DIRECT OR DERIVATIVE RIGHT?

EXPLORING THE PRIMARY/EXCESS INSURER RELATIONSHIP

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Abstract –

A recent review of national case law indicates that only two states, New Jersey and New York, hold that a primary insurer owes a "positive" or direct duty to an excess insurer to act in good faith with respect to settlement within policy limits.[1] In contrast, the remaining states that have addressed this issue, about twenty states to date, reason that an excess insurer's right to proceed against a primary insurer who unreasonably fails to settle within policy limits is a derivative right and vests through the principles of equitable subrogation.[2] Roughly half the states do not appear to have addressed this issue.[3]

Objective –

By examining the legal, economic and public interest principles articulated by courts, this article explores whether the distinction between a "positive" or direct duty and a derivative right is material or word play.

Introduction –

Men are moved by two levers only: fear and self-interest.
- - Napoleon Bonaparte
* * *
We have always known that heedless self-interest was bad morals;
we know now that it is bad economics.
- - President Franklin D. Roosevelt

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1. Identification of the Problem: The Self-Interested Primary Insurer.

Almost universally, courts have identified a conflict of interest between policyholder and primary insurer when a near-policy-limits demand is made. Since a primary insurer controls defense (and with it, settlement), self-interest may motivate a primary insurer to reject a near-policy limits-demand on the hope that a court or jury will award less. As stated by the Seventh Circuit in *Twin City Fire Ins. Co. v. Country Mutual Ins. Co.*, a primary insurer may view such situation as a "[h]eads I win, tails you [the policyholder] lose" proposition.[4] For example:

> Suppose the claim was for $2 million, the policy limit was $1 million, the plaintiff was willing to settle for this amount, but the defendant's insurer believed that if the case was tried the plaintiff would have a 50 percent chance of winning $2 million and a 50 percent chance of losing. The insurer's incentive would be to refuse to settle, since if it lost the trial it would be no worse off than if it settled – in either case it would have to pay $1 million – but if it won it would have saved itself $1 million.[5]

In contrast, it is commonly assumed that "[o]bviously, it will always be in the insured's interest to settle within the policy limits when there is any danger, however slight, of a judgment in excess of those limits."[6] Therefore, the primary insurer's contractually-created, unwavering right to control the defense coupled with a near-policy-limits demand arguably incentivizes the primary insurer's self-interested conduct to save money, i.e., "to gamble with the insured's money."[7]

2. A Solution to the Problem Identified.

To address this problem, courts have universally reasoned that "an insurer should not be permitted to further its own interests by rejecting opportunities to settle within the policy limits unless it is also willing to absorb losses which may result from its failure to settle."[8] "It is in order to quench this kind of temptation that the liability insurer's duty to settle in good faith was read into liability insurance contracts."[9]

> An insurer, in handling the defense of claims against its insured, has a duty to use the same degree of care and diligence as a person of ordinary care and prudence should exercise in the management of his own business. For when the insured has surrendered to the insurer all control over the handling of the claim, including all decisions with regard to litigation and settlement, then the insurer must assume a duty to exercise such control and make such decisions in good faith and with due regard for the interests of the insured.
>
> The good faith duty obligates the insurer to advise the insured of settlement opportunities, to advise as to the probable outcome of the litigation, to warn of the possibility of an excess judgment, and to advise the insured of any steps he might take to avoid same. The insurer must investigate the facts, give fair consideration to a settlement offer that is not

> unreasonable under the facts, and settle, if possible, where a reasonably prudent person, faced with the prospect of paying the total recovery, would do so.[10]

The foundation for this solution was long in place in most jurisdictions: "There is an implied covenant of good faith and fair dealing in every contract that neither party will do anything which will injure the right of the other to receive the benefits of the agreement."[11] Since an insurance policy is a contract, courts did not venture too far in acknowledging its implied covenant with respect to settlement of claims.[12] Other courts have grounded the primary insurer's settlement obligations in the special relationship by which the insurer becomes the "agent" of the insured in handling its defense and making settlement decisions.[13]

The self-interested primary-insurer problem is not exclusive to policyholders. Courts have recognized that primary insurers conduct affects excess insurers as well.[14] However, the solution with respect to excess insurers has been more complicated. For example, generally speaking, no contract exists between primary and excess insurers, and the primary insurer does not undertake the defense of the excess insurer. Therefore, the foundations so readily available in the policyholder/primary insurer context does not exist. Nevertheless, to date, courts have fashioned two remedies.

a. A Derivative Rights Approach.

A majority of states conclude, at least within the context of settlement, that a primary insurer owes a duty of good faith to an excess insurer; such duty, however, is derivative. As stated by the California Supreme Court:

> This rule, however, is based on the theory of equitable subrogation: Since the insured would have been able to recover from the primary carrier for a judgment in excess of policy limits caused by the carrier's wrongful refusal to settle, the excess carrier, who discharged the insured's liability as a result of this tort, stands in the shoes of the insured and should be permitted to assert all claims against the primary carrier which the insured himself could have asserted. . . . Hence, the rule does not rest upon the finding of any separate duty owed to an excess insurance carrier.[15]

Equitable subrogation is defined as a "legal fiction through which a person who pays a debt for which another is primarily responsible is substituted, or subrogated, to all rights and remedies of other."[16] A California court has identified essential elements of equitable subrogation:

(a) The insured suffered a loss for which the defendant [i.e., primary insurer] is liable, either as the wrongdoer whose act or omission caused the loss or because the defendant is legally responsible to the insured for the loss caused by the wrongdoer;

(b) The claimed loss was one for which the [excess] insurer was not primarily liable;

(c) The [excess] insurer has compensated the insured in whole or in part for the same loss for which the defendant [i.e. primary insurer] is primarily liable;

(d) The [excess] insurer has paid the claim of its insured to protect its own interest and not as a volunteer;

(e) The insured has an existing, assignable cause of action against the defendant which the insured could have asserted for its own benefit had it not been compensated for its loss by the [excess] insurer;

(f) The [excess] insurer has suffered damages caused by the act or omission upon which the liability of the defendant depends;

(g) Justice requires that the loss be entirely shifted from the [excess] insurer to the defendant [i.e., primary insurer], whose equitable position is inferior to that of the [excess] insurer; and

(h) The [excess] insurer's damages are in a liquidated sum, generally the amount paid to the insured.[17]

Equitable subrogation, therefore, provides a literal, or at least a *more* literal, connection to the insurance policy—the contract within which the primary insurer expressly takes control of the policyholder's defense: "We will have the right and duty to defend the insured against any suit seeking those damages."[18]

Why do the majority of states tie or otherwise limit an excess insurer's rights against a primary insurer to the insurance policy itself? Overall, courts have reasoned:

(1) Absent a contract between a primary and excess insurer, an excess insurer lacks standing to sue the primary insurer directly.[19]

(2) Judicial recasting of the *contractual* duty of good faith and fair dealing as a tort subverts proper application of equitable subrogation.[20]

(3) The reasons that support a tort-based cause of action in the policyholder against his or her primary insurer for failing to settle within policy limits do not exist between a primary and excess insurer, for example:

(a) The policyholder "expressly relinquishes to the [primary] insurer the right to control the defense and settlement of any action," so the insured must rely on the primary insurer's good faith. However, excess insurers generally reserve in their policies the right to participate in defense and settlement of claims.[21]

(b) Differences in bargaining power.

(i) The insurance policy shifts financial risk from the policyholder, with minimal litigation experience, to the primary insurer, with substantial litigation experience. However, primary and excess insurers "stand on more equal footing." Each has litigation experience. "Without a contract, there can be no contractual shifting of financial risk" between them.[22]

(ii) Excess insurance, by its nature, can eliminate or at least reduce risk it faces with respect to excess judgments by pooling the risk of many policyholders. A policyholder cannot do that. A policyholder can only buy insurance to reduce or eliminate risk of personally owing a judgment.[23]

(4) Equitable subrogation provides an excess insurer an adequate remedy.[24]

(5) Imposing on the primary insurer a direct duty to the excess insurer could impose conflicting duties, especially where the insured urges rejection of a settlement offer it believes is not in its long-term interests.[25]

(6) An excess insurer can protect itself. "For instance, an excess insurer can provide in its contract that it may control the defense whenever potential for excess liability exists," require notice of suits, and require that all settlements be approved by it.[26]

(7) A resistance to parentalism over insurance companies. As the Seventh Circuit queried but did not address: "Should courts strain to create novel tort duties on behalf of insurance companies? Do insurance companies need the protection of tort law against their own insureds and other insurance companies?"[27]

In sum, absent an express contract between primary and excess insurers, the majority of courts seem to resist creation of what they apparently view as a novel tort because the law already provides an adequate and firmly rooted remedy—equitable subrogation.

A core principle of equitable subrogation is that the excess insurer has only those rights against the primary insurer that are held by their mutual insured; the primary insurer can assert against the excess any defense it could assert against the insured.[28] In the settlement context, if the primary insurer's refusal to settle within primary limits was done at the insured's insistence, or with its approval, neither the insured nor the excess insurer can successfully maintain a bad faith claim against the primary insurer.[29]

The Supreme Court of Alabama has applied a particularly strict version of this rule. In *Federal Insurance Co. v. Travelers Casualty & Surety Co.*,[30] the excess insurer (Federal) paid $3.6 million of a $4.6 million post-judgment settlement of a case that apparently could have been settled before trial for $350,000. Federal sued Travelers, the primary carrier, for breaching its duty to settle within its $1 million primary limits. After holding Travelers owed no duty directly to Federal, the Alabama Supreme Court held that Federal also could not recover under equitable subrogation, because the settlement on appeal meant that the insured was "never subject to a final judgment ordering the payment of money that [the insured] personally—and not [its] insurer—would have to pay."[31]

b. A "Positive" or Direct-Duty Approach.

In contrast to the majority of states, New Jersey and New York have affirmatively concluded that a primary insurer owes a "positive" or direct duty to an excess insurer.[32]

i. New Jersey – A Counterpose.

a) 1977 – *Estate Of Penn.*

The seminal New Jersey decision holding that a primary insurer owes a direct duty of good faith and fair dealing to an excess insurer is *Estate of Penn v. Amalgamated General Agencies*.[33] In *Penn*, the New Jersey Appellate Division held "that the primary carrier owes to the excess carrier the same positive duty to take the initiative and attempt to negotiate a settlement within its policy limit that it owes to its assured."[34]

In *Penn*, Penn was sued by four individuals who alleged injury resulting from a motor vehicle accident. Penn was insured by Empire Mutual for $10,000/$20,000. On the excess level, Penn was insured by Western World for $90,000/$280,000. As the primary insurer, Empire Mutual assumed Penn's defense. Prior to trial, the claimants offered to settle for about $11,000. Empire Mutual rejected the settlement demand. Following a jury trial, a $30,000 or so judgment was entered against Penn.

In a concurrent policyholder/insurer action, the trial court denied Western World judgment against Empire Mutual for failing to settle within policy limits. The trial court reasoned that a primary insurer does not owe an excess insurer the same duty of good faith and fair dealing owed to the policyholder. Western World appealed. On appeal, the appellate court reversed the trial court, holding that "Western World, as the excess carrier, has precisely the same status as the assured Penn for purposes of this action."[35] The appellate court based its conclusion on *Fireman's Fund Ins. Co. v. Security Ins. Co. of Hartford*,[36] and "[t]he general rule under which the excess carrier is subrogated to the assured's rights against the primary carrier."[37]

Interestingly, the *Penn* court provides no detailed discussion of the *Fireman's Fund* decision. Upon examination, the *Fireman's Fund* court expressly stated that the excess insurer sued as an assignee of the insured and that "[t]he parties agree that plaintiff's status is no different than that of the insured and that no additional rights flow to it because it was an excess insurer."[38] Thus, arguably, the leading New Jersey decision is based on equitable subrogation principles, not an independent tort cause of action. Further, in support of its conclusion, the *Penn* court relied on a federal district court of California decision that squarely applied equitable subrogation in the primary/excess insurer context.[39] Putting aside the legal principle actually applied, the *Penn* court's reasons for its holding are plain:

(1) No Increase of Risk to the Primary Insurer.

"The primary carrier's duty arises by way of a contract with the insured, and this duty is not reduced merely because of another contract between the insured and its excess insurer. 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 liability of the primary."[40]

(2) Prevent Increase in Excess Insurance Premiums.

"While the interests of the primary insurer are, for the most part, unaffected by the existence of excess coverage, the interests of the excess carrier are very much affected by the actions of the primary. If the primary carrier undertakes the representation of the insured, then it has the sole right to negotiate settlements. If the primary carrier is relieved of its duty to accept reasonable offers by the existence of excess insurance, it would put an additional financial liability on the excess carrier which would be reflected in increased premiums."[41]

(3) Encourage the Prompt and Just Settlement of Claims.

"If the primary carrier is relieved of its duty to accept reasonable offers by the existence of excess insurance, it would […] have the effect of reducing the incentive of a primary insurer to settle when the settlement offer is near or over its policy limits. This is contrary to the interests of the public and the insured in obtaining prompt and just settlement of claims."[42]

As noted, the *Penn* Court adopted these reasons from a California federal district decision based on equitable subrogation. While these reasons may justify subrogating an excess insurer to a policyholder's rights against a primary insurer, are they sufficient to justify creation of a "positive" or direct duty?

b) 1995 – *Warner-Lambert*.

In 1995, the Law Division of the New Jersey Superior Court affirmed and significantly extrapolated on the bases that arguably support imposing a "positive" or direct duty on a primary insurer towards an excess insurer in *American Centennial Ins. Co. v. Warner-Lambert Co.*[43] found that the primary breached its duty to the excess by allowing their mutual insured to control "all litigation and negotiation maneuvers."[44] In sum, the court established three pillars on which the duty is based, as follows:

(1) Unique Relationship.

As a first pillar supporting a direct duty, the court relied on the "unique" relationship between primary and excess insurers:

The primary insurer has certain duties and obligations that it owes to the excess insurer as a result of the distinctive relationship between the two carriers. 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:

[a] discharging its claims handling obligations;

[b] discharging its defense obligations;

[c] properly disclosing and apprising the excess carrier of events which are likely to affect that carrier's coverage; and

[d] safeguarding the rights and interests of the excess carrier by not placing the primary carrier's own interests above that of the excess insurer. The actions of the primary carrier can affect the rights of the excess carrier.[45]

(2) <u>A Contract.</u>

As a second pillar supporting a direct duty, the court *found* what the majority of states conclude is lacking – a contract between the primary and excess insurer:

> The insurance industry has promulgated an industry contract known as the "The Guiding Principles for Primary and Excess Insurance Companies." The Guiding Principles offer a uniform set of rules to govern the relationships between primary and excess insurers, and both Continental and ACIC are signatories to the Principles. The Principles provide[:]
>
> > It is implicit in these guiding principles that the primary insurer in its dealings with an excess insurer voluntarily adopt those standards of conduct which the law imposes upon the primary insurer in its dealings with its insured.
>
> The Guiding Principles provide nine different obligations which define the relationship between the primary and excess carriers. The following five are relevant to these proceedings:
>
> > [a] 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.
> >
> > [b] 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.
> >
> > [c] Evaluation must be realistic and without regard

to the policy limit.

[d] 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.

[e] 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.

The Guiding Principles can be used to establish the standard of care which a primary insurer must use when settling a claim where an excess insurer may also ultimately be responsible for coverage.[46]

(3) Common Law.

As a final, third pillar supporting a direct duty, the Law Division held that common law principles warrant finding a direct duty:

> Basic principles of tort law require imposing a duty of good faith on the primary carrier. Under New Jersey law, the question of whether a duty of care exists "is largely a question of fairness or policy," and it is for the court to decide if the duty exists. . . . "The inquiry involves a weighing of the relationship of the parties, the nature of the risk and the public interest in the proposed solution." . . . Fairness and policy require the imposition of a duty of good faith on the primary carrier.
>
> The primary is in a knowledgeable position as it has current information of the status of an underlying claim, while the excess carrier relies on the primary carrier to keep it properly apprised of negotiation and litigation. It is a unique relationship between the parties, and it is reasonable for the excess carrier to rely on the primary carrier to act in good faith. The primary carrier should understand the risk involved to the excess carrier if it does not perform its duties in good faith. The excess carrier charges the insured a premium that assumes the primary carrier will act in good faith to settle and litigate claims, thereby decreasing the excess carrier's exposure to risk. When the primary carrier does not perform its duties in good faith, the public suffers, as excess carriers will then charge higher premiums for excess coverage.[47]

c) 1999 – *Baen*.

Two years after publication of *Warner-Lambert*, the New Jersey Appellate Division, in *Baen v. Framers Mutual Fire Ins. Co. of Salem County*, affirmed that "[a]n insurer owes its insured the duty to exercise good faith in handling claims" and that "[t]he primary carrier owes the excess carrier the same positive duty it owes its insured, to take the initiative and attempt to negotiate a settlement within its policy limit."[48] The *Baen* Court relied, in part, on the *Penn* and *Warner-Lambert* decisions. While the *Baen* Court distinguished the matter before it, the court nevertheless stated it was "in accord with the reasoning and result" in the *Warner-Lambert* case.

In light of *Baen* and pending further input from the New Jersey Supreme Court, New Jersey is and remains a "positive" or direct duty state for the reasons stated.

ii. New York

New York is likewise a "direct duty" state, according to *Hartford Accident & Indemnity Co. v. Michigan Mutual Ins. Co*.[49] The Appellate Division held in 1983 that "the primary carrier owes to the excess insurer the same fiduciary obligation which the primary insurer owes to its insured."[50] This duty of good faith "requires a primary insurer to give as much consideration to the excess carrier's interests as it does to its own."[51] The obligation "arises as a result of the independent and direct duty to the excess insurer and is not dependent upon equitable principles of subrogation."[52] The justification for adopting the direct duty rule offered by the *Hartford* court was that it had "been recognized in [New York] and other States, as well as in the Federal courts."[53] At least one New York court has held that it can be bad faith for a primary carrier to handle its insured's defense in a manner that is arguably in the insured's best interest (as well as its own), but causes the excess insurer to bear more of the loss.[54]

CONCLUSION

This article started with the objective of exploring whether the distinction between a "positive" or direct duty and a derivative right is material or word play.

Judge Posner in *Twin City* downplayed the difference between equitable subrogation and direct duty. He acknowledged that if the primary insurer failed to settle a lawsuit in deference to the insured's wishes, equitable subrogation would preclude a claim against the primary by the excess.[55] But he suggested that if "the insured was acting irresponsibly in pressing the case to trial, the excess insurer" might "have a contract defense to the insured's claim against it," because the "duty of good faith between insured and insurer is a reciprocal one."[56] He criticized as "obtuse" two courts who "had trouble seeing this"—California and Texas, both of which had found that an insured generally owes no duty to its excess insurer to settle a lawsuit for an amount below the excess layer.[57] The only case cited for the Seventh Circuit's position was the short-lived *Spinks* decision by a California appellate court which—besides having been disapproved by the California Supreme Court—rejected equitable subrogation and would have imposed direct duties on each of the parties, under a theory it dubbed "triangular reciprocity."[58] Unless courts widely adopt the broad statement of duties described in *Twin City* and *Spinks,* the excess insurer's inability to pursue claims against the primary insurer based on actions or positions taken by their mutual insured remains a material distinction between the direct-duty approach and equitable subrogation.

In short, by exploring the legal, economic, and public interest principles articulated in case law, this paper finds an apparent consensus that while under limited circumstances (namely, policyholder conduct impairing equitable subrogation rights) a material distinction may exist, it remains insufficient to warrant judicial creation of a new tort by which a primary insurer owes duties directly to the excess insurer. The majority of courts that have considered these issues have concluded an excess insurer is best situated to protect its own interests: Either through equitable subrogation (preserving the public's interest in prompt and just settlements), active participation in defense and settlement of claims, or policy language (such as consent to settlement, notice, or cooperation provisions).

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1 *See, e.g.*, *Estate of Penn v. Amalgamated Gen. Agencies*, 372 A.2d 1124, 1127 (N.J. Super. Ct. App. Div. 1977); *Am. Centennial Ins. Co. v. Warner-Lambert Co.*, 681 A.2d 1241, 1246 (N.J. Super. Ct. Law Div. 1995); *Hartford Accident & Indem. Co. v. Michigan Mut. Ins. Co*., 93 A.D.2d 337, 341 (N.Y. App. Div. 1983).

2 *See, e.g., Steadfast Ins. Co. v. Agric. Ins. Co*., 548 Fed. App'x 544, 546 (10th Cir. 2013) (applying Oklahoma law and relying on *Niemeyer v. United States Fid. & Guar. Co.*, 789 P.2d 1318, 1322 (Okla. 1990)); *Reliance Ins. Co. v. Chitwood*, 433 F.3d 660, 664. (8th Cir. 2006) (applying Missouri law); *Evanston Ins. Co. v. Stonewall Surplus Lines Ins. Co.*, 111 F.3d 852, 858-59 (11th Cir. 1997) (applying Georgia law); *Puritan Ins. Co. v. Canadian Universal Ins. Co.*, 775 F.2d 76, 80-81 (3d Cir. 1985) (applying Pennsylvania law); *Auto-Owners Ins. Co. v. Am. Yachts, Inc.*, 492 F. Supp. 2d 1379, 1386 n.6 (S.D. Fla. 2007); *Elec. Ins. Co. v. Nationwide Mut. Ins. Co.*, 384 F. Supp. 2d 1190, 1194 (W.D. Tenn. 2005); *PHICO Ins. Co. v. Aetna Cas. & Sur. Co. of Am.*, 93 F. Supp. 2d 982, 989 (S.D. Ind. 2000)*; Saint Paul Fire & Marine Ins. Co. v. Continental Ins. Co.*, No. HAR 88-3487, 1993 U.S. Dist. LEXIS 6556, *25-28 (D. Md. May 10, 1993); *Fed. Ins. Co. v. Travelers Cas. & Sur. Co*., 843 So.2d 140, 143 (Ala. 2002); *Twin City Fire Ins. Co. v. Superior Court*, 792 P.2d 758, 760 (Ariz. 1990); *Commercial Union Assurance Cos. v. Safeway Stores, Inc.*, 610 P.2d 1038, 1041 (Cal. 1980) (overruling *Transit Cas. Co. v. Spink Corp.* 156 Cal. Rptr. 360 (Cal. Ct. App. 1979)); *Infinity Ins. Co. v. Worcester Ins. Co.*, CV000597436, 2000 Conn. Super. LEXIS 3392, *3-4 (Conn. Super. Ct., Dec. 4, 2000); *United States Fire Ins. Co. v. Zurich Ins. Co.*, 768 N.E.2d 288, 299-300 (Ill. App. Ct. 2002); *Great Southwest Fire Ins. Co. v. CNA Ins. Cos.*, 547 So.2d 1339, 1344-46 (La. Ct. App. 1989); *Hartford Cas. Ins. Co. v. New Hampshire Ins. Co.*, 628 N.E.2d 14, 19 & n.7 (Mass. 1994) (recognizing that general rule is equitable subrogation but reserving judgment on direct duty issue*); Commercial Union Ins. Co. v. Medical Protective Co.*, 393 N.W.2d 479, 485 (Mich. 1986) (reserving right to reconsider direct duty issue under more particular circumstances*)*; *Allstate Ins. Co. v. Reserve Ins. Co.* 373 A.2d 339, 340 (N.H. 1976); *Maine Bonding & Cas. Co. v. Centennial Ins. Co.*, 693 P.2d 1296, 1301-02 (Or. 1985) (describing the duty in the context of equitable subrogation); *American Centennial Ins. Co. v. Canal Ins. Co.*, 843 S.W.2d 480, 483 (Tex. 1992); *Truck Ins. Exch. v. Century Indem. Co.*, 887 P.2d 455, 460 (Wash. Ct. App. 1995); *Kranzush v. Badger State Mut. Cas. Co.*, 307 N.W.2d 256, 260-61 (Wis. 1981);

see also Hartford Accident & Indem. Co. v. Aetna Cas. & Sur. Co., 792 P.2d 749, 752-53 nn. 2, 3 (Ariz. 1990) (surveying national case law as of 1990).

3 Alaska, Arkansas, Colorado, Delaware, Hawaii, Idaho, Iowa, Kansas, Kentucky, Maine, Minnesota, Mississippi, Montana, Nebraska, Nevada, North Carolina, Ohio, Rhode Island, South Carolina, South Dakota, Utah, Vermont, and West Virginia.

4 23 F.3d 1175, 1179 (7th Cir. 1994) (applying Illinois law).

5 *Id.*

6 *Crisci v. Security Ins. Co.*, 426 P.2d 173, 176-77 (Cal. 1967). That insureds do not *always* consider settlement within primary limits to be in their interest is shown by later decisions by the same court. *See, e.g., Commercial Union Assurance Cos. v. Safeway Stores, Inc.*, 610 P.2d 1038, 1042-43 (Cal. 1980).

7 *Crisci,* 426 P.2d at 177; *see also Twin City*, 23 F.3d at 1179 ("A standard provision in liability-insurance contracts gives the insurer control over the defense of any claim against the insured, and an implied correlative of this right is the duty not to gamble with the insured's money by foregoing reasonable opportunities to settle a claim on terms that will protect the insured against an excess judgment.").

8 *Crisci,* 426 P.2d at 177.

9 *Twin City*, 23 F.3d at 1179.

10 *Auto-Owners Ins. Co. v. Amer. Yachts, Inc.*, 492 F. Supp. 2d 1379, 1380-81 (S.D. Fla. 2007) (quoting *Boston Old Colony Ins. Co. v. Gutierrez*, 386 So.2d 783, 785 (Fla. 1980)).

11 *Comunale v. Traders & Gen. Ins. Co*., 328 P.2d 198, 200-01 (Cal. 1958) (citing *Brown v. Superior Court*, 212 P.2d 878 (Cal. 1949)).

12 *Id.* (citing *Hilker v. Western Automobile Ins. Co*., 231 N.W. 257, 258 (Wis. 1930), *aff'd on rehg.*, 235 N.W. 413 (Wis. 1931), for the proposition the "the rights of the insured 'go deeper than the mere surface of the contract written for him by defendant' and that implied obligations are imposed 'based upon those principles of fair dealing which enter into every contract'").

13 *See, e.g*., *Ranger Cnty. Mut. Ins. Co. v. Guin*, 723 S.W.2d 656, 659 (Tex. 1987). Texas has steadfastedly refused to impose a duty of good faith and fair dealing on the parties to every contract. *See FDIC v. Coleman*, 795 S.W.2d 706, 709 (Tex. 1990); *English v. Fischer*, 660 S.W.2d 521, 522 (Tex. 1983).

14 *See, e.g., Twin City*, 23 F.3d at 1179 ("By virtue of an excess insurance policy the victim of the behavior that we have described is the excess insurer rather than the insured."); *Warner-Lambert*, 681 A.2d at 1246 ("The actions of the primary carrier can affect the rights of the excess carrier.").

15 *Commercial Union Assurance Cos. v. Safeway Stores, Inc.*, 610 P.2d 1038, 1041 (Cal. 1980), *overruling Transit Cas. Co. v. Spink Corp.* 156 Cal. Rptr. 360 (Cal. Ct. App. 1979).

16 Black's Law Dictionary 539 (6th ed. 1990).

17 *Firemans Fund Ins. Co. v. Maryland Cas. Co.*, 77 Cal. Rptr. 2d 296, 303 (Cal. Ct. App. 1998).

18 Insurance Services Office, Commercial General Liability Coverage Form, CG 0001 (04/13).

[19] *See*, *e.g.*, *Infinity Ins. Co. v. Worcester Ins. Co.*, CV000597436, 2000 Conn. Super. LEXIS 3392, *3-4 (Conn. Super. Ct., Dec. 4, 2000) ("It is well settled that one who [is] neither a party to a contract nor a contemplated beneficiary thereof cannot sue to enforce the promises of the contract."); *see also Evanston Ins. Co. v. Stonewall Surplus Lines Ins. Co.*, 111 F.3d 852, 858 (11th Cir. 1997) (quoting *Kranzush v. Badger State Mut. Cas. Co.*, 307 N.W.2d 256, 260-61 (Wis. 1981), for the proposition that "our cases indicate that the insurer's duties of diligent investigation, notice of excess liability potential, and communication of settlement offers runs to the insured, and the cause of action upon their breach belongs to the insured. In every one of our excess liability bad faith cases the plaintiff is either the insured or the assignee of the insured's claim.").

[20] *Twin City*, 23 F.3d at 1180 ("[M]any courts have recast the implied contractual duty of good faith settlement as a tort duty . . . . Once the duty is thus preconceived, it is easy to imagine it running to any excess insurer as well as to the insured, at least if the primary insurer knows . . . that there is an excess insurer in the picture. When this step is taken, the doctrine of equitable subrogation falls out of the picture.").

[21] *See*, *e.g.*, *Federal Ins. Co. v. Travelers Cas.& Surety Co.*, 843 So.2d 140, 143 (Ala. 2002) (no evidence that the excess insurer relinquished the right to control defense and settlement; in fact, excess insurer expressly reserved such right).

[22] *Id.*

[23] *Twin City*, 23 F.3d at 1179 ("The insured, at least if an individual, will be risk averse – that is why he buys insurance – while the insurance company eliminates risk by pooling the risks of many insureds.").

[24] *See*, *e.g.*, *Twin City Fire Ins. Co. v. Superior Court*, 792 P.2d 758, 759-60 (Ariz. 1990) (but stating "[a]dmittedly, there may be times when equitable subrogation is not an adequate remedy for the excess carrier," for example "recovery by the excess insurer may be barred in the event of wrongful conduct of the insured"); *see also Auto-Owners Ins. Co. v. Am. Yachts, Inc.*, 492 F. Supp. 2d 1379, 1385 (S.D. Fla. 2007) (where insured is released and no rights are reserved, excess insurer cannot maintain claim against primary insurer).

[25] *See, e.g.*, *Dresser*, 841 S.W.2d at 446 ("We decline to impose on [the primary insurer] a duty to wrench control of the . . . lawsuit away from Dresser and settle it against Dresser's will on terms favorable to [the excess insurer]."); *Twin City*, 23 F.3d at 1180 (imposing a direct duty to the excess insurer on the primary insurer "would place the latter in the uncomfortable position of facing a tort suit for bad faith if it settled the case and a tort suit for bad faith if it tried the case").

[26] *Twin City Fire Ins. Co. v. Superior Court*, 792 P.2d 758, 760 (Ariz. 1990) (relying on *Safeway Stores*, 610 P.2d at 1041 ("[I]f an excess carrier wishes to insulate itself from liability for an insured's failure to accept what it deems to be a reasonable settlement offer, it may do so by appropriate language in the policy.")).

[27] *Twin City*, 23 F.3d at 1180-81 ("We need not answer these questions. It is enough that the arguments in favor of the direct duty are not so compelling that we could responsibly predict that the Supreme Court of Illinois would buck the national trend and declare that under the common law of Illinois a primary insurer has a direct duty, actionable in tort, against the excess insurer.").

[28] *See Twin City*, 23 F.3d at 1180; *Safeway Stores*, 610 P.2d at 1041; *Evanston Ins. Co. v. Stonewall Surplus Lines Ins. Co.*, 111 F.3d 852, 859 (11th Cir. 1997) (applying Georgia

law); *Puritan Ins. Co. v. Canadian Universal Ins. Co.*, 775 F.2d 76, 80-81 (3d Cir. 1985) (applying Pennsylvania law).

[29] *Safeway Stores*, 610 P.2d at 1041; *Am. Centennial*, 843 S.W.2d at 483; *Stonewall Surplus Lines*, 111 F.3d at 860; *Twin City*, 792 P.2d at 759-60; *Puritan,* 775 F.2d at 80.

[30] 843 So.2d 140 (Ala. 2002).

[31] *Id*. at 145.

[32] *Estate of Penn v. Amalgamated Gen. Agencies*, 372 A.2d 1124, 1127 (N.J. Super. Ct. App. Div. 1977); *Am. Centennial Ins. Co. v. Warner-Lambert Co.*, 681 A.2d 1241, 1246 (N.J. Ch. 1995); *Hartford Acc. & Indem. Co. v. Michigan Mut. Ins. Co*., 93 A.D.2d 337, 341 (N.Y. App. Div. 1983).

[33] *Estate of Penn*, 372 A.2d at 1127.

[34] *Id.*

[35] *Id.* at 1126.

[36] 367 A.2d 864, 866-67 (N.J. 1976).

[37] *Estate of Penn*, 372 A.2d at 1126.

[38] *Fireman's Fund*, 367 A.2d at 866 n.1.

[39] *Estate of Penn*, 372 A.2d at 1126 (quoting *Peter v. Travelers Ins. Co.*, 375 F. Supp. 1347, 1350-51 (C.D. Cal. 1974)).

[40] *Id.*

[41] *Id.*

[42] *Id.*

[43] 681 A.2d 1241 (N.J. Ch. 1995). Although it did not expressly rely on it, the *Warner-Lambert* decision mirrors the reasoning applied in the 1979 California appellate court decision in *Transit Cas. Co. v. Spink Corp.* 156 Cal. Rptr. 360 (Cal. Ct. App. 1979), *overruled by Safeway Stores*, 610 P.2d 1038 (Cal. 1980). In *Spink*, due to a policyholder's refusing to consent to a settlement, the primary insurer argued that it had a complete defense to the excess insurer's equitable subrogation claim for failing to settle. In response, the *Spink* court reasoned that "[e]nforceable norms of conduct need not depend upon the ancient artificiality of equitable subrogation. Good conscience was its progenitor. Good conscience is satisfied when reciprocal care forms the law's prime demand." 156 Cal. Rptr. at 369. The *Spink* court then founded a direct duty on the unique relationship of policyholder, primary insurer, and excess insurer (coining the term "triangular reciprocity"). *Id.* at 367. However, the *Spink* decision was overruled one year later by the California Supreme Court in the *Safeway Stores* decision.

[44] *Warner-Lambert*, 681 A.2d at 1248. Apparently the excess was not aware of the insured's role in "processing the claim." *Id*. at n.3.

[45] *Id.* at 1246.

[46] *Warner-Lambert*, 681 A.2d at 1246. A Texas court, noting that the Guiding Principles directs the excess insurer never to "make formal demand upon a primary insurer that the latter settle a claim within its policy limit," held that "the Guiding Principles do not impose upon the primary insurer . . . a duty to the excess insurer to settle underlying litigation within primary limits." *Int'l Ins. Co. v. Dresser Indus., Inc*., 841 S.W.2d 437, 443 (Tex.

App.—Dallas 1992, writ denied).

[47] *Warner-Lambert*, 681 A.2d at 1247.

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

[49] 93 A.D.2d 337 (N.Y. App. Div. 1983)*, aff'd*, 463 N.E.2d 608 (N.Y. 1984).

[50] *Id.* at 341.

[51] *Fed. Ins. Co. v. N. Am. Specialty Ins. Co*., 83 A.D.3d 401, 402 (N.Y. App. Div. 2011).

[52] *Hartford*, 93 A.D.2d at 342.

[53] *Id.* at 341 (citing cases).

[54] *Fed. Ins. Co*., 83 A.D.3d at 402; *see also id*. at 406-07 (McGuire, J., dissenting).

[55] *Twin City*, 23 F.3d at 1180.

[56] *Id*.

[57] *Id*. (citing *Safeway Stores, Inc.*, 610 P.2d at 1041-42, and *Dresser*, 841 S.W.2d at 444-45). As noted above, Texas does not impose reciprocal "good faith" obligations on all contracting parties; the insurer's duties arise from the agency relationship arising from the policy. *See supra* n.13 and accompanying text. The California Supreme Court, while acknowledging "that a duty of good faith and fair dealing in an insurance is a two-way street," insisted that the scope of each party's duty "is dependent upon the nature of the bargain struck . . . and the legitimate expectations of the parties which arise from the contract." *Safeway Stores*, 610 P.2d at 1041.

[58] *Id.* (citing *Transit Casualty Co. v. Spink Corp.*, 156 Cal. Rptr. 360, 364-65 (Cal. Ct. App. 1979)).