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Extension of the Stowers Doctrine to Excess Carriers - Some Proposals and Practical Suggestions.

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ARTICLE

EXTENSION OF THE STOWERS DOCTRINE TO EXCESS CARRIERS—SOME PROPOSALS AND PRACTICAL SUGGESTIONS

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I. INTRODUCTION

In the typical insurance contract, the primary carrier not only agrees to pay an adverse judgment against the insured up to the

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policy limits, but also agrees to provide a defense for the insured.[1] The primary carrier also generally reserves the right to control the settlement of the claim.[2] Because of the dire consequences of a lawsuit against the insured, the primary carrier is charged with a duty to act with due care in regard to the settlement of the suit to protect the insured from a verdict in excess of the primary policy limits.[3] If the primary carrier negligently refuses to accept a settlement offer or to negotiate a settlement, it may be liable to the insured for a verdict even though such verdict exceeds the limits of the primary policy.[4] Whether under similar circumstances the primary carrier may be liable to an excess insurance carrier for the amount of the verdict beyond the primary policy limits is a question yet to be addressed by Texas courts.

This article will discuss case law in other jurisdictions which recognizes a cause of action in favor of an excess insurance carrier against a primary carrier for wrongful failure to settle a claim against the insured. Additionally, the article suggests a logical standard of proof and measure of damages which could be adopted by a Texas court when presented with such a case. Finally, this article sets forth a practical approach for litigants involved in such an action.

II. Recognizing a Cause of Action in Favor of an Excess Insurance Carrier Against a Primary Carrier for Wrongful Failure To Settle

A. *Other Jurisdictions*

The majority of jurisdictions which have considered this issue recognize a cause of action in favor of an excess carrier against a primary carrier for wrongfully failing to settle within the primary

1. *See, e.g.,* Lanoue v. Fireman's Fund Am. Ins. Cos., 278 N.W.2d 49, 52 (Minn. 1979) (insurer's duty to defend broader than duty to indemnify); Spitler v. State Auto. Mut., Inc., 400 N.E.2d 889, 892 (Ohio 1980) (duty to defend insured); Sloan Const. Co. v. Central Nat'l Ins. Co., 236 S.E.2d 818, 821 (S.C. 1977) (insurer has duty to defend insured).

2. *See* Farmers Ins. Exch. v. Schropp, 567 P.2d 1359, 1365 (Kan. 1977).

3. *See* Manieri v. Horace Mann Mut. Ins. Co., 350 So. 2d 1247, 1248 (La. Ct. App. 1977).

4. *See* Hodges v. State Farm Mut. Auto. Ins. Co., 488 F. Supp. 1057, 1063 (D.S.C. 1980).

policy limits.[5] Consequently, a primary carrier may not shift the entire risk of the excess loss to the excess carrier by its own negligent conduct in settling the suit. Most courts reason that since there is a duty to protect the insured from an excess verdict, there should not be a different result merely because the insured purchases excess insurance.[6] Further, allowing the excess carrier to recover the amount of the excess verdict from a primary carrier that wrongfully refuses to settle should provide an incentive that will promote more efficient settlement of claims.[7] One of the few jurisdictions that does not recognize a cause of action in favor of the excess carrier is the state of Arizona.[8] Although stating that the primary carrier owes a duty to the insured to settle claims within the policy limits, the Arizona Supreme Court refused to extend this duty to the excess carrier in the absence of privity of contract between the primary carrier and the excess carrier.[9]

B. *Texas*

There are no Texas decisions which squarely deal with the issue of whether the excess carrier has a cause of action against the primary carrier for wrongful failure to settle a claim. Texas has long

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5. *See, e.g.,* Ranger Ins. Co. v. Travelers Indem. Co., 389 So. 2d 272, 274-76 (Fla. Dist. Ct. App. 1980) (excess carrier may sue primary carrier under theory of equitable subrogation); Continental Casualty Co. v. Reserve Ins. Co., 238 N.W.2d 862, 864 (Minn. 1976) (excess carrier subrogated to rights of insured in action against primary carrier); Centennial Ins. Co. v. Liberty Mut. Ins. Co., 404 N.E.2d 759, 762 (Ohio 1980) (excess carrier entitled to sue primary carrier for breach of duty to settle). *See generally* Annot., 10 A.L.R. 4th, 881-82 (1981) (collection of jurisdictions recognizing such an action).

6. *See* Valentine v. Aetna Ins. Co., 564 F.2d 292, 297-98 (9th Cir. 1977) (quoting Peter v. Travelers Ins., 375 F. Supp. 1347, 1350 (C.D. Cal. 1974)). In *Valentine,* the court explained the fact that "an excess insurer may recover fom the primary [carrier] for a breach of duty does not increase the duty or the liability of the primary [carrier]. Under the doctrine of equitable subrogation, the duty owed an excess insurer is identical to that owed the insured." *Id.* at 298.

7. *See* Continental Casualty Co. v. Reserve Ins. Co., 238 N.W.2d 862, 864-65 (Minn. 1976). The court in *Continental Casualty* noted that disallowing such an action "imperils the public and judicial interests in fair and reasonable settlements of lawsuits." *Id.* at 864-65.

8. *See* Universal Underwriters Ins. Co. v. Dairyland Mut. Ins. Co., 433 P.2d 966, 968 (Ariz. 1967).

9. *See id.* at 968. In *Universal Underwriters,* the excess carrier had to step in and defend the insured when the primary carrier wrongfully refused to do so. The excess carrier settled the lawsuit outside the limits of the primary policy. The court allowed the excess carrier to recover from the primary carrier the limit of the primary policy, but did not permit recovery of the entire settlement amount. *See id.* at 968.

recognized, however, an action in favor of the insured against the primary carrier for failing to settle within the policy limits.[10] In the landmark case of *G.A. Stowers Furniture Co. v. American Indemnity Co.*,[11] the Texas Supreme Court allowed a suit by the insured against the primary carrier where the primary carrier was negligent in failing to accept a settlement offer within the policy limits.[12] In *Stowers,* the court reasoned that since the primary carrier contractually assumes the responsibility for and control of the defense and settlement of the claim, it becomes the agent of the insured in that regard.[13] The court would not permit the primary carrier to gamble on the outcome of the lawsuit by negligently refusing to settle and, thereby, shift the risk of the excess loss to the insured.[14] Consequently, the imposition of this duty on the primary carrier is known as the "Stowers Doctrine." Under the "Stowers Doctrine," the primary carrier is liable to the insured if it is negligent in refusing to settle a lawsuit againt the insured.[15]

Texas courts, however, have yet to decide whether to recognize a cause of action against the primary carrier in favor of the excess carrier for wrongfully failing to settle the lawsuit. Such a cause of action will probably be allowed for several reasons. As previously noted, the great majority of jurisdictions which have considered the question have approved the cause of action. In this regard, it is significant that the rationale for recognizing a cause of action in favor of excess carriers is similar to that advanced by Texas courts when allowing an insured to assert such a claim.[16] Those courts approv-

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10. *See, e.g.,* Hernandez v. Great Am. Ins. Co., 464 S.W.2d 91, 95 (Tex. 1971) (insured allowed to sue primary carrier for breach of duty to settle); Linkenhoger v. American Fidelity & Casualty Co., 152 Tex. 534, 535-36, 260 S.W.2d 884, 885, 887 (1953) (insured brought action against primary carrier for negligently refusing to settle); Rosell v. Farmers Tex. County Mut. Ins. Co., 642 S.W.2d 278, 279-80 (Tex. App.—Texarkana 1982, no writ) ("Stowers Doctrine" permits insured to recover entire amount of judgment against primary insurer if latter negligently refuses to settle).

11. 15 S.W.2d 544 (Tex. Comm'n App. 1929, holding approved).

12. *See id.* at 548.

13. *See id.* at 547.

14. *See id.* at 547-48.

15. *See, e.g.,* Hernandez v. Great Am. Ins. Co., 464 S.W.2d 91, 92, 95 (Tex. 1971) (requiring proof of negligence on behalf of insurer); Rosell v. Farmers Tex. County Mut. Ins. Co., 642 S.W.2d 278, 279-80 (Tex. App.—Texarkana 1982, no writ); Wood Truck Leasing, Inc. v. American Auto. Ins. Co., 526 S.W.2d 223, 224 (Tex. Civ. App.—San Antonio 1975, no writ) (insurer liable upon proof of its negligent failure to settle).

16. *Compare* Northwestern Mut. Ins. Co. v. Farmers Ins. Group, 143 Cal. Rptr. 415,

ing the cause of action reason that since the primary carrier usually reserves the right to control settlement, the primary carrier has a duty to act with due care in considering a settlement to protect both the insured and the excess carrier from an excess verdict.[17] Additionally, the imposition of a duty on the primary carrier will provide an incentive to the primary carrier to settle claims.[18] The same reasoning which permits an action in favor of the insured, therefore, should be applicable to and provide the rationale for Texas courts to permit an action by the excess carrier against the primary carrier.[19]

It seems highly unlikely that Texas courts would follow the minority view which disallows the action based on the lack of privity between the primary carrier and the excess carrier. The doctrine of privity of contract has steadily eroded to such a point in Texas that it is seldom relied upon to deny a third party the right to sue the wrongdoer, especially when the action is both contract and tort in nature.[20] For example, in *Nobility Homes of Texas v. Shivers,*[21] the

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425 (Cal. Dist. Ct. App. 1978) (primary carrier may not shift risk of loss to excess carrier) *with* G.A. Stowers Furniture Co. v. American Indem. Co., 15 S.W.2d 544, 548 (Tex. Comm'n App. 1929, holding approved) (negligence on part of primary carrier in failing to settle shifts risk of loss to insured).

17. *See* Smith v. Transit Casualty Co., 281 F. Supp. 661, 664 (E.D. Tex. 1968), *aff'd,* 410 F.2d 210 (5th Cir. 1969); Bostrom v. Seguros Tepeyac, S.A., 225 F. Supp. 222, 233 (N.D. Tex. 1963), *aff'd in part, rev'd in part,* 347 F.2d 168 (5th Cir. 1965).

18. *See* Valentine v. Aetna Ins. Co., 564 F.2d 292, 298 (9th Cir. 1977); Continental Casualty Co. v. Reserve Ins. Co., 238 N.W.2d 862, 864 (Minn. 1976); *see also* INSURANCE, EXCESS AND REINSURANCE COVERAGE DISPUTES 321 (Ostrager ed. 1983) (relieving primary carrier of duty to settle causes disinclination to settle).

19. *Cf.* Peter v. Travelers Ins., 375 F. Supp. 1347, 1350 (C.D. Cal. 1974). In *Peter,* the court noted that "[u]nder the doctrine of equitable subrogation, the duty owed an excess insurer is identical to that owed the insured. The excess [carrier] will not be able to force the primary [carrier] into accepting any settlement which his duty to the insured would not require accepting. . . ." *Id.* at 1350; *see also* Valentine v. Aetna Ins. Co., 564 F.2d 292, 297 (9th Cir. 1977) (excess carrier assumes rights and obligations of insured).

20. *See, e.g.,* Gupta v. Ritter Homes, Inc., 646 S.W.2d 168, 169 (Tex. 1983) (no privity requirement in action based on negligence and breach of implied warranty by purchaser of used house); Cameron v. Terrell & Garrett, Inc., 618 S.W.2d 535, 541 (Tex. 1981) (no privity needed for action under Texas Deceptive Trade Practice Act); Garcia v. Texas Instruments, Inc., 610 S.W.2d 456, 465 (Tex. 1980) (privity not required to assert personal injury claim in action on breach of implied warranty). Inroads are also being made on the requirement of privity in actions based upon an express warranty. *See* Indust-Ri-Chem v. Par-Pak Co., 602 S.W.2d 282, 287 (Tex. Civ. App.—Dallas 1980, no writ) (dispensing with privity requirement in action based upon breach of express warranty by sample); *see also* Basin Operating Co. v. Valley Steel Prods., 620 S.W.2d 773, 777 (Tex. Civ. App.—Dallas 1981, writ ref'd n.r.e.); Barthlow v. Metcalf, 594 S.W.2d 143, 144 (Tex. Civ. App.—Houston [1st Dist.] 1979, writ dism'd).

21. 557 S.W.2d 77 (Tex. 1977).

Texas Supreme Court abolished the requirement of privity of contract in a breach of implied warranty action.[22] Claiming the absence of privity of contract in an action by the excess carrier against the primary carrier, therefore, should not constitute a viable basis for denying such an action.

In some jurisdictions, the basis for allowing a cause of action in favor of the excess carrier is the fact that courts imply in the insurance contract a covenant of good faith on the part of the primary carrier to protect the policyholder or excess carrier from an excess verdict.[23] Recently, the Texas Supreme Court refused to imply a covenant of good faith in the performance of a contract.[24] It could be argued, therefore, that if the implied covenant is the basis for the suit against the primary carrier and Texas does not recognize such a covenant, it should not recognize a right of recovery by the excess carrier against the primary carrier. The cause of action in Texas, however, is not based upon a covenant of fair dealing implied from the insurance contract. Such action is premised instead upon tort concepts.[25] Thus, Texas will probably follow the majority view and permit an action by an excess carrier against the primary carrier.

III. STANDARD OF PROOF: NEGLIGENCE OR BAD FAITH?

If Texas should in the future recognize a cause of action in favor of the excess carrier, then courts must determine the standard of proof for establishing liability against the primary carrier. There are at least two alternatives: bad faith or negligence. Although negligence appears to be the logical choice under existing law, the adoption of a "bad faith" standard would be a fairer and more equitable rule in actions by the excess carrier. A determination as to the proper standard of proof requires a review of cases involving actions

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22. *See id.* at 81.

23. *See* Commercial Union Assurance Cos. v. Safeway Stores, Inc., 610 P.2d 1038, 1040, 164 Cal. Rptr. 709, 711 (1980); Fireman's Fund Ins. Co. v. Security Ins. Co., 367 A.2d 864, 869 (N.J. 1976).

24. *See* English v. Fischer, 660 S.W.2d 521, 522 (Tex. 1983). Although the *English* decision did not involve an action brought under the "Stowers Doctrine," it could be cited for the proposition that Texas should not recognize an action in favor of the excess carrier because there are no implied covenants of fair dealing in insurance contracts. *See id.*

25. *See* Hernandez v. Great Am. Ins. Co., 464 S.W.2d 91, 93-94 (Tex. 1971) (action based on primary carrier's negligent conduct); Rosell v. Farmers Tex. County Mut. Ins. Co., 642 S.W.2d 278, 279-80 (Tex. App.—Texarkana 1982, no writ) (action based on negligence).

brought by the insured and also cases from other jurisdictions which have permitted such actions by excess carriers.

A. *Actions by the Insured*

In suits initiated by the insured, the jurisdictions are divided as to the standard of proof required to establish liability. A slight majority require proof of bad faith on the part of the primary carrier in refusing to settle the suit.[26] A minority of jurisdictions, including Texas, appear to require only proof of negligence.[27] Since Texas is among the minority of jurisdictions which require an insured to prove negligence by the primary carrier in refusing to settle,[28] it could be argued the same standard should be applied in actions by excess carriers.[29] Further, argument could be made that the negligence standard should be adopted because there is little practical difference between the standards of negligence and good faith. For example, applying Texas law in an action by the insured, a federal court held that although the insured was only required to prove negligence, the primary carrier was entitled to an instruction which would blur the distinction between negligence and bad faith.[30] This instruction informed the jury that in considering the primary carrier's negligence for failure to settle, the primary carrier may take

> into consideration the interest of the insurance company as well as that of the insured, under all of the facts and circumstances known or

26. *See, e.g.,* Johansen v. California State Auto. Ass'n Inter-Ins. Bureau, 538 P.2d 744, 748, 123 Cal. Rptr. 288, 292 (1975) (proof of bad faith on part of primary insurer); Gordon v. Nationwide Mut. Ins. Co., 285 N.E.2d 849, 854-55, 334 N.Y.S.2d 691, 696-97 (N.Y. 1972) (proof of bad faith required), *cert. denied,* 410 U.S. 931 (1973); State Auto. Ins. Co. v. Rowland, 427 S.W.2d 30, 33 (Tenn. 1968) (proof of bad faith on part of primary carrier).

27. *See, e.g.,* Knudsen v. Hartford Accident & Indem. Co., 222 A.2d 811, 812 (Conn. C.P. 1966) (requiring proof of negligence); Thomas v. Nationwide Mut. Ins. Co., 177 S.E.2d 286, 288 (N.C. 1970) (proof of negligence required); G.A. Stowers Furniture Co. v. American Indem. Co., 15 S.W.2d 544, 548 (Tex. Comm'n App. 1929, holding approved) (requiring proof of negligence).

28. *See* Rosell v. Farmers Tex. County Mut. Ins. Co., 642 S.W.2d 278, 279 (Tex. App.—Texarkana 1982, no writ).

29. *Cf.* Valentine v. Aetna Ins. Co., 564 F.2d 292, 297-98 (9th Cir. 1977). In *Valentine,* the court stated that the primary insurer's duty to the insured was identical to the duty it owed to an excess insurer. *See id.* at 298. Upon breach of this duty, the excess insurer is subrogated to the rights of the insured. *See id.* at 297. It would seem logical, therefore, that the standard of proof for its breach would be the same for both the insured and the excess carrier.

30. *See* Fidelity & Casualty Co. v. Robb, 267 F.2d 473, 476 (5th Cir. 1959).

> reasonably available to the insurance company, its agents or attorneys, at the time the offer of settlement was made by [the plaintiffs] at the opening of the trial of the State Court action .[31]

Such an instruction permits the primary carrier to consider its own interests and not only the interests of the insured or excess carrier when determining whether to settle the suit. With this instruction, there may be very little difference in the proof offered to show either negligence or bad faith.[32]

Despite these contentions, the adoption of a bad faith standard would be more equitable in actions initiated by the excess carrier. The limiting instruction does not alter the fact that the issue of liability is a fact question for the jury to decide. In this regard, negligence is easier to prove than bad faith. To a juror, bad faith may connote a state of mind similar to dishonesty, whereas negligence may only infer carelessness. Further, the more stringent bad faith rule should be adopted because the excess carriers are more sophisticated in litigation matters than the typical insured, and consequently, do not require the same degree of protection. Additionally, the fact that excess carriers are voluntarily writing such coverages to seek a profit with full knowledge of the risks involved mandates the adoption of a more rigorous standard. It would be inequitable to permit the excess carrier to earn its profit with full knowledge of the attendant risks and then be permitted to shift the entire excess loss to a primary carrier upon proof of the less stringent standard of negligence.

B. *Actions By the Excess Carrier*

The adoption of a bad faith standard in Texas finds additional support in the fact that most jurisdictions which permit an action by the excess carrier also require proof of bad faith on the part of the primary carrier in refusing to settle.[33] Unlike Texas, however, most of these jurisdictions follow the majority "bad faith" rule in actions

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31. *Id.* at 475 n.1.

32. *See* Holmes, *Third Party Insurance Excess Liability and Its Avoidance,* 34 ARK. L. REV. 525, 534-36 (1981).

33. *See, e.g.,* Portland Gen. Elec. Co. v. Pacific Indem. Co., 579 F.2d 514, 515 (9th Cir. 1978) (Oregon law requires proof of bad faith in action by excess carrier); Valentine v. Aetna Ins. Co., 564 F.2d 292, 297-98 (9th Cir. 1977) (California law requires proof of bad faith on part of excess carrier); Ranger Ins. Co. v. Travelers Indem. Co., 389 So. 2d 272, 275 (Fla. Dist. Ct. App. 1980) (requires bad faith on part of excess carrier).

brought by the insured.[34] One might conclude that there would be no logical reason for a Texas court to require proof of bad faith in an action by the excess carrier when the insured in a similar case must only show negligence.[35] As previously noted, however, the substantially different degree of sophistication regarding litigation that an excess carrier possesses compels the adoption of a different standard. For example, the excess carrier has trained claims personnel and vast experience in litigation which render it far more capable than the typical insured in evaluating settlements and, therefore, less in need of protection. Another critical point to note is that such a claim is based upon equitable subrogation and, therefore, is governed by principles of equity.[36] Accordingly, there is a sense of unfairness in permitting an excess carrier to profit from the excess insurance contract by shifting its entire risk to the primary carrier upon proof of mere negligence on the part of the primary carrier. For these reasons, if the Texas courts recognize a claim on behalf of the excess carrier they should require proof of bad faith on the part of the primary carrier for failing to settle a claim against the insured.[37]

IV. TYPES OF ADMISSIBLE EVIDENCE

It is easy to predict that a primary carrier which considers only its own interests in refusing to settle will be liable for an excess judgment. It is equally easy to predict the non-liability of a primary carrier which considers only the interests of the insured. Most cases are more difficult to predict because the primary carrier's conduct falls between these extremes. In *Fidelity & Casualty Co. v. Robb,*[38] the Fifth Circuit held that a primary carrier need not consider only

34. *See, e.g.,* Johansen v. California State Auto. Ass'n Inter-Ins. Bureau, 538 P.2d 744, 748, 123 Cal. Rptr. 288, 292 (1975) (requiring bad faith in action by insured); Boston Old Colony Ins. Co. v. Gutierrez, 386 So. 2d 783, 785 (Fla. 1980); Groce v. Fidelity Gen. Ins. Co., 448 P.2d 554, 561 (Or. 1968) (insurer must prove bad faith of primary carrier).

35. *See* G.A. Stowers Furniture Co. v. American Indem. Co., 15 S.W.2d 544, 548 (Tex. Comm'n App. 1929, holding approved).

36. *See* Northwestern Mut. Ins. Co. v. Farmers Ins. Group, 143 Cal. Rptr. 415, 426 (Cal. Ct. App. 1978); Home Ins. Co. v. Royal Indem. Co., 327 N.Y.S.2d 745, 748, (N.Y. Sup. Ct.), *aff'd,* 332 N.Y.S.2d 1003-04 (N.Y. App. Div. 1972).

37. *See* Holmes, *Third Party Insurance Excess Liability and Its Avoidance,* 34 ARK. L. REV. 525, 535-38 (1981) (advocating unified standard of liability in actions by both insureds and excess insurers).

38. 267 F.2d 473 (5th Cir. 1959).

the interests of the insured, but may also take into account its own interests in determining whether to settle the suit against the insured.[39]

There are several factors that aid in predicting the potential liability of the primary carrier that refuses to settle a claim resulting in an excess verdict. Perhaps the most important considerations in determining the liability of the primary carrier are whether there is a substantial likelihood that the claimant will establish liability, and whether the potential damages will exceed the policy limits.[40] Where there is a strong possibility of an adverse verdict, i.e., where the chances of liability exceed fifty percent and the probability of a damage award in excess of the primary policy limits is substantial, then the primary carrier is charged with the duty to exercise ordinary care and/or good faith in attempting to settle the case.[41]

An analysis of case law involving actions by both the insured and the excess carrier indicates that the foreseeable liability of the insured and the probability of a substantial excess verdict are critical. In an action by the insured, the court in *Highway Insurance Underwriters v. Lufkin-Beaumont Motor Coaches*[42] held that liability facts, which favored the injured person, and damages, which were likely to exceed the policy limits, were important factors in determining the primary carrier's liability.[43] Similarily, in *Smith v. Transit Casualty Co.,*[44] the district court held that a primary carrier was negligent in failing to accept a settlement offer within the policy limits where there was a high probability of an excess verdict.[45]

An analysis of cases initiated by the excess carrier also indicates that these two factors are important in evaluating the potential liability of the primary carrier. For example, in *Valentine v. Aetna Insurance Co.,*[46] where the likelihood of an excess verdict was

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39. *See id.* at 476.

40. *See* Lienemann v. State Farm Mut. Auto. Fire & Casualty Co., 540 F.2d 333, 340 (8th Cir. 1976); Ward v. State Farm Mut. Auto. Ins. Co., 539 F.2d 1044, 1049 (5th Cir. 1976).

41. *See* Gibbs v. State Farm Mut. Ins. Co., 544 F.2d 423, 426-27 (9th Cir. 1976); Hodges v. State Farm Mut. Auto. Ins. Co., 488 F. Supp. 1057, 1063 (D.S.C. 1980).

42. 215 S.W.2d 904 (Tex. Civ. App.—Beaumont 1948, writ ref'd n.r.e.).

43. *See id.* at 928-29.

44. 281 F. Supp. 661 (E.D. Tex. 1968).

45. *See id.* at 670. The *Smith* case involved a wrongful death action with serious damage potential. The insured had negligently crossed into the decedent's lane of traffic and there was no evidence of contributory negligence. *See id.* at 670.

46. 564 F.2d 292 (9th Cir. 1977).

substantial, the court permitted an excess carrier to recover the difference between the amount paid in settlement after the verdict and the amount for which the case should have settled before the verdict.[47] Likewise, in *Fireman's Fund Insurance Co. v. Security Insurance Co.,*[48] there was a substantial probability that an excess verdict might reach $400,000 in a malpractice claim.[49] Consequently, the court held that there was bad faith on the part of the primary carrier that refused to attempt a settlement negotiation following a settlement offer of $147,000.[50] Finally, in *Portland General Electric Co. v. Pacific Indemnity Co.,*[51] the court held that there was bad faith on the part of the primary carrier in refusing to accept a settlement offer of $125,000 where a workman was severely burned and the defense attorney predicted an adverse verdict of up to $400,000.[52]

In defending a primary carrier in such an action, the most difficult fact is that the case against him has already been lost and a substantial excess verdict rendered against the insured. After the lawsuit, it is not difficult for the excess carrier to contend that there was a substantial probability of an adverse excess verdict which should have been foreseeable to the primary carrier. The conduct of the primary carrier will not be judged upon hindsight but rather upon the facts known to the primary carrier at the time that it refused to settle.[53] The primary carrier, therefore, should seek to develop evidence which indicates that the facts known to it at the time that it refused to settle supported the view that there was a better than even chance of winning the lawsuit or at least minimizing the award of damages to an amount within the primary policy limits.[54]

Other evidence which should be developed in the defense of the primary carrier include facts which show that the investigation and opinions of defense counsel suggested that the insured would win

47. *See id.* at 296-98.

48. 367 A.2d 864 (N.J. 1976).

49. *See id.* at 866.

50. *See id.* at 866-67.

51. 574 F.2d 469 (9th Cir. 1978).

52. *See id.* at 473-74.

53. *See* Covill v. Phillips, 452 F. Supp. 224, 226-27 (D. Kan. 1978); Austero v. National Casualty Co., 148 Cal. Rptr. 653, 672 (Ct. App. 1978).

54. *See* Commercial Union Assurance Cos. v. Safeway Stores, Inc., 610 P.2d 1038, 1041 (Cal. 1980); Shelton v. Commercial Union Assurance Co., 396 So. 2d 1379, 1383 (La Ct. App. 1981).

the case or the damage award would be within policy limits.[55] For example, in *Centennial Insurance Co. v. Liberty Mutual Insurance Co.*,[56] an excess carrier failed in its effort to impose liability upon a primary carrier for an excess verdict.[57] In that case, the court concluded that the investigation by the primary carrier was adequate. Further, although the primary carrier rejected a settlement offer within the policy limits, the court considered its counter-offer higher than what was considered a reasonable offer.[58] This case is illustrative of the fact that the primary carrier is not strictly liable for judgments which exceed the policy limit.[59] Thus, in cases where there is a substantial probability of an excess verdict against the insured, the liability of the primary carrier for the excess verdict will depend on its efforts to settle the case.[60] In such instances, counsel should consider introducing evidence indicating the primary carrier's efforts to settle the case.[61] Additional factors which are relevant to the liability issue in an action against the primary carrier include the primary carrier's investigation and efforts to ascertain facts[62] and its reliance on or rejection of the advice of its attorney.[63] Further, counsel should consider facts indicating that the primary carrier rejected an offer to settle after a verdict had been rendered against the insured.[64] Finally, evidence should be relevant if it shows the primary carrier's efforts to inform the insured of a compromise offer[65] or its misrepre-

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55. *See* Cotton States Mut. Ins. Co. v. Trevethan, 390 So. 2d 724, 727 (Fla. Dist. Ct. App. 1980) (reliance by primary carrier on advice of its counsel is evidence on bad faith issue).

56. 404 N.E.2d 759 (Ohio 1980).

57. *See id.* at 763.

58. *See id.* at 762-63.

59. *See, e.g.,* Austero v. National Casualty Co., 148 Cal. Rptr. 653, 672 (Ct. App. 1978) (mere failure to settle claim alone is not basis for liability); Edwins v. General Casualty Co., 397 N.E.2d 1231, 1232 (Ill. App. Ct. 1979) (failure to settle within policy limits does not of itself impose liability on primary carrier); Champion v. Farm Bureau Ins. Co., 352 So. 2d 737, 740 (La. Ct. App. 1977) (primary carrier not strictly liable for failure to settle claim within policy limits).

60. *See* Covill v. Phillips, 452 F. Supp. 224, 237-38 (D. Kan. 1978) (focus on insurer's efforts to settle claim); Centennial Ins. Co. v. Liberty Mut. Ins. Co., 404 N.E.2d 759, 762-63 (Ohio 1980) (focus on primary carrier's negotiations to settle claim).

61. *See* Kriz v. Government Employees Ins. Co., 600 P.2d 496, 500 (Or. Ct. App. 1979).

62. *See* Boston Old Colony Ins. Co. v. Gutierrez, 386 So. 2d 783, 785 (Fla. 1980).

63. *See* Cotton States Mut. Ins. Co. v. Trevethan, 390 So. 2d 724, 727 (Fla. Dist. Ct. App. 1980).

64. *See* Covill v. Phillips, 452 F. Supp. 224, 227 (D. Kan. 1978).

65. *See id.*; Boston Old Colony Ins. Co. v. Gutierrez, 386 So. 2d 783, 785 (Fla. 1980).

sentation of facts which induced the insured to reject a settlement offer.[66]

V. MEASURE OF DAMAGES

In an action by the excess carrier against the primary carrier, the proper measure of damages depends upon whether there was a firm offer to settle the suit against the insured. In instances where the primary carrier wrongfully rejects an offer to settle within the policy limits, courts uniformly permit the excess carrier to recover the entire amount of the excess verdict that it was required to pay.[67] Where there is no offer within the policy limits, the measure of damages is the difference between the amount paid by the excess carrier and what it should have contributed had the primary carrier properly settled the claim.[68]

The following hypothetical demonstrates the measure of damages in both instances. While operating a truck, the insured collides with an oncoming vehicle and causes the deaths of two individuals. Their survivors file a lawsuit seeking $3,000,000 in actual and punitive damages resulting from the insured's negligence and gross negligence in causing the collision. The insured has primary coverage of $300,000 pursuant to a general liability policy, and a policy of excess liability insurance with a limit of $5,000,000. The insured had a poor driving record and denied seeing the oncoming vehicle before he turned in front of it, causing the accident. There is some evidence that the oncoming vehicle was being driven at an excessive rate of speed. Two variations on this hypothetical situation will be considered. First, the plaintiffs make an offer to settle within the $300,000 limits of the primary policy; and second, the plaintiffs make an offer to settle for $550,000. In both instances, assume that the primary carrier refuses these offers and the case is tried and lost

66. *See* Covill v. Phillips, 452 F. Supp. 224, 227 (D. Kan. 1978).

67. *See, e.g.,* Portland Gen. Elec. Co. v. Pacific Indem. Co., 574 F.2d 469, 474 (9th Cir. 1978) (recovery of entire excess verdict); Norhtwestern Mut. Ins. Co. v. Farmers Ins. Group, 143 Cal. Rptr. 415, 429-30 (Ct. App. 1978) (entire amount of verdict recoverable even if in excess of primary carrier's policy); Continental Casualty Co. v. Reserve Ins. Co., 238 N.W.2d 862, 864 (Minn. 1976) (primary carrier may be liable for amount exceeding policy if wrongfully rejects settlement offer).

68. *See* Valentine v. Aetna Ins. Co., 564 F.2d 292, 295 (9th Cir. 1977); Continental Casualty Ins. Co. v. United States Fidelity & Guar. Co., 516 F. Supp. 384, 391 (N.D. Cal. 1981).

resulting in a verdict against the insured of $1,000,000. The excess carrier pays the excess verdict and sues the primary carrier for $700,000.

Under the first variation of the hypothetical involving the rejection of a settlement offer within the policy limits, the excess carrier should recover its entire $700,000 payment since the primary carrier had the opportunity to settle but wrongfully refused to accept the offer of settlement. The appropriate measure of damages in the second hypothetical is a bit more complex. The answer is suggested in the extremely well-reasoned opinion of *Continental Casualty Insurance Co. v. United States Fidelity & Guaranty Co.*[69] In that case, the parties would not settle within the primary policy limits and the primary carrier was found to have acted negligently or in bad faith by failing to settle.[70] The court held that the measure of damages would be the difference between the amount paid by the excess carrier to discharge the judgment and the amount it would have been required to contribute to the settlement.[71] Under the second hypothetical, the excess carrier paid $700,000 to discharge the judgment, but would have been required to contribute $250,000 to a settlement had one been made. The measure of damages is therefore $450,000. It should be noted that when defending a case where the plaintiff will not settle within policy limits, it will always be a defense to show that the excess carrier would not have contributed sufficient funds to secure the settlement.[72] It should be a complete defense to the primary carrier in the second hypothetical if it can show that the excess carrier would not have contributed the $250,000 necessary to accomplish the settlement.[73]

VI. Defense of the Primary Carrier

A. *No Firm Offer To Settle Within Policy Limits*

A review of cases involving actions initiated by the insured and by the excess carrier indicates that it is not a complete defense for the primary carrier to claim that there was no offer of settlement

69. 516 F. Supp. 384 (N.D. Cal. 1981).
70. *See id.* at 390.
71. *See id.* at 391.
72. *See id.* at 392.
73. *See id.* at 392.

within the primary policy limits.[74] In *Fidelity & Casualty Co. v. Robb,*[75] a case arising out of Texas and initiated by the insured, the court rejected an argument that the primary insurance carrier could not be held liable in the absence of a settlement offer within policy limits.[76] Several cases initiated by excess insurance companies reach the same result. In *North River Insurance Co. v. St. Paul Fire & Marine Insurance Co.,*[77] the court held that a primary carrier owes a duty to the excess carrier to seek a settlement within the policy limits.[78] Additionally, the court stated that, in a serious case, the primary carrier may owe a duty to contribute to the policy limits. At the very least, the primary carrier should inform the excess carrier of settlement offers and seek its contributions to a settlement.[79] In *General Accident Fire & Life Assurance Corp. v. American Casualty Co.,*[80] a wrongful death action against the insured resulted in a verdict which exceeded the primary policy limits.[81] In that case, the primary carrier did not receive an offer to settle within the policy limits, and the defense counsel thought it was probable that a verdict would exceed the primary policy limits.[82] Entering judgment for the excess carrier, the court noted that the majority of cases do not require an offer within policy limits to hold the primary carrier liable for failure to negotiate a settlement.[83] Consequently, it appears that the primary carrier has a continuing duty to negotiate a settlement even in the absence of an offer to settle.[84] The absence of such an offer, however, may be used in the defense of the primary carrier to show that the primary carrier made a diligent or good faith, although unsuccessful, effort to settle the claim.[85]

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74. *See* Davis v. Nationwide Mut. Fire Ins. Co., 370 So. 2d 1162, 1163 (Fla. Dist. Ct. App. 1979).

75. 267 F.2d 473 (5th Cir. 1959).

76. *See id.* at 476.

77. 600 F.2d 721 (8th Cir. 1979).

78. *See id.* at 722.

79. *See id.* at 724.

80. 390 So. 2d 761 (Fla. Dist. Ct. App. 1980).

81. *See id.* at 762-63.

82. *See id.* at 763-64.

83. *See id.* at 765.

84. *See* Chancey v. New Amsterdam Casualty Co., 336 S.W.2d 763, 765 (Tex. Civ. App.—Amarillo 1960, no writ).

85. *See* Globe Indem. Co. v. Gen-Aero, Inc., 459 S.W.2d 205, 208 (Tex. Civ. App.—San Antonio 1970, no writ). In *Gen-Aero,* the court stated that one factor to consider in determining the liability of the primary carrier is its opportunity to settle the case during the investigation or trial. *See id.* at 208.

B. *Settlement by the Insured*

The clear weight of authority indicates that the excess carrier may settle the claim against the insured and then sue the primary carrier.[86] In *Continental Casualty Co. v. Reserve Insurance Co.*,[87] the court noted that the excess carrier may settle a claim prior to verdict and later sue the primary carrier for a failure to settle the claim.[88] Similarly, the fact that the excess carrier settled the case after the verdict without the primary carrier's consent is not a complete defense to the primary carrier.[89] The non-consenting primary carrier, however, may later show at its trial that the settlement was not just or fair.[90]

C. *Conduct of the Primary Carrier*

When the primary carrier refuses an offer within the policy limits, the focus shifts to the primary carrier's reason for refusing to settle. Facts must be developed which tend to support the decision to try the case. For example, it should be shown where possible that there was a greater than fifty percent probability of either prevailing on the liability issue or that the damages would not exceed the primary policy limits.[91] These conclusions are supported by facts revealed by the investigation, facts surrounding the accident, the contributory negligence of the claimant, mitigating factors favoring the insured, reliance upon the advice of an attorney, and knowledge and concurrence of the insured and excess carrier in the rejection of settlement.[92] The defendant should request an instruction that the

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86. *See* Continental Casualty Co. v. Reserve Ins. Co., 238 N.W.2d 862, 864 (Minn. 1976); Western Pac. Ins. Co. v. Farmers Ins. Exch., 416 P.2d 468, 469, 472 (Wash. 1966).

87. 238 N.W. 2d 862 (Minn. 1976).

88. *See id.* at 865.

89. *See* Peter v. Travelers Ins. Co., 375 F. Supp. 1347, 1350 (C.D. Cal. 1974); Home Ins. Co. v. Royal Indem. Co., 327 N.Y.S.2d 745, 747-48 (N.Y. Sup. Ct. 1972).

90. *Cf.* Continental Casualty Co. v. Pacific Indem. Co., 184 Cal. Rptr. 583, 587-88 (Ct. App. 1982).

91. *See* McCall v. Southern Farm Bureau Casualty Ins. Co., 501 S.W.2d 223, 224-25 (Ark. 1973) (primary carrier held not negligent where probability of excess verdict was "close question"); Commercial Union Assurance Cos. v. Safeway Stores, Inc., 610 P.2d 1038, 1040, 164 Cal. Rptr. 709, 711 (Cal. 1980) (primary carrier liable for not settling within policy limits where substantial liklihood of recovery in excess of policy limits).

92. *See* Covill v. Phillips, 452 F. Supp. 224, 227 (D. Kan. 1978).

primary carrier is entitled to consider not only the interests of the insured and the excess carrier, but also its own interests in refusing a settlement.[93] Where there is a rejection of an offer within the policy limits, a substantial verdict generally proves to be a very formidable obstacle to the primary carrier. In such instances, the primary carrier is faced with the task of trying to persuade a jury *after the verdict* that this same verdict was not reasonably foreseeable to the primary carrier *prior to verdict.* This task may prove impossible. Nevertheless, the conduct of the primary carrier is not to be judged with the benefit of hindsight, but rather based upon the facts known by and available to the primary carrier at the time the decision was made to reject the settlement offer.[94]

In a case where the settlement amount is in excess of the primary limits, the primary carrier can always prove that the excess carrier would not have contributed sufficient funds toward the settlement which constitutes a complete defense to the action. In *Continental Casualty Co. v. United States Fidelity & Guaranty Co.,*[95] the primary carrier argued that the excess carrier's failure to contribute to settlement should also support the submission of an issue of contributory negligence or failure to mitigate damages.[96] In rejecting this contention, the court noted that the measure of damages assumes these issues and the excess carrier has no duty to contribute until the primary policy limits are exhausted.[97] It seems logical that if the excess carrier acts negligently in failing to contribute to a settlement which exceeds the primary limits, there should be a proportionate reduction of the excess carrier's recovery against the primary carrier.

It is less clear to what extent equitable defenses will apply in such an action. The legal premise for the excess carrier's right to sue the primary carrier is not based on contract, but rather on an equitable subrogation theory.[98] It would be logical to assume, therefore, that the equitable defenses and maxims such as laches, unjust enrichment, and unclean hands should be applied by a court in equity.[99]

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93. *See* Fidelity & Casualty Co. v. Robb, 267 F.2d 473, 476 (5th Cir. 1959).

94. *See* Covill v. Phillips, 452 F. Supp. 224, 227 (D. Kan. 1978).

95. 516 F. Supp. 384 (N.D. Cal. 1981).

96. *See id.* at 392.

97. *See id.* at 393.

98. *See* Valentine v. Aetna Ins. Co., 564 F.2d 292, 296-98 (9th Cir. 1977); Vencill v. Continental Casualty Co., 433 F. Supp. 1371, 1376 (S.D.W. Va. 1977).

99. *But see* Continental Casualty Co. v. United States Fidelity & Guar. Co., 516 F.

Finally, the statute of limitations will not begin to run until the judgment becomes final or is paid by the primary or excess carrier.[100]

The successful defense of the primary carrier begins prior to the excess verdict. The attorney assigned to the defense of the insured should be permitted to conduct a reasonable and necessary investigation to successfully defend the insured. If there are conflicts as to the coverage of the policy, these conflicts should be resolved first by a declaratory judgment. Alternatively, the claim should be settled first and issues concerning the coverage of the policy resolved later because an honest but erroneous belief by the primary carrier that the claim was not covered by the primary policy is not a defense in the action by the excess carrier.[101] The primary carrier is strictly liable, therefore, for its rejection of settlement offers because of its unilateral erroneous coverage decision even when attributable to an honest mistake.[102] The primary carrier should offer the services of its agents and defense attorney to make complete disclosure to the insured and to the excess carrier of all the facts pertaining to liability and settlement. If the case warrants, the primary carrier should consider offering its policy limits in settlement and requesting the excess carrier and/or the insured to contribute to a settlement.

VII. CONCLUSION

Texas courts will probably recognize a cause of action in favor of an excess carrier against a primary carrier for a wrongful failure to settle a claim against the insured. Although an insured in such a case is only required to prove negligence in Texas, it would be more equitable to require an excess carrier to prove bad faith on the part of the primary carrier. Where the evidence shows a refusal of an offer to settle within the policy limits, the primary carrier should be liable for the entire excess verdict where there was a strong probability of an adverse verdict against the insured in excess of the

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Supp. 384, 393 (N.D. Cal. 1981) (rejecting defensive issue on excess carrier's bad faith refusal to contribute to settlement).

100. *See* Linkenhoger v. American Fidelity & Casualty Co., 152 Tex. 534, 534-35, 260 S.W.2d 884, 886 (1953).

101. *See* Johansen v. California State Auto. Ass'n Inter-Ins. Bureau, 538 P.2d 744, 746, 123 Cal. Rptr. 288, 292 (1975).

102. *See* Gibbs v. State Farm Mut. Ins. Co., 544 F.2d 423, 427 (9th Cir. 1976); Samson v. Transamerica Ins. Co., 636 P. 2d 32, 43, 178 Cal. Rptr. 343, 353-54 (Cal. 1981).

primary limits. When there is no offer to settle within the primary policy limits, the primary carrier may have a duty to initiate a negotiation for a settlement. Upon its wrongful failure to negotiate a settlement the primary carrier may be liable to the excess carrier for the difference between what was actually paid and what should have been paid had there been a settlement before the verdict. In this regard, it should be a defense if the primary carrier can show that the excess carrier would not have contributed sufficient funds to settle the case. The excess carrier's contributory negligence and/or failure to mitigate damages should be defensive issues. Since the cause of action is based upon equitable subrogation, the equitable maxims and defenses should be asserted where appropriate. The adoption of these principles will provide a balanced approach to resolving these complex issues arising in disputes involving the policy holder, the primary carrier, and the excess carrier.