.*, 517 N.E.2d at 464.

720. *See id.*

721. *See id.*

722. *See id.* at 467.

723. *See id.* at 464-66.

724. *See Mission Ins. Co. v. United States Fire Ins. Co.*, 517 N.E.2d 463, 467 (Mass. 1988).

725. *See Mission Ins. Co.*, 517 N.E.2d at 468.

726. *See id.* at 467.

727. *See id.*

728. *See id.*

## V. MALPRACTICE SUITS AGAINST DEFENSE COUSEL

Malpractice claims by insurance companies against defense attorneys are on the rise.<sup>729</sup> Though primary insurers have for some time been willing to sue the defense attorneys they hire, and their right to sue defense counsel for malpractice is acknowledged in various jurisdictions,<sup>730</sup> excess insurers now are willing to pursue defense counsel when verdicts exceed primary limits. Excess insurers have sued defense counsel on both direct duty and equitable subrogation theories.<sup>731</sup>

Why the rise in malpractice claims by excess insurers against defense counsel? In some ways, such claims make little sense. An excess insurer has no direct relationship with the defense attorneys it sues; it did not retain them, nor did it pay for their services.<sup>732</sup> An excess insurer does not share an attorney-client relationship with the defense attorneys that a primary carrier hires. Yet this very detachment may actually encourage malpractice claims, for an aggrieved excess carrier may have no continuing business relationship with defense counsel, such that loyalty and the perspective that comes with judging many cases as compared to one are no bar to litigation. Additionally, as cost-conscious liability insurers have seen their litigation expenses rise in recent years, the possibility of recovering some portion of an excess verdict or settlement from other sources has driven insurers to look to defense counsel in certain circumstances.<sup>733</sup>

### A. *Actions by Excess Carriers Allowed*

Courts that allow an excess insurer to sue defense counsel hired by a primary insurer for malpractice typically hold that the excess insurer is equitably subrogated to the insured's rights against the attorneys.<sup>734</sup> The

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729. See Donald L. Myles, Jr. & Kathleen L. Wieneke, *Attorney Malpractice in Claims Handling & Settlement Strategy: Avoiding the Road to Liability*, 47 FED'N INS. & CORP. COUNS. Q. 247, 247 (1997); Shaun M. Baldwin & Lisa C. Breen, *Malpractice Claims By Primary and Excess Insurers: Is the Honeymoon Over?*, 62 DEF. COUNS. J. 18, 18 (1995).

730. See, e.g., *Am. Int'l Adjustment Co. v. Galvin*, 86 F.3d 1455 (7th Cir. 1996) (applying Indiana law); *Mutuelles Unies v. Kroll & Linstrom*, 957 F.2d 707 (9th Cir. 1992); *Bohna v. Hughes, Thorsness, Gantz, Powell & Brundin*, 828 P.2d 745 (Alaska 1992); *State Farm Mut. Auto. Ins. Co. v. Fed. Ins. Co.*, 86 Cal. Rptr. 2d 20, 24 (Ct. App. 1999); *Pa. Ins. Guar. Ass'n v. Sikes*, 590 So. 2d 1051 (Fla. Dist. Ct. App. 1991); *Mid-Am. Bank & Trust Co. v. Commercial Union Ins. Co.*, 587 N.E.2d 81 (Ill. App. Ct. 1992); *Atlanta Int'l Ins. Co. v. Bell*, 475 N.W.2d 294 (Mich. 1991).

731. See Myles & Wieneke, *supra* note 729, at 253-54; Baldwin & Breen, *supra* note 729, at 18.

732. See Baldwin & Breen, *supra* note 729, at 22.

733. See *id.* at 19.

734. See, e.g., *Nat'l Union Fire Ins. Co. v. Dowd & Dowd, P.C.*, 2 F. Supp. 2d 1013, 1019-22 (N.D. Ill. 1998) (interpreting Illinois law); *Allstate Ins. Co. v. Am. Transit Ins. Co.*, 977 F. Supp. 197 (E.D.N.Y. 1997) (interpreting New York law); *Am. Centennial Ins. Co. v. Canal Ins. Co.*, 843 S.W.2d 480 (Tex. 1992).

leading case in this area is *American Centennial Insurance Co. v. Canal Insurance Co.*<sup>735</sup>

In *American Centennial*, General Rent-A-Car was sued for injuries and death allegedly attributable to a defective tire on one of its rental cars.<sup>736</sup> At the time of the accident, General was insured under three policies.<sup>737</sup> Canal Insurance provided primary coverage up to \$100,000.<sup>738</sup> A first level excess insurer, First State, insured General from \$100,000 up to \$1,000,000. American Centennial provided an additional \$3,000,000 in excess coverage above the First State policy.<sup>739</sup> Canal defended the suit and hired counsel for General. Because defense counsel allegedly mishandled the suit, the insurers were forced to settle for \$3,700,000. First State and American Centennial then sued Canal and its chosen defense counsel on a number of theories, including negligence.<sup>740</sup>

The trial court granted summary judgment for the defendants, holding that all of the excess carriers' claims were barred by the statute of limitations, and further finding that defense counsel owed no duty to First State or American Centennial.<sup>741</sup> A lower appellate court affirmed the trial court's judgment on the malpractice claims based on the attorneys' statute of limitations defense.<sup>742</sup> The Texas Supreme Court granted review.<sup>743</sup>

The *American Centennial* court determined that the excess insurers' malpractice claims against defense counsel were not time barred, thus opening inquiry into whether an excess insurer could even bring such an action.<sup>744</sup> Under Texas law, attorneys ordinarily cannot be held liable to non-clients because there is no privity of contract.<sup>745</sup> Privity as a prerequisite to malpractice liability is the product of judicial reluctance to permit malpractice actions by non-clients because of the potential negative impact on attorneys' duties to their clients.<sup>746</sup> This concern is heightened in the insurance defense context, where attorneys must be especially

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735. 843 S.W.2d 480 (Tex. 1992).

736. See *Am. Centennial Ins. Co.*, 843 S.W.2d at 481.

737. See *id.*

738. See *id.*

739. See *id.*

740. See *id.*

741. See *Am. Centennial Ins. Co. v. Canal Ins. Co.*, 843 S.W.2d 480, 481 (Tex. 1992).

742. See *Am. Centennial Ins. Co.*, 843 S.W.2d at 482.

743. See *id.*

744. See *id.* at 484.

745. See *id.* (citing *Parker v. Carnahan*, 772 S.W.2d 151, 156 (Tex. Ct. App. 1989); *First Mun. Leasing Corp. v. Blankenship, Potts, Aikman, Hagin & Stewart*, 648 S.W.2d 410 (Tex. Ct. App. 1983); *Bell v. Manning*, 613 S.W.2d 335 (Tex. Ct. App. 1981)).

746. See *id.* (citing Supreme Court of Texas, State Bar Rules art. X § 9).

“sensitive to the varying interests of the insured and the insurer which produce complex and often conflicting relationships.”<sup>747</sup>

The Texas Supreme Court reasoned that recognizing an equitable subrogation action by an excess insurer against defense counsel would not interfere with the attorney-client relationship, however, nor would it create additional conflicts of interest.<sup>748</sup> Equitable subrogation would only permit an insurer to enforce defense counsel's existing duties to the insured.<sup>749</sup> Further, the interests of the insured, its primary insurer and its excess insurer generally overlap when it comes to ensuring that a defense attorney's malpractice does not prevent the presentation of a meritorious defense.<sup>750</sup> Insureds' and insurers' interests converge in expectations of competent representation.<sup>751</sup>

The *American Centennial* court observed that those considerations compelling its recognition of an excess insurer's right to bring an equitable subrogation action against a primary insurer for failing to settle a claim within policy limits also supported an excess insurer's right to sue defense counsel hired by a primary insurer.<sup>752</sup>

No new or additional burdens are imposed on the attorney, who already has the duty to represent the insured . . . Defense counsel should not be relieved of these obligations merely because the insurer, rather than the client, must pay the claim. If the asserted malpractice has resulted in the payment of a judgment or settlement within the excess carrier's policy limits, the insured has little incentive to enforce its right to competent representation. Refusal to permit the excess carrier to vindicate that right would burden the insurer with a loss caused by the attorney's negligence while relieving the attorney from the consequences of legal malpractice. Such an inequitable result should not arise simply because the insured has contracted for excess coverage.<sup>753</sup>

The supreme court thus reversed the court of appeals decision for failing to allow the excess insurers to pursue their malpractice claims against defense counsel.<sup>754</sup>

Courts' embrace of equitable subrogation as a vehicle for excess insurers' potential recovery from negligent defense attorneys hired by a primary insurer while declining to impose a direct duty is nicely illustrated by *National Union Fire Insurance Co. v. Dowd & Dowd, P.C.*<sup>755</sup> In

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747. See *Am. Centennial Ins. Co. v. Canal Ins. Co.*, 843 S.W.2d 480, 484 (Tex. 1992).

748. See *Am. Centennial Ins. Co.*, 843 S.W.2d at 484.

749. See *id.*

750. See *id.*

751. See *id.* (quoting *Atlanta Int'l Ins. Co. v. Bell*, 475 N.W.2d 294, 298 (Mich. 1991)).

752. See *id.*

753. *Am. Centennial Ins. Co. v. Canal Ins. Co.*, 843 S.W.2d 480, 484-85 (Tex. 1992).

754. See *Am. Centennial Ins. Co.*, 843 S.W.2d at 485.

755. 2 F. Supp. 2d 1013 (N.D. Ill. 1998).

*Dowd & Dowd*, an Illinois federal court was forced to apply Illinois law in the absence of any guidance from the state's appellate courts.<sup>756</sup>

Schneider National Carriers hired the law firm of Dowd & Dowd to defend it and its driver, Henry Howard, in a personal injury action brought by John Miksis.<sup>757</sup> Miksis suffered catastrophic injury when Howard drove a Schneider tractor-trailer rig into a stationary lift truck on which Miksis was working.<sup>758</sup> At the time of the accident, Schneider was self-insured up to \$3 million with a \$5 million National Union excess policy above its SIR.<sup>759</sup>

The case went to trial and Miksis recovered a verdict of \$8 million.<sup>760</sup> Schneider paid the first \$3 million and National Union paid the remaining \$5 million.<sup>761</sup> National Union then sued Dowd & Dowd for malpractice.<sup>762</sup> Dowd & Dowd moved to dismiss National Union's complaint, arguing that "an excess insurer cannot maintain a legal malpractice claim against the insured's defense attorney."<sup>763</sup>

Dowd & Dowd asserted that National Union could not state a cause of action for legal malpractice because it could not establish the first prerequisite, that being an attorney-client relationship with the law firm.<sup>764</sup> Illinois law jealously guards the fiduciary relationship between attorney and client as personal and confidential, and only a client can assert a malpractice claim against an attorney.<sup>765</sup> National Union argued in response that an attorney-client relationship did exist and, alternatively, that it was equitably subrogated to Schneider's legal malpractice action against Dowd & Dowd.<sup>766</sup> The case was one of first impression under Illinois law.<sup>767</sup>

In arguing for a direct claim against Dowd & Dowd, National Union first asserted that the Illinois Supreme Court would expand the tripartite relationship that exists between an insured, a primary insurer, and defense counsel to recognize that a defense attorney also owes a fiduciary duty to an excess insurer.<sup>768</sup> Illinois law clearly provides that a defense

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756. See *Nat'l Union Fire Ins. Co.*, 2 F. Supp. 2d at 1016.

757. See *id.* at 1015.

758. See *id.*

759. See *id.*

760. See *id.*

761. See *Nat'l Union Fire Ins. Co. v. Dowd & Dowd, P.C.*, 2 F. Supp. 2d 1013, 1015 (N.D. Ill. 1998).

762. See *Nat'l Union Fire Ins. Co.*, 2 F. Supp. 2d at 1015.

763. See *id.*

764. See *id.*

765. See *id.* 1016.

766. See *id.*

767. See *Nat'l Union Fire Ins. Co. v. Dowd & Dowd, P.C.*, 2 F. Supp. 2d 1013, 1016 (N.D. Ill. 1998).

768. See *Nat'l Union Fire Ins. Co.*, 2 F. Supp. 2d at 1017.

attorney hired by a primary insurer owes a fiduciary duty to both the insured and the insurer, and that either can sue the attorney for malpractice.<sup>769</sup> National Union argued that Illinois law would permit a direct action because “there is no logical reason to distinguish between a primary insurer and an excess carrier in determining when an insurer may sue for malpractice.”<sup>770</sup>

The court rejected National Union's argument because it “completely ignore[d]” the fact that a primary insurer actually contracts with a defense attorney to represent the insured.<sup>771</sup>

Since the primary insurer contracts with the attorney, pays the attorney's legal fees, and directs the litigation or settlement of the claim, it stands to reason that the primary insurer is one of the attorney's clients . . . . Excess insurers, on the other hand, do not have the duty to defend the insured . . . . Thus, unlike a primary insurer, an excess insurer has no direct relationship with the attorney retained to defend an action against the insured.<sup>772</sup>

“Illinois courts' recognition of the tripartite relationship is premised upon [a] primary insurer's legal duty to retain and pay for an attorney to defend an action against its insured.”<sup>773</sup> Thus, the *Dowd & Dowd* court reasoned, the Illinois Supreme Court would be unlikely to enlarge the tripartite relationship to include an excess insurer.<sup>774</sup> National Union acknowledged that it did not retain Dowd & Dowd to defend Schneider and Howard. Schneider made that decision.<sup>775</sup> The insurer's tripartite relationship argument for the existence of an attorney-client relationship had no basis in fact or law.<sup>776</sup> Dowd & Dowd owed no fiduciary duty to National Union, and the court dismissed that portion of the insurer's complaint.<sup>777</sup>

National Union next contended that Schneider retained Dowd & Dowd for the insurer's direct or primary benefit.<sup>778</sup> Accordingly, it was a third-party beneficiary to the contract between Schneider and the law firm.<sup>779</sup>

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769. *See id.*

770. *See id.* (quoting National Union's response at 6).

771. *See id.*

772. *Id.* at 1017-18 (citations and footnotes omitted).

773. *Nat'l Union Fire Ins. Co. v. Dowd & Dowd, P.C.*, 2 F. Supp. 2d 1013, 1018 (N.D. Ill. 1998).

774. *See Nat'l Union Fire Ins. Co.*, 2 F. Supp. 2d at 1018.

775. *See id.*

776. *See id.*

777. *See id.*

778. *See id.* at 1019.

779. *See Nat'l Union Fire Ins. Co. v. Dowd & Dowd, P.C.*, 2 F. Supp. 2d 1013, 1019 (N.D. Ill. 1998).



Under Illinois law, an attorney generally only owes his client a duty to exercise requisite skill and care in the course of a representation.<sup>780</sup> There is an exception, however, for intended third-party beneficiaries.<sup>781</sup> This exception is narrower in cases of an adversarial nature.<sup>782</sup> In such cases, there must be a clear indication that the intent of the attorney's representation of the client is to directly confer a benefit upon the third party.<sup>783</sup>

The *Dowd & Dowd* court did not believe that the Illinois Supreme Court would find that Schneider entered into its relationship with its defense attorneys for National Union's benefit.<sup>784</sup> Schneider's intent in hiring Dowd & Dowd was to directly benefit itself and Howard.<sup>785</sup> Though National Union also benefited by virtue of its harmonious relationship with its insureds, its incidental benefit was not sufficient to support a direct duty of care on the part of defense counsel.<sup>786</sup>

The court finally reached National Union's equitable subrogation argument. The court was convinced that the Illinois Supreme Court would recognize an excess liability insurer's right to be subrogated to its insured's rights unless the nature of the subrogated claim and public policy considerations dictated a different conclusion.<sup>787</sup>

Legal malpractice claims are not assignable in Illinois.<sup>788</sup> The policy considerations that cut against the assignment of legal malpractice claims arguably apply with equal force in the equitable subrogation context. Subrogation opponents might argue, for example, that permitting an excess insurer to sue defense counsel strains the tripartite relationship, a point that was not lost on the *Dowd & Dowd* court.<sup>789</sup> Nonetheless, the court was persuaded to permit an excess insurer's equitable subrogation to its insured's rights against defense counsel because it does not entail any additional burdens.<sup>790</sup>

780. See *Nat'l Union Fire Ins. Co.*, 2 F. Supp. 2d at 1019.

781. See *id.*

782. See *id.*

783. See *id.* (quoting *Pelham v. Griesheimer*, 440 N.E.2d 96, 100 (Ill. 1982)).

784. See *id.*

785. See *Nat'l Union Fire Ins. Co. v. Dowd & Dowd, P.C.*, 2 F. Supp. 2d 1013, 1019 (N.D. Ill. 1998).

786. See *Nat'l Union Fire Ins. Co.*, 2 F. Supp. 2d at 1019.

787. See *id.* at 1022.

788. See *id.* at 1023 (citing *Kleinwort Benson N. Am., Inc. v. Quantum Fin. Servs., Inc.*, 692 N.E.2d 269, 271 (Ill. 1998)).

789. See *id.* ("The court acknowledges that an attorney's independent, legal judgment might be compromised, consciously or subconsciously, because of concern about being sued by an excess insurer.").

790. See *id.* (citing *Am. Centennial Ins. Co. v. Canal Ins. Co.*, 843 S.W.2d 480, 484-85 (Tex. 1992)).

[Equitable subrogation] merely allows an excess insurer, who pays for any excess liability, to enforce the duties that the attorney already owes to the insured, who might have little incentive to sue his attorney since he has excess insurance coverage . . . Evidently, if the insured had not contracted for excess insurance coverage, the attorney would have to be similarly concerned about being sued by the insured for any excess liability . . . Malpracticing attorneys should not enjoy a windfall merely because the insured contracted for excess insurance coverage . . . Further, the social costs of legal malpractice [are] best borne by the malpracticing attorneys.<sup>791</sup>

Additionally, in the equitable subrogation context, there is less concern that legal malpractice claims will become a commodity to be exploited by strangers to the attorney-client relationship.<sup>792</sup> Basic subrogation principles strictly limit the right to be subrogated to a legal malpractice claim to a non-client who, pursuant to a legal duty, has paid the client's debt or loss attributable to the malpractice.<sup>793</sup> Any concern about an "uncontrollable flow" of baseless malpractice action by excess insurers is speculation.<sup>794</sup> Finally, the *Dowd & Dowd* court noted, while excess insurers possess the sophistication necessary to protect themselves in many situations, that ability or capability does not preclude the application of equitable subrogation doctrine.<sup>795</sup>

#### B. *Actions by Excess Carriers Not Allowed*

A few courts have declined to allow excess insurers to sue defense counsel for malpractice even on an equitable subrogation theory.<sup>796</sup> This is not surprising, inasmuch as a number of courts have generally rejected equitable subrogation in the legal malpractice context.<sup>797</sup>

The leading case favoring defense counsel is *Continental Casualty Co. v. Pullman, Comley, Bradley & Reeves*, decided by the Second Cir-

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791. *Nat'l Union Fire Ins. Co. v. Dowd & Dowd, P.C.*, 2 F. Supp. 2d 1013, 1023-24 (N.D. Ill. 1998). (citations omitted).

792. *See Nat'l Union Fire Ins. Co.*, 2 F. Supp. 2d at 1024.

793. *See id.*

794. *See id.*

795. *See id.*

796. *See, e.g., Cont'l Cas. Co. v. Pullman, Comley, Bradley & Reeves*, 929 F.2d 103 (2d Cir. 1991) (interpreting Connecticut law); *St. Paul Ins. Co. v. AFIA Worldwide Ins. Co.*, 937 F.2d 274 (5th Cir. 1991) (applying Louisiana law); *Am. Cont'l Ins. Co. v. Weber & Rose, P.S.C.*, 997 S.W.2d 12 (Ky. Ct. App. 1998).

797. *See, e.g., Fireman's Fund Ins. Co. v. McDonald, Hecht & Solberg*, 36 Cal. Rptr. 2d 424 (Ct. App. 1994) (rejecting claim by primary insurer); *Nat'l Union Fire Ins. Co. v. Salter*, 717 So. 2d 141 (Fla. Dist. Ct. App. 1998) (prohibiting subrogation by primary insurer), *review denied*, 727 So. 2d 908 (Fla. 1999); *Bank IV Wichita v. Arn, Mullins, Unruh, Kuhn & Wilson*, 827 P.2d 758 (Kan. 1992) (rejecting bank's claim against debtor's attorney). *But see Chem. Bank of N.J., N.A. v. Bailey*, 687 A.2d 316 (N.J. Super. Ct. App. Div. 1997) (permitting subrogation); *Gen. Accident Ins. Co. of Am. v. Schoendorf & Sorgi*, 549 N.W.2d 429 (Wis. 1996) (permitting subrogation).

cuit under Connecticut law.<sup>798</sup> *Pullman* arose out of a medical malpractice action against Griffin Hospital. The hospital was insured by Aetna at the primary level, with Continental Casualty its excess insurer.<sup>799</sup> Aetna hired the law firm of Pullman, Comley, Bradley & Reeves to defend the malpractice action.<sup>800</sup> The case went to trial and resulted in a staggering verdict against the hospital.<sup>801</sup> Continental paid over \$10 million under its excess policy to satisfy the judgment.<sup>802</sup> The insurer then sued the Pullman firm for legal malpractice for failing to adequately defend the underlying tort case.<sup>803</sup>

Pullman moved for judgment on the pleadings, arguing that Continental had no standing to sue because it was Aetna that retained the firm.<sup>804</sup> Continental argued that it had standing to sue because (1) it was an intended and foreseeable beneficiary of the Pullman firm's services for the hospital, such that it shared an attorney-client relationship with Pullman; (2) it was equitably subrogated to Griffin Hospital's right to sue Pullman; and (3) it shared an "actual attorney-client relationship" with Pullman.<sup>805</sup> After Continental unsuccessfully pursued an interlocutory appeal and amended its complaint, the district court granted a motion to dismiss by the law firm.<sup>806</sup> Continental then appealed to the Second Circuit, raising the same arguments in support of its claim against Pullman that it made in the district court below.<sup>807</sup>

The *Pullman* court first addressed Continental's claim that because it was an intended and foreseeable beneficiary of Pullman's legal services for the hospital, Pullman owed it a duty of care.<sup>808</sup> The court observed that under Connecticut law attorneys are not liable to persons other than their clients except in will cases.<sup>809</sup> Only in estate work may a third party beneficiary sue an attorney for malpractice. The court declined to equate an attorney's dual representation of an insured and its insurer with that of a testator and his beneficiary. Moreover, Continental was free to monitor the defense of the medical malpractice action through its own attorneys to assure itself that Aetna was living up to responsibilities as the primary

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798. 929 F.2d 103 (2d Cir. 1991).

799. See *Cont'l Cas. Co.*, 929 F.2d at 104.

800. See *id.*

801. See *id.*

802. See *id.*

803. See *id.* Continental also sued Aetna for bad faith, negligence, and failing to provide an adequate defense. See *id.*

804. See *Cont'l Cas. Co. v. Pullman, Comley, Bradley & Reeves*, 929 F.2d 103, 104 (2d Cir. 1991).

805. See *Cont'l Cas. Co.*, 929 F.2d at 104 (citing *Cont'l Cas. Co. v. Pullman, Comley, Bradley & Reeves*, 709 F. Supp. 44, 46 (D. Conn. 1989)).

806. See *id.* at 105.

807. See *id.* at 104-05.

808. See *id.* at 105.

809. See *id.* (quoting *Krawczyk v. Stingle*, 543 A.2d 733, 735 (Conn. 1988)).

insurer.<sup>810</sup> Under these circumstances, it seemed implausible that the primary or direct purpose of the transaction at issue (Aetna's engagement of Pullman to defend Griffin Hospital) was intended to benefit a third-party (Continental).<sup>811</sup>

Continental next argued that once it satisfied the judgment against Griffin Hospital, it was subrogated to its insured's rights, and it could therefore bring any legal malpractice claims against Pullman that the hospital should have brought.<sup>812</sup> The *Pullman* court gave this argument short shrift, rejecting it as running contrary to Connecticut public policy.<sup>813</sup> The court presumably feared that permitting non-clients to sue attorneys via equitable subrogation would potentially interfere with attorneys' ethical obligations to their clients.<sup>814</sup>

Continental's final argument for a direct duty owed to it by the Pullman law firm came in for harsh treatment by the Second Circuit. The *Pullman* court was especially critical of Continental's attempts to plead a direct duty in the district court, describing Continental's amended complaint as "[r]esonating . . . with bald conclusions."<sup>815</sup> In its amended complaint, Continental alleged that it shared an attorney-client relationship with Pullman because the law firm communicated with it about the progress of the medical malpractice action, advised it with respect to settlement, and served as its counsel on the appeal of the underlying action.<sup>816</sup> Continental never pleaded B nor could it B that it retained Pullman, a fact the *Pullman* court found interesting, but not dispositive.<sup>817</sup>

"It is clear beyond cavil," the *Pullman* court observed, "that in the insurance context the attorney owes his allegiance, not to the insurance company that retained him but to the insured defendant."<sup>818</sup> Though a defense attorney may be retained and paid by the insurer, and may inform the insurer about the progress of the case he is defending, the attorney owes his allegiance to the insured.<sup>819</sup> Accordingly, the district court

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810. See *Cont'l Cas. Co. v. Pullman, Comley, Bradley & Reeves*, 929 F.2d 103, 106 (2d Cir. 1991).

811. *Cont'l Cas. Co.*, 929 F.2d at 106.

812. See *id.*

813. See *id.* at 107 (citing *Krawczyk v. Stingle*, 543 A.2d 733 (Conn. 1988)).

814. See *id.* at 106 (citing and quoting *Krawczyk v. Stingle*, 543 A.2d 733, 735-36 (Conn. 1988)).

815. See *id.* at 108.

816. See *Cont'l Cas. Co. v. Pullman, Comley, Bradley & Reeves*, 929 F.2d 103, 108 (2d Cir. 1991).

817. *Cont'l Cas. Co.*, 929 F.2d at 108.

818. See *id.* (citing 16A John A. Appleman & Jean Appleman, *Insurance Law & Practice* § 8839.35, at 108 & n.9.5 (1981)).

819. See *id.* (citing *Novella v. Hartford Accident & Indem. Co.*, 316 A.2d 394, 405 (Conn. 1972); *Martyn v. Donlin*, 198 A.2d 700, 706 (Conn. 1964)).

did not err in dismissing Continental's amended complaint for pleading insufficient facts to support an attorney-client relationship.<sup>820</sup>

Although some courts may find *Pullman* persuasive, the last portion of the opinion may not travel well. Connecticut is a "single client" state in the insurance defense context, meaning that the law considers the insured to be the defense attorney's sole client.<sup>821</sup> Many jurisdictions follow the "dual client doctrine,"<sup>822</sup> which holds that so long as the insured's interests and the insurer's interests are aligned, they are each a client of the defense attorney and the defense attorney owes each client an equal duty of loyalty.<sup>823</sup> Of course, even in dual client states, the primary insurer hired the defense attorney and the defense must be faithful to both the *primary* insurer and the insured. The defense attorney shares an attorney-client relationship with the primary insurer and the excess insurer remains a step removed.

A Kentucky court rejected an excess insurer's equitable subrogation claim against defense counsel hired by the insured under its SIR in *American Continental Insurance Co. v. Weber & Rose*.<sup>824</sup> The *American Continental* court was convinced that permitting an excess insurer to sue defense attorneys under an equitable subrogation theory "would be inimical to the preservation of traditional and longstanding concepts associated with [the] attorney-client relationship."<sup>825</sup> Allowing excess insurers to sue their insureds' defense attorneys would undermine the traditional view of the attorney-client relationship as both personal and fiduciary.<sup>826</sup>

The *American Continental* court also rejected the insurer's claim that it was an intended and foreseeable beneficiary of the defense attorneys' services to the insured.<sup>827</sup> Unlike *Pullman*, in which the primary insurer hired the defense counsel, the insured hired the defense counsel as authorized by the SIR.<sup>828</sup> Accordingly, there was even less of a basis for the court to conclude that the defense attorneys were hired to repre-

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820. See *id.*

821. See *Higgins v. Karp*, 687 A.2d 539, 543 (Conn. 1997) (citing *Novella v. Hartford Accident & Indem. Co.*, 316 A.2d 394, 405 (Conn. 1972); *Martyn v. Donlin*, 198 A.2d 700, 706 (Conn. 1964)).

822. See, e.g., *Home Indem. Co. v. Lane, Powell, Moss & Miller*, 43 F.3d 1322, 1330 (9th Cir. 1995) (interpreting Alaska law); *State Farm Mut. Auto. Ins. Co. v. Fed. Ins. Co.*, 86 Cal. Rptr. 2d 20, 24 (Ct. App. 1999); *Unigard Ins. Group v. O'Flaherty & Belgum*, 45 Cal. Rptr. 2d 565, 569 (Ct. App. 1995); *Mobil Oil Corp. v. Maryland Cas. Co.*, 681 N.E.2d 552, 561 (Ill. App. 1997); *Moeller v. Am. Guarantee & Liab. Ins. Co.*, 707 So. 2d 1062, 1070 (Miss. 1996).

823. See *Nat'l Union Fire Ins. Co. v. Stites Prof'l Law Corp.*, 1 Cal. Rptr. 2d 570, 575 (Ct. App. 1991).

824. 997 S.W.2d 12 (Ky. Ct. App. 1998).

825. See *Am. Cont'l Ins. Co.*, 997 S.W.2d at 13.

826. *Id.* at 14.

827. *Id.*

828. *Id.* at 12-13.

sent the excess carrier. The insured hired the defense attorneys for its sole benefit, and American Continental was at most an incidental beneficiary of their contract. The defense attorneys did not owe American Continental a duty that could form the basis for a malpractice action.<sup>829</sup>

### C. Summary

The development of excess insurers' rights against defense attorneys hired by primary carriers is far from complete. The law in many states is uncertain, and there are good arguments both for and against recognizing excess insurers' right to bring malpractice suits against defense attorneys they did not hire. It is, for example, difficult to refute the *American Centennial* and *Dowd & Dowd* courts' conclusions that malpractice defense attorneys should not be able to escape liability simply because an insured prudently purchased excess insurance.<sup>830</sup> At the same time, excess insurers are far from helpless. They can employ their own attorneys to work with the defense attorneys hired by the primary insurer, sometimes referred to as devising a "shadow strategy," or providing a "shadow defense." In some cases an excess insurer actually may be able to take over the defense and direct counsel, control defense and settlement strategy, and so on.

## VI. CONCLUSION

There is no questioning the importance of excess insurance and umbrella coverage. Such policies protect insureds against catastrophic loss at prices that most businesses and individuals can afford. Excess and umbrella coverage are in fact quite common.

Controversies involving excess insurance are not new. Much of the litigation involving excess insurers has involved claims by and against primary carriers. Not surprisingly, there have been efforts over time to structure the relationship between primary and excess insurers. In 1974, several insurance industry associations and interested insurers jointly created the Guiding Principles for Primary and Excess Insurers.<sup>831</sup> The Guiding Principles most particularly address settlement and trial decisions. They are:

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.

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829. See *id.* at 14.

830. See *Nat'l Union Fire Ins. Co. v. Dowd & Dowd, P.C.*, 2 F. Supp. 2d 1013, 1023-24 (N.D. Ill. 1998) (citing *Am. Centennial Ins. Co. v. Canal Ins. Co.*, 843 S.W.2d 480, 484 (Tex. 1992)). These cases are discussed *supra* at notes 734-95.

831. See *Baldwin & Midkiff, supra* note 22, at 38-39.

2. Liability must be assessed on the basis of all 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 a claim.

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

4. When evaluating all aspects of a claim, if 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 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 the excess insurer when known. It shall 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 tender 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 a formal demand upon a primary insurer that the latter settle a claim within its policy limit. In any subsequent proceedings 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.<sup>832</sup>

Many primary and excess insurers either declined to adopt the Guiding Principles or have withdrawn as signatories to them because unfair claims practices statutes and newer policy language better frame their respective obligations.<sup>833</sup> The Guiding Principles have also drawn scholarly criticism.<sup>834</sup> At least two courts, however, have specifically applied the Guiding Principles as though they are an industry standard, with liability flowing from of their breach.<sup>835</sup>

The law of excess insurance goes far beyond the primary insurer/excess insurer relationship, however, and much of it is unsettled. Excess insurance has received little scholarly attention, and many courts do not fully appreciate or understand excess and umbrella insurers' differing obligations. Nevertheless, that understanding must come because litigation involving excess and umbrella carriers is growing and that growth seems sure to continue. The size of many losses and verdicts gives excess insurers a powerful incentive to vigorously enforce and protect their rights and interests.

Clarifying and steadying the law of excess insurance might rest with the insurance industry. Aspirational standards such as the Guiding Principles, while perhaps well intended, are unnecessary. The industry must standardize excess and umbrella policies, just as the industry standardized primary liability policies long ago.

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832. See *id.* at 39-40.

833. See *id.* at 39; See also *Puritan Ins. Co. v. Canadian Universal Ins. Co.*, 775 F.2d 76, 79 (3d Cir. 1985) (observing that "very few [insurance] companies ultimately subscribed" to the Guiding Principles).

834. See *Baldwin & Midkiff*, *supra* note 22, at 39.

835. See, e.g., *United States Fire Ins. Co. v. Nationwide Mut. Ins. Co.*, 735 F. Supp. 1320, 1324-25 (E.D.N.C. 1990) (applying North Carolina law); *Am. Centennial Ins. Co. v. Warner-Lambert Co.*, 681 A.2d 1241, 1246-48 (N.J. Super. Ct. Law Div. 1995).



