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Duties of a Primary Insurer to an Excess Insurer

I. INTRODUCTION

It is now generally acknowledged that a liability insurer owes its insured the duty to make a good faith effort to settle an action against its insured within the policy limits. Where the insured has purchased an excess liability policy to indemnify it against amounts recovered in excess of the underlying or primary policy limits, the primary insurer is responsible for paying the costs of the defense of the action and indemnifying the insured for any recovery by the injured plaintiff up to the primary policy limits, while the excess insurer is obligated to indemnify the insured for amounts recovered in excess of the primary insurer's policy limits. The primary insurer usually controls the litigation against the insured through its right to designate and obligation to pay defense counsel. But the excess insurer often must pay a far greater amount than the primary insurer to satisfy a judgment obtained by the injured plaintiff. Thus, serious questions have arisen as to the

2. In a typical case, the primary policy obligates the insurer to indemnify the insured against recovery by settlement or judgment up to a specified limit, e.g., $50,000 per occurrence. The excess policy generally obligates the excess insurer to indemnify against the same risks as the primary policy but with coverage limits extending from the primary policy limits up to its own limit, e.g., from $50,000 up to $500,000 per occurrence. If recovery by one or several claimants arising out of one covered occurrence surpasses $500,000, the excess above $500,000 is paid by the insured. An "umbrella" policy is a form of excess policy which insures against more types of risks than are covered by the insured's primary policy.
primary insurer's duty to the excess insurer to settle the litigation in good faith within the primary insurer's policy limits or to tender its policy limits where a reasonable possibility exists that a judgment may be rendered in excess of the policy limits.3 This Article will explore the development and ramifications of a primary insurer's good faith settlement obligation where the excess insurer would be liable to pay that part of a plaintiff's judgment in excess of the primary's limits of coverage.

Most jurisdictions hold that the primary insurer owes a duty of utmost good faith to its insured to settle a claim within the primary insurer's policy limits.4 In every policy of insurance, as in every contract, there is an implied covenant of good faith and fair dealing by which each party agrees to refrain from acts or omissions which would prevent the other from receiving the benefits of the agreement. Good faith and fair dealing require the insurer to effect reasonable settlements of claims within the policy limits where there is a substantial likelihood of recovery in excess of those limits.5 Liability insurance policies generally reserve to the insurer the right to decide whether to settle or litigate a claim asserted against an insured.6 In determining whether to accept or reject a settlement offer, the insurer must give the interests of the insured at least as much consideration as its own.7 The test of the reasonableness of the insurer's determination is whether a prudent insurer without policy limits would have accepted the amount demanded by the plaintiff for settlement of its claim.8 If the in-

3. The standard of "good faith" in negotiating settlements to which the primary insurer must adhere is discussed at note 57 infra. Despite this good faith obligation, the primary insurer is not a guarantor as to the results of a jury verdict, and "it is not required to prophesy or foretell the results of litigation at its peril." St. Paul-Mercury Indem. Co. v. Martin, 190 F.2d 455, 458 (10th Cir. 1951).
   Although the term "utmost" is not generally used in bad faith cases, a significant line of cases enunciates the principle that the insurer must act as a fiduciary to its insured, so that the relationship between insurer and insured goes beyond the usual contractual duty of good faith. We wish to emphasize the fiduciary nature of this duty by using the term "utmost" good faith. See, e.g., Kavanaugh Interstate Fire & Cas. Co., 35 Ill. App. 3d 350, 342 N.E.2d 116 (1976); Fireman's Fund Ins. Co. v. Security Ins. Co., 72 N.J. 63, 367 A.2d 864 (1976).
surer breaches its duty to settle in good faith within the policy limits, the insured has a cause of action against the insurer for the amount of the judgment in excess of the policy limits.9

Where an excess insurer rather than an insured is obligated to pay that part of the plaintiff's judgment which is greater than the primary insurer's policy limits, many courts have held that the primary insurer owes an equivalent duty to the excess insurer to exercise utmost good faith in attempting to settle the case within the excess insurer's policy limits.10 Although no privity of contract exists between the primary and excess insurer, the courts have granted a cause of action to the excess insurer for damages against the primary insurer where the primary insurer has breached its duty to settle litigation in good faith.11 The courts generally have not created a separate and distinct duty running from the primary to the excess insurer but instead have held that the excess insurer is equitably subrogated to the rights of the insured against the primary insurer, whose breach of its obligation to settle claims in good faith has caused the insured, or in its place and stead the excess insurer, to sustain damages.12

12. The types of misconduct underlying an action for bad faith failure to settle by the excess insurer against the primary insurer can be illustrated as follows:

1) [A]n unreasonable refusal to settle by the primary insurer when settlement would have been the prudent course of action;
2) [T]he primary insurer wrongfully failed to accept the settlement advice of its own attorneys and their evaluation as to value and liability [of the claim];
3) [T]he primary insurer failed to conduct a proper and appropriate investigation and... failed to exercise the standard of care required of an insurer in investigating and defending a claim and litigation;
4) [T]he primary insurer willfully or negligently failed to advise the excess insurer of all material developments with regard to the liability and settlement opportunities;
5) [T]he primary insurer demanded that the excess insurer make a contribution to a settlement amount within the limits afforded by the primary insurer's policy;
6) [T]he primary insurer willfully violated the fiduciary relation-
Although the primary insurer's duty to make good faith settlement efforts never varies, the excess insurer's assertion of a claim against the primary for failure to settle in good faith arises in two distinct factual contexts. The normal bad faith action is predicated upon four elements: (1) the plaintiff's offer to settle within the primary policy limits, (2) the primary insurer's rejection of such offer, (3) the subsequent judgment for an amount in excess of the primary policy limits, and (4) the excess insurer's liability to pay that part of the judgment above the primary insurer's coverage. However, in numerous cases the factual situation is as follows: (1) the plaintiff offered to settle for an amount greater than the primary policy limits, (2) the settlement demand was far in excess of the primary coverage and yet less than the potential judgment, (3) the excess insurer concluded that the offer was reasonable and should be accepted, and (4) the primary insurer refused to contribute its policy limits to effectuate a settlement. In actions commenced by excess insurers under the second factual situation, primary insurers have argued either that the excess insurer's cause of action is conditioned upon the plaintiff's offer to settle within the primary policy limits or that the primary insurer cannot be subjected to liability in the absence of an adjudication of the insured's liability.  

The courts have consistently rejected these arguments, and have established that the excess carrier need not allege the existence of a settlement offer within policy limits, but only that the excess carrier offered to contribute a specific sum for which settlement could have been made or that it offered to contribute an indefinite amount which, together with the primary insurer's policy limits, would have effected a settlement for an amount less than the sum which the excess carrier was subsequently required to pay because of the primary insurer's refusal to contribute its policy limits.

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13. See note 33 infra.


II. EARLY CASES

The doctrine of subrogation was employed in an early line of cases in the Court of Appeals for the Tenth Circuit to permit suits by excess insurers against primary insurers where improper conduct by the primary insurer resulted in payments by the excess insurer. The court grounded the excess insurer's cause of action on general equitable principles and on the subrogation clause contained in the excess insurer's policy. In one case, *American Fidelity & Casualty Co. v. All American Bus Lines, Inc.*, the insured brought an action against its primary insurer for bad faith failure to accept an offer of settlement. The court ruled on the first appeal that the insured was not the real party in interest since its excess insurer had paid the judgment above the limits of the primary insurer's policy. On remand the excess insurer was substituted for the insured on the basis of its payment of the excess amount of the judgment and the existence of a subrogation clause in the excess insurance policy. On a second appeal, the court held that the subrogation clause enabled the excess insurer to assert an action for damages against the primary insurer for the latter's breach of its duty to act in good faith in considering settlements within its policy limits.

III. EQUITABLE SUBROGATION

Recently, the courts have departed from reliance upon the existence of a subrogation provision in the excess insurance policy and, instead, have articulated a fully developed theory of equitable subrogation as the basis of an excess insurer's right of action against a primary insurer who breaches its duty to attempt good faith settlement within its coverage limits. In *Peter v. Travel*
Travelers provided primary liability insurance with policy limits of $250,000, while Lloyds of London issued an excess policy with limits above $250,000. As a result of confusion between the primary's home and branch offices, the primary insurer refused to authorize any offer to settle greater than $15,000, and the plaintiff's offers to settle within the primary policy limits were thus refused. At trial the jury returned a verdict in the sum of $407,000. After judgment the plaintiff agreed to accept, in compromise settlement, the sum of $387,984.10, or $137,984.10 in excess of the primary limits of $250,000.

The excess insurer sued to recover the excess amount on the ground that the primary insurer's breach of its duty to settle in good faith within its policy limits subjected the excess insurer to liability for $137,984.10. The court, first considering the question of the primary insurer's liability to its insured under the facts presented, concluded that the primary insurer refused to give "meaningful consideration" to settlement and breached its duty by failing "to give any adequate consideration to the settlement prospect." The court then considered whether the primary insurer's breach of duty to its insured was actionable by the excess insurer and held that the excess insurer's cause of action was based upon the doctrine of equitable subrogation and was subject to compliance with its requirements. The court found that the excess in-

22. Id. at 1348.
23. Id. at 1349. The Peter court relied upon the criteria enunciated in Crisci v. Security Ins. Co., 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967), for determining the good faith of an insurer in negotiating settlements and found a more significant breach of duty by Travelers in Peter than occurred in Crisci because "the failure even to consider the question of what settlement would be reasonable is a breach of greater proportion than the refusal of a reasonable offer." 375 F. Supp. at 1349.
24. The Peter court stated that the elements of an insurer's cause of action based upon equitable subrogation are:
   (1) The insured has suffered a loss for which the party to be charged is liable, either because the latter is a wrongdoer whose act or omission caused the loss or because he is legally responsible to the insured for the loss caused by the wrongdoer;
   (2) [T]he insurer, in whole or in part, has compensated the insured for the same loss for which the party to be charged is liable;
   (3) [T]he insured has an existing, assignable cause of action against the party to be charged, which action the insured could have asserted for his own benefit had he not been compensated for his loss by the insurer;
   (4) [T]he insurer has suffered damages caused by the act or omission upon which the liability of the party to be charged depends;
   (5) [J]ustice requires that the loss should be entirely shifted from the insurer to the party to be charged, whose equitable position is inferior to that of the insurer; and
   (6) The insurer's damages are in a stated sum, usually the amount
surer met all such requirements and was therefore equitably subrogated to its insured's cause of action for damages against the primary insurer. It further stated that strong equitable and economic factors compelled the judicial recognition of the duty owed by a primary to an excess insurer to settle claims in good faith within the primary insurer's policy limits. The court observed:

An insurance company's duty to act in good faith in settling claims within its policy limits is well established and is reflected in its premiums. That an excess insurer may recover from the primary for a breach of duty does not increase the duty or the liability of the primary. Under the doctrine of equitable subrogation, the duty owed an excess insurer is identical to that owed the insured. . . . In considering whether it will settle a claim, the primary insurer may consider its own interests, but it must equally consider the interests of the insured, which become the interests of the excess insurer by subrogation.25

The Peter court also noted that the primary insurer's control of the litigation and settlement negotiations makes the interests of the excess insurer dependent upon the primary insurer, while the primary insurer is rarely affected by the existence of excess coverage. For example, a finding that the insured's purchase of excess liability insurance absolved the primary insurer from its good faith duty to settle would have the dual adverse effects of placing potentially severe financial constraints upon the excess insurer, resulting in higher premiums, and reducing the primary insurer's incentive to settle when an injured plaintiff's demand hovered near the primary insurer's limits.26 These problems are obviated where the excess insurer may enforce by equitable subrogation the duty to settle in good faith owed by the primary insurer to its insured.

The Minnesota Supreme Court, in Continental Casualty Co. v. Reserve Insurance Co.,27 expanded upon the Peter rationale for the

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25. 375 F. Supp. at 1350 (quoting Patent Scaffolding Co. v. William Simpson Constr. Co., 258 Cal. App. 2d 506, 509, 64 Cal. Rptr. 187, 190 (1967)). Subsequent cases have eliminated from the doctrine of equitable subrogation any requirement that the insured sustain actual loss. "It is not a prerequisite to equitable subrogation that the subrogore suffered actual loss; it is required only that he would have suffered loss had the subrogee not discharged the liability or paid the loss." Northwestern Mut. Ins. Co. v. Farmers Ins. Group, 76 Cal. App. 3d 1031, 1044, 143 Cal. Rptr. 415, 423 (1978).

26. For example, if the liability policy limits were $20,000, plaintiff's demand were $18,000, and liability was likely but not certain, the primary insurer might decide to risk a jury verdict in the absence of a duty by the primary to the excess carrier since the primary's only risk in refusing the demand would be $2,000 together with higher attorney's fees. See Northwestern Mut. Ins. Co. v. Farmers Ins. Group, 76 Cal. App. 3d 1031, 1045, 143 Cal. Rptr. 415, 423 (1978).

27. 307 Minn. 5, 238 N.W.2d 862 (1976).
duty which the primary insurer owes to the excess insurer to negotiate settlements in good faith.\textsuperscript{28} The court stated:

When there is no excess insurer, the insured becomes his own excess insurer, and his single primary insurer owes him a duty of good faith in protecting him from an excess judgment and personal liability. If the insured purchases excess coverage, he in effect substitutes an excess insurer for himself. It follows that the excess insurer should assume the rights as well as the obligations of the insured in that position.\textsuperscript{29}

The court recognized that the scope of the primary insurer's duty to settle claims in good faith is not dependent upon whether the insured had sufficient foresight to obtain an excess liability policy. Irrespective of whether the insured purchased excess insurance, the primary insurer will be held to the same high standard of good faith in considering settlement offers.

The court identified two significant policy considerations which compelled the creation of a cause of action in equitable subrogation by the excess against the primary insurer. First, a primary insurer who breaches its duty to settle in good faith within its policy limits "imperils the public and judicial interests in fair and reasonable settlement of lawsuits."\textsuperscript{30} The excess insurer's cause of action by virtue of equitable subrogation acts to constrain the primary insurer from rejecting settlements in bad faith. Second, the excess insurer's ability to enforce the primary insurer's duty to settle in good faith rectifies what would otherwise be an unfair distribution of losses between the two insurers. The court observed:

The insured has paid for two distinct types of coverage, undoubtedly at different rates because they involve different amounts and kinds of risks. Primary coverage is designed to cover liability from zero to certain policy limits (in this case $50,000); excess coverage is designed to cover liability only after those initial limits are exhausted.\textsuperscript{31}

The excess insurer's equitably subrogated claim against the primary insurer safeguards the excess insurer from losses which it may sustain by reason of the improper conduct of the primary insurer who has control over settlement negotiations.\textsuperscript{32} It insures

\begin{itemize}
  \item \textsuperscript{28}\textit{Continental} involved an excess insurer who settled the underlying claim during trial for a sum above the primary policy limits and paid the full amount thereof while the primary insurer refused to participate in the settlement. Subsequently, the excess insurer sued the primary to recover the primary's policy limits of $50,000 which the excess insurer contended was withheld from the settlement negotiations in bad faith. \textit{Id.} at 7, 238 N.W.2d at 864.
  \item \textsuperscript{29} \textit{Id.} at 8-9, 238 N.W.2d at 864.
  \item \textsuperscript{30} \textit{Id.} at 9, 238 N.W.2d at 864-65.
  \item \textsuperscript{31} \textit{Id.} at 9, 238 N.W.2d at 865.
  \item \textsuperscript{32} The \textit{Continental} court soundly rejected the primary's contention that the excess insurer could not recover because there had been no adjudication of the liability of the insured in light of the settlement reached during trial by the excess insurer. The court held that the primary's bad faith failure to settle occurred prior to trial, and since the decision not to settle was to be evaluated...
that the essential purposes of the different coverages and their rating structures will not be thwarted by the primary insurer's casting of the excess insurer into liability through a breach of duty to settle claims in good faith. The Continental rationale for the judicial recognition of an excess insurer's equitably subrogated cause of action has met with approval in subsequent decisions.

The court in Valentine v. Aetna Insurance Co.\textsuperscript{33} held that excess insurers were equitably subrogated to the insured's rights against the primary insurer and were entitled to assert claims against it in the sum of $200,000, which represented the difference between the $700,000 jury verdict and the $500,000 amount for which the original action could reasonably have been settled. The court advanced many of the same cogent policy considerations cited by the Continental court, stating:

\begin{quote}
[If the existence of excess insurance relieved a primary insurer of its responsibility to negotiate and settle up to its policy limits in good faith, then the primary insurer would have a disincentive to settlement. Moreover, if during settlement negotiations the primary insurer is allowed to force the excess insurer to cover part of the primary's insurance exposure, the coverages and rate structures of the two different types of insurance—primary and excess—would be distorted, and excess insurance premiums would have to be adjusted. On the other hand, allowing an excess insurer to enforce a primary carrier's duty to negotiate and settle in good faith to the full limits of the primary carrier's policy does not add to or change that carrier's duties.\textsuperscript{34}]
\end{quote}

Most decisions have held that the excess insurer's measure of damages is the difference between the amount of the adverse judgment against the insured and the amount for which the claim could reasonably have been settled.\textsuperscript{35} However, in a case where the po-

\textsuperscript{33} Id. at 11-14, 238 N.W.2d at 866-67. In a similar factual setting, the court in Fireman's Fund Ins. Co. v. Security Ins. Co., 72 N.J. 63, 367 A.2d 864 (1976), upheld the excess insurer's cause of action for damages sustained by reason of the primary's failure to tender its policy limits. The court held that the insured or the excess insurer by equitable subrogation could proceed to make a prudent good faith settlement for an amount in excess of the [primary] policy limits and then, upon proof of the breach of the insurer's obligation and the reasonableness and good faith of the settlement made, to recover the amount of the policy limits from the [primary] insurer. Id. at 75, 367 A.2d at 870.

\textsuperscript{34} Id. at 298.

\textsuperscript{35} It is settled that recoverable damages for the failure of an insurer to effect reasonable settlement within its policy limits includes the entire amount of the insured's liability to the injured claimant, even though that amount be in excess of the insurer's policy limits. ... And we entertain no doubt that an excess insurer which has settled and discharged the insured's liability, may recover from the primary
potential judgment against the insured was greatly in excess of the primary policy limits, the plaintiff made a demand for an amount greater than the primary policy limits, and the primary insurer refused to contribute its policy limits towards the settlement, the court held that the excess insurer, who had settled the action for $135,000, was entitled to recover up to the primary insurer's policy limits of $50,000.36 The basis for the decision was that the excess insurer suffered no loss greater than the amount of the primary insurer's policy limits since it was responsible for contributing the difference between the primary policy limits of $50,000 and the settlement amount of $135,000. Thus, where the excess insurer settles a claim for a reasonable amount, it is entitled to damages resulting from the primary insurer's bad faith only by reason of the primary insurer's refusal to contribute its policy limits towards the settlement.

Although the clear trend of the law is to recognize the excess insurer's equitably subrogated cause of action, its development has not gained unanimous support in all jurisdictions. A minority view holds that in the absence of a direct contractual relationship, the primary insurer owes the excess insurer no duty to settle in good faith. In *Universal Underwriters Insurance Co. v. Dairyland Mutual Insurance Co.*,37 the Arizona Supreme Court disallowed a bad faith cause of action by an excess against a primary insurer on the grounds that no privity of contract existed between the two insurance companies. It is noteworthy, however, that despite the court's refusal to permit a bad faith action by the excess carrier, it allowed recovery by the excess against the primary insurer on the grounds that "where two companies insure the same risk and one is compelled to pay the loss, it is entitled to contribution from the other."38

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37. *Id.* at 520, 433 P.2d at 968. This case was said to be a controlling statement of Arizona law and a bad faith claim by an excess against a primary insurer was thereby denied in *Rocky Mountain Fire & Cas. Co. v. Dairyland Ins. Co.*, 432 F.2d 693 (9th Cir. 1971). See also *Iowa Nat'l Mut. Ins. Co. v. Universal Underwriters Ins. Co.*, 276 Minn. 362, 150 N.W.2d 233 (1967); *Smoral v. Hanover Ins. Co.*, 37 A.D.2d 23, 322 N.Y.S.2d 12 (1971).
DUTIES OF A PRIMARY INSURER

An excess insurer's enforcement of the primary insurer's duty to settle litigation in good faith has widespread ramifications, as discussed in the following subsections.

A. Duty of Primary to Excess Insurer Where Insureds are not Identical

The cases discussed above pertain to a “true” primary-excess insurance relationship, where one insured has procured primary liability and excess liability policies from two different insurers. However, in Northwestern Mutual Insurance Co. v. Farmers' Insurance Group,39 the court considered the good faith duty to settle concept in a different setting. The issues before the court were: (1) whether a permissive user of an automobile who was listed as an insured under the owner's liability insurance policy had a right of action against the owner's insurer for its bad faith refusal to effect settlement within its policy limits, and (2) whether the permissive user's automobile liability insurer, whose coverage was in excess of the owner's coverage,40 was equitably subrogated to the permissive user's cause of action where it had been required to pay the excess amount of a judgment rendered against the insured as a result of the owner's insurer's bad faith refusal to settle. The court held that although the permissive user was not a party to the contract, he was “one of a class for whose benefit the policy was expressly made,”41 and was therefore an express third-party beneficiary.42 The court concluded that the permissive user could enforce the owner's liability insurance policy, including the implied covenant of good faith and fair dealing to effect reasonable settlements.43

The owner's insurer argued that the distinction between the factual situation at bar and a “true” primary-excess insurance relationship required the court to deny to the permissive user's insurer equitable subrogation to the rights of the permissive user.44 Its contention was that in a “true” primary-excess relationship, the two different policies have been issued at premium rates structured to reflect the difference in exposure, so that a “true” excess carrier should be permitted to rely upon the primary's good faith efforts to settle claims within the primary insurer's policy limits.45

40. The owner's liability insurance was found to be primary insurance under Cal. [Ins.] Code § 11580.9(d) (West 1972). 76 Cal. App. 3d at 1038, 143 Cal. Rptr. at 418.
41. 76 Cal. App. 3d at 1042, 143 Cal. Rptr. at 421.
42. Id.
43. Id. at 1042, 143 Cal. Rptr. at 421-22.
44. Id. at 1045-47, 143 Cal. Rptr. at 424.
45. Id. at 1047, 143 Cal. Rptr. at 424.
In contrast, under the *Northwestern* facts, since each insurer was a primary insurer to its own insured, it was argued that it was unreasonable to place the burden of settlement entirely on one of the insurers. Moreover, the owner's insurer argued that since both insurers had a separate duty to their own insureds to effect reasonable settlements in good faith, the permissive user's insurer should not be relieved of its duty by asserting claims against the owner's insurer for its refusal to settle.

The court carefully analyzed the rights and obligations of each insurer and upheld the cause of action asserted by the permissive user's insurer, as an excess insurer, against the owner's insurer, as the primary insurer, for the primary's bad faith refusal to settle. The court reasoned that both insurers knew that under existing insurance statutes their respective policies would constitute primary coverage in some cases and excess coverage in others, and both were able to set their premium rates in order to reflect this economic and legal reality. Although the permissive user's insurer owed the duty of good faith and fair dealing to its insured, the permissive user was an insured under the owner's policy, which the court characterized as primary insurance. Thus, the owner's insurer owed a duty to the insured to attempt a good faith settlement of the claim against the permissive user. However, the court held that the excess insurer's duty to settle "requires no more than that it effect reasonable settlement within its own policy limits."46 The court concluded:

> Permitting an excess insurer to recover from the primary insurer for its unreasonable failure to settle within its policy limits, in no way reduces or diminishes the duty of the excess insurer to settle within the limits of its own policy. Neither does it in any way discourage settlements. However, denying recovery, that is, relieving a primary insurer of its duty to effect reasonable settlement where excess coverage exists, would tend to deter settlements.47

The duty of good faith and fair dealing owed by the excess insurer to its insured is consistent with and complementary to the excess insurer's enforcement of the primary's duty to the insured to make

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46. *Id.* at 1048, 143 Cal. Rptr. at 425.
47. *Id.* (emphasis in original). In a similar factual situation, the court in Farmers' Ins. Group v. Progressive Cas. Ins. Co., 84 Mich. App. 474, 269 N.W.2d 647 (1978), held that the permissive user's liability insurer was subrogated to the rights of its insured pursuant to the subrogation provisions of the excess policy and was entitled to assert a cause of action against the owner's insurer who had wrongfully denied coverage on the grounds that the owner's policy had been cancelled. Although the court confusingly identified the action by the permissive user's insurer as one of "indemnification," it correctly analyzed the situation in terms of subrogation theory. See also St. Paul-Mercury Indem. Co. v. Martin, 120 F.2d 485 (10th Cir. 1951); Smoral v. Hanover Ins. Co., 37 A.D.2d 23, 322 N.Y.S.2d 12 (1971).
reasonable settlements in good faith. The Northwestern decision was a proper extension of the adoption of equitable subrogation by an excess insurer of the insured’s rights against a primary insurer. If the permissive user’s insurer had no cause of action against the owner’s insurer, the incentive to the owner’s insurer (primary insurer) to settle cases would be significantly reduced. The potentially diminished incentive for settlement is contrary to the policy considerations underlying the judicially enforced duty of good faith of an insurer toward his insured. The recognition of the equitably subrogated cause of action by the permissive user’s insurer is an effective means to encourage the primary insurer to comply with its good faith obligation to attempt to make settlements. Moreover, the court recognized the interface between law and economics by pointing out that the primary insurer charged premiums in anticipation that certain cases would arise in which the owner’s policy of insurance would be considered primary and other cases in which the policy would be considered an excess policy so that each insurer’s premiums could be adjusted in accordance with its anticipated exposure in different circumstances.

B. Duties of Insured to Excess Insurer

Two conflicting California appellate cases, and their resolution by the California Supreme Court, have clarified, in that state, the duty owed by an insured to its excess carrier to settle litigation. In Transit Casualty Co. v. Spink Corp.,48 an engineering firm, Spink, obtained primary coverage from the insurer up to $100,000 with a $15,000 deductible and excess coverage from Transit Casualty under an “umbrella” policy up to $1,000,000. Both policies contained a standard clause permitting the insured to refuse to consent to a settlement. When a wrongful death action was brought against Spink, charging negligent supervision of a construction site, the owner of the project cross-claimed against Spink for its alleged negligence in failing to effect the inclusion of a hold-harmless clause in the prime construction contract and to have the project owner listed as an additional insured on the prime contractor’s liability and workmen’s compensation policies. Prior to and at the commencement of the trial, the plaintiff offered to settle for a total sum of $300,000, including a $76,000 contribution from Spink, which would have been within the primary policy limits. The defense attorneys designated by the primary insurer recommended this settlement to Spink, and while the primary insurer favored the

settlement, it did not place any pressure on Spink to accept it. However, Spink stated that it would not settle "under any circumstances," and the primary insurer failed to advise the excess insurer of Spink's refusal to settle.

After a jury verdict was rendered in the sum of $632,000, the trial court held Spink liable to the project owner on its crossclaim. The ultimate result of the trial was that Spink paid $15,000, the primary insurer, $100,000, and the excess insurer, $175,000. The excess insurer contributed $285,000 to settle other claims and then brought an action against the insured and the primary insurer alleging their bad faith refusal to settle the wrongful death action within the primary policy limits. The appellate court stated that the application of equitable subrogation would defeat the excess insurer's bad faith claim against the primary insurer because a subrogee has no greater rights than a subrogor and the insured Spink acted in bad faith in refusing to settle the wrongful death action within the primary policy limits. However, the court held that the excess insurer's compliance with the requirements of equitable subrogation was not an indispensable element of its claim for damage against the primary insurer. The court stated: "The law, then, would be unrealistic in demanding that either carrier use the policyholder as its stepping stone to the assertion of a mutual obligation to each other. Triangular reciprocity is far more rational." In positing a theory of triangular reciprocity of good faith duties among the insured, primary, and excess carriers, the court stressed the delictual rather than contractual nature of a claim grounded upon a bad faith failure to settle and reasoned that each of the three parties should be held responsible in a bad faith action in accordance with the measure of its own fault.

The court held that a policy provision which permitted an insured to reject settlements tended to defeat the public interest in the settlement of litigation and would be narrowly construed in order to give full effect to the implied covenant of good faith and fair

49. 94 Cal. App. 3d at 130, 156 Cal. Rptr. at 364. Testimony revealed that Spink had consulted its insurance broker, who advised that a settlement by Spink would impair its future insurability and that of the engineering profession in general. Id.

50. Since the excess insurer also paid $285,000 to settle other wrongful death and injury claims arising out of the same accident, part of its claim against the insured and primary insurer was that their failure to settle the first action when plaintiff had demanded $300,000 increased the settlement value of the other death and injury claims. Id. at 130-31, 156 Cal. Rptr. at 364.

51. Id. at 133, 156 Cal. Rptr. at 365.

52. In an analogy to comparative negligence, the court intimated that if the plaintiff in a bad faith action had itself acted in bad faith in failing to settle an underlying action, its recovery would be proportionately reduced. Id. at 134, 156 Cal. Rptr. at 368.
dealing in every policy. The court concluded that, despite the presence of the settlement rejection clause, the insured could not unreasonably withhold its consent to settle, and the burden at trial was upon the insured to prove that its refusal to settle was reasonable under all the circumstances, including the insured's concern for its professional reputation.

In the second California case involving an insured's duty to its excess carrier, Commercial Union Assurance Cos. v. Safeway Stores, Inc., the excess insurer brought an action against the insured and primary insurer based upon their alleged failure to settle a claim in an amount less than the $100,000 liability limit of the primary insurer's policy. The excess insurer alleged two causes of action, one in negligence and the other for breach of the duty of good faith and fair dealing. The excess insurer contended that the insured and primary insurer could have settled the claim for $60,000 or less, that they had a duty to the excess insurer to settle for less than $100,000 when they had an opportunity to do so, and that as a result of their failure to settle, a judgment was obtained by the underlying plaintiff for $125,000, of which the excess insurer was required to pay $25,000. The court held that the excess insurer failed to state a cause of action either in negligence or for breach of contract.

While the court recognized that an insurer may be liable to the insured where it has breached the implied covenant of good faith and fair dealing by unreasonably rejecting a settlement offer within the policy limits, the court expressly refused to make such

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53. Id. at 135-36, 156 Cal. Rptr. at 367.
54. Id. at 136, 156 Cal. Rptr. at 367.
56. The insurance coverage was unusual in that the insured was a self-insurer for a layer above the primary policy and below the excess policy. The insurance coverage was as follows: (a) Travelers Insurance Company and Travelers Indemnity Company insured Safeway with policy limits of $50,000; (b) Safeway insured itself for liability between the sums of $50,000 and $100,000; and (c) Commercial Union Assurance Companies and Mission Insurance Company provided coverage in excess of $100,000 to $20,000,000. 26 Cal. 3d at 915-16, 610 P.2d at 1040, 164 Cal. Rptr. at 711.
57. In Merritt v. Reserve Ins. Co., 34 Cal. App. 3d 358, 110 Cal. Rptr. 511 (1973), the court held that an action for breach of the implied covenant of good faith and fair dealing must be based upon bad faith, and that an allegation of negligence alone is insufficient to impose liability. Most courts have held that bad faith requires more than negligence, and "imports a dishonest purpose, moral obliquity, conscious wrongdoing, breach of a known duty through some ulterior motive or ill will partaking of the nature of fraud. It also embraces actual intent to mislead or deceive another." Centennial Ins. Co. v. Liberty Mut. Ins. Co., 62 Ohio St. 2d 221, 224, 404 N.E.2d 759, 762 (1980) (citing Slater v. Motorists Mut. Ins. Co., 174 Ohio St. 148, 151, 187 N.E.2d 45, 48 (1962)).
duty reciprocal by extending to the excess insurer a cause of action against its insured based upon the breach of such duty. The court reasoned that although both parties to an insurance contract must observe the implied covenant of good faith and fair dealing, the content of the insured's duty depends upon the nature of the "bargain struck" between the parties and their "legitimate expectations" arising from the contract. In a conventional liability insurance policy, the insurer, in exchange for the payment of premiums, undertakes to provide defense of lawsuits and indemnification in order to protect the insured from liability. The insured is justified in expecting that in carrying out its contractual obligations, the insurer will act in good faith in attempting to effectuate settlements. While the basis of the insurance contract is to give the insured the security that the insurer will hold the insured harmless in the event of litigation by reason of the risk covered by the insurance policy, the gain which the insurer seeks from this bargain is the premium paid by the insured, so that the insurer has no anticipation or expectation that the insured will act to minimize the financial loss to the insurer by reason of the insured's failure to agree to a reasonable settlement. For the insured, the basis of the insurance policy is his legitimate expectation that the insurer will act in good faith to make settlements in order to minimize the financial risk to the insured of any claim covered under the policy. However, the excess insurer has no legitimate expectation that its interests will be similarly protected by an insured. The purpose of excess insurance is to provide the insured with additional resources and thus shield it from personal liability if recovery against the insured is greater than a specified sum. Therefore, the court reasoned, the insured has no duty to consider the interests of the excess insurer as it would its own, and the insurer has no legitimate expectation that the insured will do so. The court stated:

The insured owes no duty to defend or indemnify the excess carrier; hence, the carrier can possess no reasonable expectation that the insured will accept a settlement offer as a means of "protecting" the carrier from exposure. The protection of the insurer's pecuniary interests is simply not the object of the bargain.

The court criticized the Transit court's theory of triangular reciprocity by stating that it failed to consider the disparity of bargaining power between the insured and the insurer and the difference in the legitimate contractual expectations of each of the parties. The court concluded that the insured's duty of good faith and fair dealing with its excess insurer did not compel it to accept a settle-
ment even where it was likely that an adverse judgment would require payments under the excess policy.

On appeal, the court of appeals' opinion in Commercial was adopted with only minor changes by the California Supreme Court. In dealing with the conflict between Commercial and Transit as to the scope of the insured's duty to an excess insurer, the supreme court disapproved Transit insofar as it held that an insured's duty of good faith and fair dealing encompassed the duty to accept settlements where there was a likelihood that a judgment against the insured would cast liability on the excess insurer. The supreme court wholly incorporated the lower court's rationale that the insured owed no such duty to the excess insurer to settle claims in order to protect the excess insurer's financial interests.

C. Standards for Finding Bad Faith by Primary Insurer

Several courts have considered the factors determinative of a primary insurer's bad faith in refusing to settle cases within its policy limits. In Centennial Insurance Co. v. Liberty Mutual Insurance Co., the primary insurer issued a policy with limits of $300,000 per occurrence, and the excess insurer furnished coverage above $300,000 up to $5,000,000 per occurrence. The underlying action was settled for $700,000 after an adverse jury verdict, and the excess insurer claimed that the primary insurer had acted in bad faith in refusing to settle. The court permitted the excess insurer's action by approving the doctrine of equitable subrogation but held that the excess insurer did not prove that the primary insurer had acted in bad faith. The court noted that the primary insurer had conducted a thorough investigation of the claim, had apprised the excess insurer regularly concerning the status of the action, had permitted the excess insurer access to its files, and had engaged in extensive settlement negotiations which resulted in a plaintiff's

62. Id. at 921, 610 P.2d at 1043, 164 Cal. Rptr. at 714. Kaiser Found. Hosps. v. North Star Reinsurance Corp., 90 Cal. App. 3d 786, 153 Cal. Rptr. 678 (1979), held that both the insured and primary insurer owed the excess insurer the duty of good faith and fair dealing and that the excess insurer could recover from its insured if it proved that the insured and primary insurer fraudulently concluded to assign dates of loss on malpractice claims to policy years other than those in which the losses actually occurred. The Kaiser court expressly limited its holding to the facts presented and did not venture to define the ambit of the insured's duty to the excess carrier. The supreme court in Commercial cited Kaiser with approval for the principle that "the insured's status as such is not a license for the insured to engage in unconscionable acts which would subvert the legitimate rights and expectations of the excess insurance carrier." 26 Cal. 3d at 921, 610 P.2d at 1043, 164 Cal. Rptr. at 714.
63. 62 Ohio St. 2d 221, 404 N.E.2d 759 (1980).
demand of $275,000 and in the primary's offer of $250,000. The excess insurer argued that bad faith was shown by the primary insurer's request that the excess insurer contribute the $25,000 difference between the offer and demand, since $275,000 was within the primary policy limits. The court rejected the argument, holding that the primary insurer's request for contribution was by itself insufficient to prove bad faith and that only the primary insurer's insistence upon contribution from the excess insurer as the condition of settlement would warrant a finding of bad faith. A mere request for contribution is only one fact to be considered in the court's determination as to the primary insurer's bad faith. In general, a finding of bad faith will not be supported merely by evidence of negligent conduct; the concept of bad faith has been interpreted to contain the element of willful conduct.

In *North River Insurance Co. v. St. Paul Fire & Marine Co.*, the court held that the excess insurer had not proven as a matter of law that the primary insurer had acted in bad faith and so left undisturbed the trial court's verdict in favor of the primary. The court, applying South Dakota law, declared that a bad faith claim against a primary insurer must be grounded upon misconduct more serious than error in judgment, lack of foresight, or negligence, although negligence was one factor in the determination of bad faith.

Similarly, in *Valentine v. Liberty Mutual Insurance Co.*, the court held that the trial court was not clearly erroneous in ruling that the primary insurer did not act in bad faith in its failure to notify the insured or excess insurer in a timely manner of plaintiff's repeated increases to its ad damnum clause. Although holding that the failure to notify was negligent conduct which prejudiced the insured's position, the court concluded that such a showing of negligence was legally insufficient to prove bad faith.

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64. 600 F.2d 721 (8th Cir. 1979).
65. The primary insurer, whose policy limits were $150,000, refused to offer more than $93,000 to settle an action, which resulted in a judgment rendered against the insured for $500,000. *Id.* at 723.
66. The court also found that the excess insurer failed to prove that the primary insurer's bad faith was the proximate cause of the excess insurer's damage. *Id.* at 724-25.
67. 620 F.2d 583 (6th Cir. 1980).
68. The injured plaintiff had instituted its action against the insured in May, 1970, seeking $25,000 in damages. In May, 1972, the trial judge allowed an increase in the demand contained in the complaint to $100,000. After a mistrial, the court permitted the plaintiff again to increase its ad damnum clause to seek recovery of $750,000. The primary insurer did not give notice of these increases to its insured or to the excess insurer until a subsequent trial was held in June, 1973, which resulted in a judgment in excess of the primary limits. *Id.* at 584.
In denying recovery to the excess insurer as equitable subrogee of the insured, the court pointed to the fact that no proof had been adduced that the failure to give notice was motivated by a "selfish purpose" to protect the primary insurer's interest at the expense of the insured. Since the primary insurer's negligent conduct was not actuated by a harmful or venal intent, the court held that the excess insurer in proving negligence did not meet the higher standard of "bad faith."

D. Prejudicial Settlements by Primary Insurer

Recent opinions reaching inconsistent results have examined the excess insurer's right of action against a primary insurer where the primary insurer has settled with the original plaintiff in a manner that exposed the excess insurer to liability. In American Home Assurance Co. v. Commercial Union Assurance Co., the primary insurer with policy limits of $300,000 settled with two injured plaintiffs for $214,000; however, the plaintiffs reserved their rights to continue their claim against the insured and excess insurer for amounts over and above the $300,000 primary policy limits. The excess insurer thereafter assumed the defense of the action and settled for $62,500. Subsequently, it sued the primary insurer on the basis of equitable subrogation and unjust enrichment asserting that the claims could have been fully settled within the $300,000 policy limits. The court denied recovery on both theories, stating that the excess insurer's payment to the plaintiffs was in settlement of its own liability, not that of the primary insurer, so there was no basis for subrogation. Moreover, since each insurer settled with plaintiffs by reason of its own policy and therefore its own exposure, no claim could be maintained that the primary insurer had been unjustly enriched.

In Elas v. State Farm Mutual Automobile Insurance Co., the plaintiff, insured, and primary insurer entered into a court-approved settlement in which the primary policy limit of $20,000 was paid to the plaintiff in return for an agreement to hold the insured and primary insurer harmless against recovery above the primary policy limits, while reserving plaintiff's rights against the excess insurer. The excess insurer disclaimed coverage, refused to de-

69. Id. at 586.
70. Id.
72. 379 So. 2d at 758.
73. Id.
75. This was a personal injury action arising out of an automobile accident in which the owner's insurer acted as primary insurer and the driver's policy
fend the insured, and did not participate in the nonjury trial which resulted in a $100,000 judgment in favor of the plaintiff. The court held that the insured and the primary insurer were entitled to make a partial settlement with the plaintiff to protect their own interests where the excess insurer refused to participate in the defense of the action and therefore breached its obligations under the policy. It is significant that the court limited the excess insurer's liability to its policy limits of $30,000, rather than the entire excess judgment, on the grounds that the parties to the settlement relied upon a specific amount of excess insurance. The Elas court found the settlement to be a proper response to the breaches of the policy committed by the excess insurer.

An opposite result was reached in United States Fire Insurance Co. v. Lay, where the excess insurer brought a declaratory judgment action against the primary insurer, the insured, and the administratrix who was the plaintiff in a wrongful death action, in order to be relieved of liability for the judgment rendered in favor of the administratrix. The primary insurer, whose policy coverage was up to $100,000, negotiated a settlement in which it paid $70,000 and was released from any further payments as a result of any judgment. The settlement provided that if a judgment was rendered in excess of $100,000, the primary insurer and insured "were to be given credit' of $100,000 on the judgment 'and any verdict or judgment in excess of . . . ($100,000.00) . . . [would] be marked satisfied within available insurance coverages.' Subsequently, the administratrix filed a wrongful death action against the insured, and an agreed judgment was entered in the sum of $150,000.

The court, in reviewing the provisions of the excess policy, found that the excess insurer was liable only if the insured sustained a loss in excess of the primary policy limits of $100,000. Since the pre-litigation settlement agreement released the insured from liability in excess of $70,000, the insured could not sustain losses in excess of the primary limits; thus the obligation of the

76. Id. at 945-46, 352 N.E.2d at 61.
77. Id. at 948, 352 N.E.2d at 63.
78. 577 F.2d 421 (7th Cir. 1978).
79. The excess insurer knew of and participated in the negotiating of the agreed judgment but was not a party to that agreement. The court found that it was not estopped and did not waive its right to contest its obligations to pay the unsatisfied portion of the judgment. Id.
excess insurer to indemnify its insured did not arise. The court held that the excess insurer’s liability was extinguished by the settlement which released its insured from liability for any amount above the settlement figure of $70,000. The court disapproved of the attempted prejudice to the excess insurer’s rights, stating:

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

E. Recovery of Defense Costs

There is a wide split of authority as to the liability of the primary insurer to the excess insurer for defense costs and attorney’s fees in the underlying action where the primary has wrongfully refused to participate in the defense of the insured. In two cases, the courts denied recovery against the primary on the grounds that both the primary and excess policies independently obligated each insurer to defend its insured and to pay the costs of defense. One court stated: “The duty to defend is personal to each insurer. The obligation is several and the [excess insurer] is not entitled to divide the duty nor require contribution from [the primary] absent a specific contractual right.”

Other courts have permitted recovery of defense costs by the excess against the primary insurer on the grounds that the primary is obligated in the first instance to defend its insured and must not be allowed, by a wrongful refusal to defend the insured, to place the burden of such defense upon the excess insurer. In Farmers Insurance Group v. Progressive Casualty Insurance Co., the court recognized the split of authority as to an excess insurer’s

80. Id. at 423. The court held that the agreed judgment did not purport to impose liability upon the insured and in fact, the wrongful death action instituted by the administratrix was a “sham” since neither the insured nor the primary insurer which purported to defend the action, had any interest in its disposition. Id.

81. Id.


recovery of attorney’s fees and held that the “better rule” was to allow recovery of defense costs as part of the rights to which the excess insurer is equitably subrogated. The court reasoned: “To hold otherwise, would encourage insurers to deny coverage and subsidize refusal to defend. Unless attorney fees can be recovered, insurance companies might profit by unscrupulous tactics.”

Thus courts will penalize a primary insurer for a wrongful failure to provide a defense for the insured by allowing the excess insurer to recover defense costs through the mechanism of equitable subrogation.

IV. THE GUIDING PRINCIPLES FOR PRIMARY AND EXCESS INSURERS

The insurance industry has attempted to resolve the various problems which arise between primary and excess insurers when claims are asserted against their insured by promulgating a set of standards, designated the Guiding Principles, to govern each insurer’s rights and obligations. These principles provide:

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

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

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

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

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

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

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

86. Id. at 486, 269 N.W.2d at 653.

contribution to a settlement within its policy limit from the excess insurer when such contribution is voluntarily offered.

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

(9) The excess insurer shall refrain from coercive or collusive conduct designed to force a settlement. It shall never make formal demand upon a primary insurer that the latter settle a claim within its policy limit. In any subsequent proceeding between excess insurer and primary insurer, the failure of the excess insurer to make formal demand that the claim be settled shall not be considered as having any bearing on the excess insurer's claim against the primary insurer.88

There has been criticism of the Guiding Principles on the grounds that they impair the excess insurer's rights while they create new obligations which do not at present exist by contract or common law. For example, Principle 8 states that if the primary insurer elects not to appeal an adverse judgment, and tenders its policy limit, it will 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. This proposition is directly contrary to the decision in Fidelity General Insurance Co. v. Aetna Insurance Co.,89 which held that an excess insurer was equitably subrogated to the rights of the insured against the primary insurer for the cost of an appeal from an adverse judgment, where there were reasonable grounds for appeal and the primary refused to take such appeal. The court held that the nature of the excess policy made secondary the excess insurer's obligations with regard to an appeal and that the primary insurer held the obligation to take an appeal in circumstances where such appeal was reasonable.

Another departure from insurance industry practice and well established judicial principles is Principle 9, which demands that the excess insurer refrain from making formal demands upon a

89. 27 A.D.2d 932, 278 N.Y.S. 787 (Sup. Ct. 1967).
primary insurer to settle a claim within the primary’s policy limit, and the disregard of such demand in any subsequent proceedings between the primary and excess insurers. Principle 9 attempts to change dramatically the common practice of excess insurers to make such demands for settlement within policy limits upon the primary insurers, as well as to deprive primary insurers from asserting the doctrines of waiver and estoppel where the excess insurer has made no such demands. The Guiding Principles, in seeking to make the relationship between the excess and primary insurers more amicable and less adversarial in nature, seek to modify, and in certain cases, severely limit the rights and remedies of both the primary and excess insurers.

V. CONCLUSION

The courts have developed the doctrine of equitable subrogation to permit an excess insurer to enforce its insured's rights against a primary insurer who has breached its duty to effectuate settlements in good faith. The courts have utilized this doctrine to redress the unfair and prejudicial situation in which a primary’s bad faith refusal to settle causes damage to the excess insurer who cannot control the settlement negotiations in the underlying action. In so doing, the courts have clearly understood the disparity between the position of the primary and excess insurers in the management and control of litigation, in negotiation of settlements, and in the respective premiums charged for each policy. A primary insurer who places its own interests higher than those of the insured and the excess insurer will generally be liable for damages when the excess insurer bears the brunt of the primary insurer's failure to settle in good faith. The rationale of the courts in recognizing this principle is that it will encourage settlement and minimize those instances in which the primary insurer will breach its duty of good faith to its insured and the excess insurer.

Although the courts have made substantial progress in the direction of recognizing the duty of the primary insurer to an excess insurer, further principles need enunciation with regard to the duty of good faith existing between the insured, the primary insurer, and the excess insurer. When a claim is asserted against the insured, the rights and interest of the insured, the primary insurer, and the excess insurer become enmeshed, and it is clear that only the judicial recognition of the interdependence between these three parties will assure that the high standard of good faith will be maintained so that the public policy goals of reasonable settlements of claims will be upheld. We believe that the initial attitude of the California intermediate appellate court, recognizing a tripartite duty between the insured, primary, and excess insurer sets
forth a more realistic expression of rights and duties that would be more conducive to the prompt disposition of litigation. Until this tripartite, reciprocal duty is given judicial support, the interrelationship of the rights and duties of these three parties will remain largely undefined.