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APPLYING THE BAD FAITH DOCTRINE TO THE PRIMARY AND EXCESS INSURANCE CARRIER RELATIONSHIP IN CALIFORNIA

INTRODUCTION

As juries persistently award sizeable verdicts in personal injury claims, there is a concomitant surge in exposure of assured defendants to judgments far in excess of insurance policy limits.¹ Since the insurer has the dual responsibility of indemnifying the assured for losses covered by the policy and providing the assured with a defense,² the fact that the assured's personal assets may be jeopardized by an "excess" judgment often creates situations in which the insurer's interests conflict with those of the assured.³ In order to protect assureds in such situations, California courts have implied a covenant of good faith and fair dealing extending from insurance companies to their assureds,⁴ a breach of which gives rise to a cause of action with mixed

1. Bloom, *Recovery Against Primary Insurer By Excess Carrier For Bad Faith Or Negligent Failure To Settle*, 36 INS. COUNSEL J. 235 (1969).

2. In return for these promises on the part of the insurer, the assured must relinquish control of the litigation and terms of settlement. The "Travelers Personal Automobile Policy," Policy Forms 100, 102, and LP (2d ed); Policy Forms 101, at 3, for example, provides, in part:

[T]he company shall have the right and duty to defend any suit against the insured seeking damages on account of such bodily injury or property damage, even if any of the allegations of the suit are groundless, false or fraudulent, and may make such investigation and settlement of any claim or suit as it deems expedient

Generally, this is an advantageous relationship since the assured benefits from the company's expertise in claims handling, while the company has control of the litigation in order to protect its financial interest. The problem occurs, however, when both the financial interests of the assured and the company are at stake, *i.e.*, when there is a risk of a judgment in excess of the available coverage.

3. Situations in which trials result in judgments in excess of policy limits are commonly referred to as "excess judgments." The position of the assured in this context was vividly described by one author:

The insurance company, of course, being in the business, plays the law of averages. The policyholder who is in court perhaps for the only time in his life cannot afford to concern himself with "averages." There is no averaging so far as he is concerned—this is *his* lawsuit.

Appleman, *Circumstances Creating Excess Liability*, 1960 INS. L.J. 553, 554. See also Keeton, *Liability Insurance and Responsibility For Settlement*, 67 HARV. L. REV. 1136, 1169 (1954) [hereinafter cited as Keeton].

4. See, *e.g.*, *Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 328 P.2d 198 (1958).

tort/contract colors, commonly termed "bad faith."⁵

The "bad faith" concept encompasses three distinct relationships. Initially, the concept is applicable in "third party" suits commonly arising out of auto accidents.⁶ In such cases, an injured third party files a complaint alleging personal injuries caused by the assured defendant and praying for damages in excess of the assured's available insurance coverage. The plaintiff attorney then makes a settlement offer for a figure within the policy limits. For whatever reason, the offer is refused, and the case goes to trial, resulting in an excess judgment against the assured and a bad faith claim by the assured against the insurer.

Secondly, bad faith applies to "first party" suits wherein the claim is pursued not by a stranger to the insurance contract, but by the assured himself.⁷ For example, an assured might pursue a bad faith claim if a fire insurer refused indemnity for losses falling within the coverage of the assured's policy.

Significantly, bad faith has begun its extension into a third type of insurance relationship: primary-excess insurer suits.⁸ There, the assured has coverage with two distinct insurers; one, an insurer who assumes, as the name suggests, the "primary" obligation to defend and/or indemnify the insured from third party suits; and, the other insurer, called upon to indemnify the insured *only* in the event of a judgment or settlement in "excess" of the primary insurer's policy limits. If the primary insurer refuses a settlement offer and a subsequent excess judgment results in excess carrier liability, a suit between the excess carrier and the primary carrier for bad faith is likely.

5. See 2 B. WITKIN, CALIFORNIA PROCEDURE 969 (2d ed. 1970); *Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 663, 328 P.2d 198, 203 (1958). The court speaks of the cause of action for bad faith as "sounding both in contract and tort" with the plaintiff having the power to elect. *Id.* But see *Critz v. Farmers Ins. Group*, 230 Cal. App. 2d 788, 799, 41 Cal. Rptr. 401, 407 (1964) (held the cause of action was solely in contract). This distinction becomes critical when considering the nature of damages that can be obtained and whether or not the cause of action can be assigned.

One author, after reviewing *Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967), stated that the bad faith area had been chosen by the plaintiff's bar (regarding personal injury cases) as one of its "prime targets" in terms of amici curiae support for the future. *Snyder, Defense in Excess of Policy Limit Litigation*, 18 FED'N INS. COUNSEL Q. 9, 12 (Winter 1968) [hereinafter cited as *Snyder*].

6. See, e.g., *Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 328 P.2d 198 (1958).

7. See *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973); *Richardson v. Employers Liab. Assurance Corp.*, 25 Cal. App. 3d 232, 102 Cal. Rptr. 547 (1972); *Fletcher v. Western Nat'l Life Ins. Co.*, 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970).

8. See text accompanying notes 48-64 *infra*.

Despite the obvious importance of the issue, California has yet to determine the applicability of the bad faith concept to the primary-excess insurer relationship. This Comment, after exploring necessary background, *i.e.*, the contours of the bad faith cause of action in third and first party contexts, will argue that California should decline to extend the bad faith cause of action into the primary-excess arena.

I. THE THIRD PARTY CONTEXT

The first California case to adopt the bad faith cause of action in a third party context, *Brown v. Guarantee Insurance Co.*,⁹ sharply confined the limits of the action:

[W]e are convinced that only bad faith should be the basis of the insured's cause of action. Bad faith may involve negligence, or negligence may be indicative of bad faith, but negligence *alone* is insufficient to render the insurer liable.¹⁰

In *Merritt v. Reserve Insurance Co.*,¹¹ this proposition was reaf-

9. 155 Cal. App. 2d 679, 319 P.2d 69 (1957).

10. *Id.* at 688-89, 319 P.2d at 75 (emphasis added).

11. 34 Cal. App. 3d 858, 110 Cal. Rptr. 511 (1973). There, the insurer had issued a policy of insurance with \$100,000 policy limits to the J.A. Stafford Trucking Company. A Stafford truck was rear-ended by a truck driven by Merritt on Highway 99. The statement of a witness, Cox, indicated that Merritt's truck passed him at about 60 miles per hour and "whipped" back into the slow lane, colliding with the slower moving Stafford truck. The California Highway Patrol accident report confirmed the witness' account of the accident. Merritt then filed a suit against Stafford and its driver for \$400,000 in bodily injury damages. Stafford was informed via an "excess letter" that the complaint's prayer was in excess of the available insurance coverage.

Because of Merritt's extensive injuries and the size of the workmen's compensation lien, the insurer's defense counsel ruled out "any possibility of even considering or discussing settlement." Furthermore, based on the favorable witness statement and California Highway Patrol accident report, the case was assessed as "one of no liability." The case went to trial without the plaintiff's attorney asserting a demand for settlement within the policy limits and ended with a plaintiff's verdict totaling \$434,000. Stafford then assigned its cause of action for bad faith to Merritt.

Merritt alleged, among other things, that Reserve Insurance (Stafford's insurer) was negligent in that it had (1) failed to initiate settlement discussions; and (2) ineptly handled the assured's defense. The court concluded that: "With respect to the first charge, negligent failure to initiate settlement discussions, . . . actionable failure to settle must encompass bad faith . . . negligence alone is insufficient to support the charge." *Id.* at 880, 110 Cal. Rptr. at 526.

Regarding the second count of negligently litigating the matter, the court stated: "We do not accept the claim that vicarious liability falls on one who retains independent trial counsel to conduct litigation on behalf of a third party when retained counsel have conducted the litigation negligently." *Id.* However, the court's conclusion is questionable. Professor Keeton for example, has written:

If the attorney fails to give proper consideration to the interests of insured in his recommendation that a settlement offer be declined, and the company acts on that

firmed: "The cases unanimously agree that in considering a carrier's

recommendation causing a loss to insured, insured has a cause of action against company but not against the attorney.

Keeton, *supra* note 1, at 1169. See also 7A J.A. APPLEMAN & J. APPLEMAN, *INSURANCE LAW AND PRACTICE* § 4687, at 479-80 (rev. ed. 1972) [hereinafter cited as APPLEMAN]; G. COUCH, 14 *CYCLOPEDIA OF INSURANCE LAW* § 51, at 133 (2d ed. R. Anderson (1965)); Comment, *Insurer's Liability for Judgments Exceeding Policy Limits*, 38 *TEXAS L. REV.* 233, 247 (1949).

Counsel employed by the insurer has been deemed a subagent of the insurer acting for the best interests of the assured in some jurisdictions. See, e.g., *Highway Ins. Underwriters v. Lufkin-Beaumont Motor Coaches, Inc.*, 215 S.W.2d 904, 932 (Tex. Civ. App. 1948), where the court stated:

Responsibility for Insured's defense rested upon Insurer not upon Insurer's agents. The judgment which was to be formed in determining whether Insurer would accept Alexander's offer was Insurer's judgment, not the judgment of the lawyers who defended Insured and advised Insurer.

The court concluded that any contrary result would reduce the insurer's obligation to nothing more than retention of competent counsel, thereby relieving the insurer of the duty of good faith and due care. *Id.* But see *Gordon v. Nationwide Mut. Ins. Co.*, 285 N.E.2d 849 (N.Y. 1972) (reliance on the advice of counsel is a good defense to an action for bad faith).

In *Dumas v. Hartford Ins. Co.*, 56 A.2d 57 (N.H. 1947), an action for negligent failure to settle within the policy limits, the court was of the opinion that "professional negligence of counsel is imputed to the client when his attorney is acting within the scope of his authority." *Id.* at 61. See also *Smoot v. State Farm Mut. Auto. Ins. Co.*, 299 F.2d 525 (5th Cir. 1962) (holding that the insurer's duty to its assured is non-delegable and, therefore, cannot be satisfied by the retention of competent counsel); and *Farmers Gin Co. v. St. Paul Mercury Indem. Co.*, 191 So. 415 (Miss. 1939) (indicating that although counsel retained by the insurer exercises expertise, he is not an independent contractor). It should be noted that insurers have made it a practice to inform their assureds by letter of the fact that a suit has been filed claiming damages in excess of their available coverage. Assureds are then generally advised that they may retain personal counsel to protect their interests at their own expense. Insurers adopted this course of conduct in order to guard against any contentions of "waiver," i.e., that by litigating the matter without apprising the assured of the personal liability exposure, they waive the limits of the policy.

The following is a sample letter used by one Los Angeles defense firm:

Gentlemen:

You had previously requested that this insurance company assume your defense. In assuming this defense we wish to spell out the extent and nature of the coverage available to you.

In reviewing the . . . Complaint filed by the [plaintiff], we note that they seek to recover damages against you of \$500,000.00 punitive damages, \$50,000.00 general damages, their attorneys fees and loss of income.

The limit of liability under your insurance policy is [\$_____] and for that reason any part of the judgment in excess of \$_____ will have to be paid by you.

Your insurance policy does not provide coverage for any portion of a judgment which may be awarded by way of punitive damages. . . .

In light of the above, you therefore have a personal interest in the defense of this suit. This company will afford a defense to the action on your behalf without any expense to you. However, in view of your excess liability and the portions of the claim for which no coverage is provided, we wish to advise you that you may, if you so desire, associate your own counsel with ours in the defense. This, of course, would be done at your own expense. . . .

Very truly yours,

liability for rejection of an offer to settle within policy limits the test is bad faith and not negligence."¹²

Despite the language of *Brown* and *Merritt*,¹³ there are few, if any, situations where an insurer can act negligently and not evince bad faith.¹⁴

Indeed, the year following the *Brown* decision, the California Supreme Court decided a case which narrowed the gap between negligence and bad faith. In *Comunale v. Traders & General Insurance Co.*,¹⁵ the court recognized that:

But see *Executive Aviation, Inc. v. National Ins. Underwriters*, 16 Cal. App. 3d 799, 94 Cal. Rptr. 347 (1971) (wherein the court stated that insurers are responsible for the payment of attorney's fees of the assured's independent counsel if the retention was necessitated by a conflict of interest).

12. 34 Cal. App. 3d at 873, 110 Cal. Rptr. at 521.

13. There is additional language excluding negligence as a basis of bad faith in *Ivy v. Pacific Auto. Ins. Co.*, 156 Cal. App. 2d 652, 320 P.2d 140 (1958), wherein the court, citing *Brown*, concluded:

There is some conflict as to whether liability in such cases is predicated on negligence or upon bad faith. California has recently aligned itself with the jurisdictions that apply the bad faith test. In that well reasoned opinion [*Brown*] . . . the court collects and discusses most of the pertinent authorities on the subject, rejects the negligence test, and applied the bad faith test.

Id. at 659, 328 P.2d at 145-46 (citations omitted). *See also* *Martin v. Hartford Accident & Indem. Co.*, 228 Cal. App. 2d 178, 39 Cal. Rptr. 342 (1964), wherein the court commented:

The defense need not have made anything like an accurate prediction of what a jury would do. Nevertheless, the verdict itself is one indication of what the company might have anticipated. We mean, of course, according to the test of good faith, and not of ordinary care, because this type of action is not based upon negligence.

Id. at 183, 39 Cal. Rptr. at 346 (citations omitted). *See also* *Palmer v. Financial Indem. Co.*, 215 Cal. App. 2d 419, 428, 30 Cal. Rptr. 204 (1963); Comment, *Excess Liability: Reconsideration of California's Bad Faith Negligence Rule*, 18 STAN. L. REV. 475 (1966).

14. Witness some of the factors listed in *Brown* as indicia of bad faith:

[T]he strength of the injured claimant's case on the issues of liability and damages; . . . failure of the insurer to properly investigate the circumstances so as to ascertain the evidence against the insured; the insurer's rejection of advice of its own attorney or agent; failure of the insurer to inform the insured of a compromise offer; the amount of financial risk to which each party is exposed in the event of a refusal to settle.

155 Cal. App. 2d at 689, 319 P.2d at 75.

15. 50 Cal. 2d 654, 328 P.2d 198 (1958). The defendant-assured, Sloan, who had struck Mr. and Mrs. Comunale in a crosswalk had policy limits of \$20,000 for each accident and \$10,000 per person. The insurer refused to defend the negligence action based on the fact that Sloan was driving a non-owned vehicle at the time of the accident. The insurer also refused a settlement offer of \$4,000 and the jury returned a verdict for a total of \$26,250 (that being \$16,250 over the \$10,000 per person limit). The supreme court based its finding of an implied covenant of good faith and fair dealing on *Brown v. Superior Court*, 34 Cal. 2d 559, 212 P.2d 878 (1949), a case involving an agreement between parties to make certain dispositions of property by will at death.

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.¹⁶

Since insurance policies are nothing more than contracts for insurance, the court stated, without discussion, that the implied obligation of good faith and fair dealing applies and requires insurers to settle in appropriate cases even in the absence of express terms in the policy imposing such a duty.¹⁷ In *Comunale*, the insurer denied coverage under the policy¹⁸ and rejected an offer of settlement in circumstances where

In *Comunale*, the assured had assigned his cause of action for bad faith against the insurer to the prevailing plaintiff (judgment creditor) in the underlying bodily injury action. As is the practice, the assured received in return for his assignment, the plaintiff's promise, in covenant form, not to execute against the assured on the unsatisfied judgment. The validity of this assignment procedure was upheld in *Comunale*.

Bad faith actions of the excess judgment variety are commonly maintained by a judgment creditor of the assured who has been assigned the assured's cause of action either by the assured himself, as in *Comunale*, or by a trustee in bankruptcy of the assured should the judgment have forced the defendant assured into bankruptcy. See *Reichert v. General Ins. Co.*, 68 Cal. 2d 822, 442 P.2d 377, 69 Cal. Rptr. 321 (1968); cf. *Young v. American Cas. Co.*, 416 F.2d 906 (2d Cir. 1969), *petition for cert. dismissed*, 396 U.S. 997 (1970); *Harris v. Standard Accident & Ins. Co.*, 297 F.2d 627 (2d Cir. 1961); *Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 328 P.2d 198 (1958); *Critz v. Farmers Ins. Group*, 230 Cal. App. 2d 788, 41 Cal. Rptr. 401 (1964).

16. 50 Cal. 2d at 658, 328 P.2d at 200. There is some controversy as to whether a failure to accept a reasonable settlement is a breach of the covenant of good faith or is an instance of bad faith, the issue being whether the bad faith concept is included in or separate from the breach of the implied covenant of good faith. See *Hills & Pivnicka, Development and Direction of the California Bad Faith Insurance Doctrine or "O Ye of Little Faith,"* 8 U. SAN FRANCISCO L. REV. 29, 32-33 (1973) [hereinafter cited as *Hills*].

17. 50 Cal. 2d at 658-59, 328 P.2d at 201-02.

18. Should an insurer believe that there is no coverage for the loss, it must take appropriate measures to adjudicate the coverage question without jeopardizing the chances for settlement. Often, insurers provide a defense to the bodily injury action under a "reservation of rights" and litigate the coverage issue independent of the bodily injury action.

As a practical matter, insurers are reluctant not to provide a defense to an assured, in light of *Gray v. Zurich*, 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966). That decision had the effect of severely limiting the situations where an insurer could afford to withhold a defense where a dispute over coverage of the lawsuit arose. The court articulated the rule thus:

Since modern procedural rules focus on the facts of a case rather than the theory of recovery in the complaint, the duty to defend should be fixed by the facts which the insurer learns from the complaint, the insured, or other sources. An insurer, therefore, bears a duty to defend its insured whenever it ascertains facts which give rise to the *potential* of liability under the policy.

Id. at 276-77, 419 P.2d at 176-77, 54 Cal. Rptr. at 112-13 (emphasis added).

In *Gray*, the assured had been sued for an assault and battery resulting from an altercation in an intersection while operating the insured vehicle. The policy, as is normal with most policies, excluded coverage for damage caused by intentional conduct

a great risk of recovery beyond the policy limits existed. The court held the company liable for the entire judgment and concluded:

When there is great risk of a recovery beyond the policy limits so that the most *reasonable* manner of disposing of the claim is a settlement which can be made within those limits, a consideration in good faith of the insured's interest requires the insurer to settle the claim.¹⁹

Invariably, in applying this test to a particular fact situation, the "reasonableness" of the insurer's or his counsel's conduct becomes the subject of the court's scrutiny. Although no specific guidelines as to what constitutes reasonableness were defined, the court alluded to a balancing of the assured's interests with those of the insurer:

The insurer, in deciding whether a claim should be compromised, must take into account the interest of the insured, and give it at least as much consideration as it does to its own interest.²⁰

as violative of the public policy of the state which opposes insuring against one's intentional wrongdoing.

Although the duty to defend and indemnify are separate and distinct obligations upon an insurer, an insurer may inadvertently waive any coverage defenses it might possess and be forced to indemnify unless it communicates to the assured the fact that it gratuitously provides a defense and "reserves" the right to later adjudicate the coverage issues bearing on the insurer's duty to indemnify. *See generally* R. KEETON, BASIC TEXT ON INSURANCE LAW 410, 429-30 (1971) [hereinafter cited as KEETON].

19. 50 Cal. 2d at 659, 328 P.2d at 201 (1958) (emphasis added).

20. *Id.* *Comunale* indicates that in California the insurer can weigh its own interests equally with that of the insured when considering a settlement. This same rule applies to insurance defense counsel. Counsel may consider both the assured and the carrier as his clients, providing the dual representation is communicated to both clients. *Lysick v. Walcom*, 258 Cal. App. 2d 136, 65 Cal. Rptr. 406 (1968). There, a collision resulted in the death of three persons with probable liability in the Rarden estate (both the plaintiff and the assured had perished in the accident). The *Lysick* estate brought a wrongful death action against the Rarden estate with a prayer in excess of the policy limits of \$10,000. Plaintiff made a demand for \$10,000, but Rarden's attorney, Walcom, adhered to his counteroffer of \$9,500. The carrier had given Walcom authority to offer the limits at the "propitious" moment. Walcom finally offered the limits one week prior to trial, but the offer was rejected. The case resulted in a verdict against the estate for \$225,000. However, the assured's estate was insolvent. Pursuant to an assignment, the plaintiff in the wrongful death action pursued the assured's bad faith action against the insurer and defense counsel. The insurer bought out for \$89,000, but the malpractice and bad faith against Walcom remained.

The appellate court determined that counsel was negligent as a matter of law and remanded to the trial court on the question of causation. However, the court indicated the obligation of good faith emanated from the general standard of professional care and not the insurance contract. *Id.* at 149, 65 Cal. Rptr. at 415.

With increased frequency, insurance defense counsel are being included as named defendants in bad faith suits. *See generally* Brodsky, *Duty of Attorney Appointed by Liability Insurance Company*, 14 CLEV.-MAR. L. REV. 375 (1965); Hills, *supra* note 16, at 34; Luvaas, *Excess Judgments-Defense Counsel's Liability*, 18 DEFENSE L.J. 259

In enunciating this guide to reasonableness, the court tempered the inherent conflict between the insurer's economic interests and those of its assured by relegating to the insurer the arduous task of preassessing the reasonableness of its treatment of the assured. Misassessment could expose the insurer to liability for the entire adverse judgment, even for amounts exceeding the policy limits.²¹ Since the insurer is the only one who stands to benefit by litigation once a settlement within the policy limits is offered, it is not unreasonable that it should concomitantly suffer the entire loss should the case end in an adverse judgment.²²

In attempting to define "reasonableness," however, the *Comunale* court merely substituted one nebulous concept for another. The court offered further elucidation nine years later in *Crisci v. Security Insurance Co.*:²³

(1969); *Panel—Conflicts of Interest Problems in Insurance Practice*, 37 INS. COUNSEL J. 497 (1970). See also Annot., 28 A.L.R.3d 390 (1969) for a compendium of cases regarding malpractice of attorney in conflict of interest cases. Some jurisdictions have taken the view that, in a conflict of interests situation, counsel's *only* client is the assured. *American Employers Ins. Co. v. Goble Aircraft Specialties, Inc.*, 131 N.Y.S.2d 393 (Sup. Ct. 1954), *motion to withdraw appeal granted*, 154 N.Y.S.2d 835 (App. Div. 1956). See also *State Farm Mut. Auto Ins. Co. v. Walker*, 382 F.2d 548 (7th Cir. 1967), *cert. denied*, 389 U.S. 1045 (1968); *Allstate Ins. Co. v. Keller*, 149 N.E.2d 482 (Ill. App. 1958).

21. 50 Cal. 2d at 660, 328 P.2d at 201-02. The court stated:

An insurer who denies coverage does so at its own risk, and, although its position may not have been entirely groundless, if the denial is found to be wrongful it is liable for the full amount which will compensate the insured for all detriment caused by the insurer's breach of the express and implied obligations of the contract.

Id.

22. *Cf. id.* at 660, 328 P.2d at 202.

23. 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967). In *Crisci*, a tenant in an apartment house owned by Mrs. Crisci fell through the staircase. The tenant and her husband brought an action alleging negligent maintenance of the stairway. The landlord had premises insurance of \$10,000 for public liability. Suit was brought for \$400,000. Although liability was clear, there was some disagreement as to the extent of the injury to the plaintiff wife. The wife had developed a psychosis as a result of the accident, and plaintiffs' attorney had an expert psychiatrist who would attest to this fact. The insurer had doctors who would, contrariwise, testify that the plaintiff's mental state was *not* related to the accident. Both the insurer's trial counsel and claims manager believed that, unless the medical experts of the insurance company could prevail on the causation issue, a verdict of over \$100,000.00 could be expected.

Despite these considerations, Security refused an offer to settle for \$9,000 which included an offer to contribute \$2,500 by the assured, Mrs. Crisci. Essentially, the company gambled with their assured's financial future on the strength of their expert's opinions. The case went to trial and resulted in a judgment for \$100,000 to the wife and \$1,000 to her husband. Security, at the time of the trial, was left in the embarrassing position of having a \$3,000 offer to settle outstanding in the face

In determining whether an insurer has given consideration to the interests of the insured, the test is whether a prudent insurer without policy limits would have accepted the settlement offer.²⁴

Although the court based its finding of bad faith on established case law,²⁵ the *Crisci* court strongly intimated that the insurer would be liable for the entire amount of a final judgment in any case where it rejected an offer to settle within the policy limits.²⁶ In response to the brief of an amicus curiae advancing that position, the court observed that the rule proposed was "a simple one to apply" and in comport with principles of "elementary justice."²⁷ Indeed, the court suggested that:

[A]n 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.²⁸

of a \$101,000 judgment. The insurance company paid only \$10,000, the maximum coverage of the policy. Mrs. Crisci brought suit to recover the amount of the judgment beyond the policy limits. In allowing the suit, the court concluded: "Liability is imposed not for a bad faith breach of the contract but for failure to meet the duty to accept reasonable settlements, a duty included within the implied covenant of good faith and fair dealing." 66 Cal. 2d at 430, 426 P.2d at 177, 58 Cal. Rptr. at 17.

In addition to the award of \$91,000 (the difference between the \$10,000 paid by the insurer and the \$101,000 judgment), the court sustained the jury's award of \$25,000 for mental suffering. It concluded that, although the action sounded in both tort and contract, the plaintiff had the freedom to elect. *Id.* at 432-33, 426 P.2d at 178, 58 Cal. Rptr. at 18. The court commented: "The general rule of damages in tort is that the injured party may recover for all detriment caused whether it could have been anticipated or not." *Id.* at 433, 426 P.2d at 178, 58 Cal. Rptr. at 18.

The *Crisci* court impliedly sought to reconcile language in *Comunale* to the effect that the bad faith of the insurer sounds in contract. *Id.* at 433, 426 P.2d at 178, 56 Cal. Rptr. at 18. *Comunale* had emphasized the contractual nature of the cause of action in order to gain the benefit of the longer statute of limitations applicable to contract actions, in addition to supporting the assignability of the cause of action. 50 Cal. 2d at 663, 328 P.2d at 202-03. See also Snyder, *supra* note 5, at 10-11; Comment, *Approaching Strict Liability of Insurer For Refusing to Settle Within Policy Limits*, 47 NEB. L. REV. 705, 713-14 (1968).

The *Crisci* decision has been greeted with mixed reactions. Compare Snow, *Excess Liability—Crisci and Lysick*, 36 INS. COUNSEL J. 51 (1969) [hereinafter cited as Snow] (wherein the author was critical of the strict liability language and mental suffering recovery) with Comment, *Crisci's Dicta of Strict Liability for Insurers' Failure to Settle: A Move Toward Rational Settlement Behavior*, 43 WASH. L. REV. 799 (1968) and Levit, *The Crisci Case—Something Old, Something New*, 2 U. SAN FRANCISCO L. REV. 1 (1967); 5 U. SAN DIEGO L. REV. 228 (1968).

24. 66 Cal. 2d at 429, 426 P.2d at 176, 58 Cal. Rptr. at 16 (citations omitted).

25. *Id.* at 431-32, 426 P.2d at 177, 58 Cal. Rptr. at 17. See also Hills, *supra* note 16, at 52.

26. 66 Cal. 2d at 430, 426 P.2d at 177, 58 Cal. Rptr. at 17.

27. *Id.* at 431, 426 P.2d at 177, 58 Cal. Rptr. at 17.

28. *Id.*

And while the court noted that it need not "determine whether there might be some countervailing considerations precluding adoption of the proposed rule,"²⁹ California courts were unlikely to disregard these pointed and unanimous comments from the state's highest court. One author commented on the aftermath of *Crisci*:

Clearly, however, all recent bad faith cases have used an "after-the-fact" approach in imposing liability on the insurer. . . . The "after-the-fact" approach may indeed soon be denominated a form of strict liability since it has long been established that no showing of negligence on the part of the insurer is required.³⁰

II. THE FIRST PARTY CONTEXT³¹

*Gruenberg v. Aetna Insurance Co.*³² is the leading California case

29. *Id.*

30. Hills, *supra* note 16, at 52 (footnote omitted).

31. The extension from the third party context to the first party suit is evident in *Fletcher v. Western Nat'l Life Ins. Co.*, 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970). There the plaintiff, who did heavy manual labor for a rubber company, purchased a disability policy which provided, among other things, for payments of \$150.00 per month for 30 years should the plaintiff become "totally disabled" because of injury. Two years after the policy had been purchased, the plaintiff injured his back while lifting at work. He was treated surgically for a hernia but continued to have back trouble. This was later diagnosed as a herniated disc. A variety of physicians deemed the plaintiff disabled. The plaintiff received disability payments from January, 1965 (immediately after the accident) through July, 1966 under the "sickness" provisions of his policy when the payments were suddenly discontinued. *Id.* at 384-85, 89 Cal. Rptr. at 81-82.

Citing a report from *one* physician that the back trouble was related to a congenital defect of the spine, the insurer demanded refund of the disability payments already made minus the premiums paid. In later correspondence, the company offered to compromise the matter by dropping its demand for past payments in return for an immediate cancellation of the policy and a full release. At this point, the plaintiff sought legal counsel, and a suit was filed.

The court concluded that the foregoing facts had establish[ed] that defendants, without probable cause . . . , embarked upon a concerted course of conduct to induce plaintiff to surrender his insurance policy or enter into a disadvantageous "settlement" of a nonexistent dispute by means of false and threatening letters and the employment of economic pressure based upon his disabled and therefore impecunious condition, (the very thing insured against) exacerbated by Western National's malicious and bad faith refusal to pay plaintiff's legitimate claim. Defendants concede that their conduct was "deplorable" and "outrageous."

Id. at 392, 89 Cal. Rptr. at 87.

There was additional evidence that the insurer's conduct had caused the plaintiff to lose property in Arizona, made him frequently delinquent on his house payments, forced his wife to go to work, required his daughter to lose two months of school in order to stay home and care for him and the small children, and had his utilities shut off on several occasions. *Id.* at 393-94, 89 Cal. Rptr. at 88.

The *Fletcher* court, analogizing to *Crisci* and other bad faith cases in a third party

exemplifying the nature of the bad faith cause of action in the first party context. Gruenberg was the owner of a bar and cocktail lounge

context, suggested that because of the contractual context, a special relationship existed between an insurer and its assured, obligating an insurer to protect the assured's interests even though, objectively speaking, it might not be good business. *Id.* at 403-04, 89 Cal. Rptr. at 94-95. While comparing the duty of a liability insurer and disability insurer the court stated:

Included within this duty [of good faith and fair dealing] in the case of a liability insurance policy is the duty to act reasonably and in good faith to settle claims against the insured by a third person. . . . We think that, similarly, the implied-in-law duty of good faith and fair dealing imposes upon a disability insurer a duty not to threaten to withhold or actually withhold payments, maliciously and without probable cause

Id. at 401, 89 Cal. Rptr. at 93 (citations omitted). However, the real significance of the case in the insurance field lies in the fact that it upheld the jury's award of damages for intentional infliction of emotional distress, including punitive damages. *See id.* at 401-02, 89 Cal. Rptr. at 93-94. The court, in upholding the award, made reference to the disparity in the bargaining positions inherent in disability policies. *Id.* at 403-04, 89 Cal. Rptr. at 95. Because of the insurer's dominant position, and the fact that the disability insurance is procured to give assureds "peace of mind and security," assureds are peculiarly "vulnerable" to oppressive tactics by the insurer. These factors combine to make the assured acutely susceptible to the tort of intentional infliction of emotional distress. *Id.* at 404, 89 Cal. Rptr. at 95.

It has been suggested that the insurer-insured relationship is such that an insurance company is continually exposed to causes of action for intentional infliction of emotional distress because of (1) the position of power the insurer has over an insured who has suffered a casualty of some sort; (2) the insurer is peculiarly aware of his dominant position and the assured's susceptibility; and (3) the presence of a special duty. Keenan & Gillespie, *The Insurer and the Tort of The Intentional Infliction of Mental Distress: Fletcher v. Western National Life Insurance Co.*, 39 INS. COUNSEL J. 335, 337-40, 342 (1972) [hereinafter cited as Keenan].

The *Fletcher* standard of good faith, regarding the payment of policy benefits in a non-third party context, was soon after adopted in *Richardson v. Employers Liab. Assurance Corp.*, 25 Cal. App. 3d 232, 102 Cal. Rptr. 547 (1972) wherein an insurer, under an uninsured motorist policy, withheld payment on a clearly valid claim for over one year. *Id.* at 239, 102 Cal. Rptr. at 552. The court citing *Fletcher* and *Comunale* stated:

In every insurance policy there is implied by law a covenant of good faith and fair dealing. This implied obligation requires an insurer to deal in good faith and fairly with its insured in handling an insured's claim against it. Here, Employers deliberately, willfully and in bad faith withheld payment of the Richardson claim months after it knew the claim to be completely valid; it forced an arbitration hearing on a claim against which it already knew that it had no defense; even after the award was made, it instructed its local office to attempt "to make the best possible settlement," and forced plaintiffs to resort to litigation to have the award judicially confirmed. This conduct toward its own insured was unconscionable, and constituted a torious breach of contract.

Id. (citations omitted). Note that this case was retried due to the trial court's failure to declare a mistrial when plaintiff's counsel exposed a prejudicial newspaper headline to the jury. The court also took the position that there was insufficient evidence for a jury instruction on emotional distress. In applying the good faith standard, the court upheld the granting of punitive damages. It concluded:

The fact that the conduct constituting the tort also involves the breach of a covenant, implied by law in the insurance policy, does not prevent the recovery of punitive damages under section 3294 by the insured from the insurer.

in Los Angeles. He had insured the premises with three insurance carriers for an aggregate of \$35,000.³³ After a fire substantially destroyed the premises, Gruenberg was arrested and charged with arson³⁴ and defrauding an insurer.³⁵ There was some evidence that Gruenberg had obtained excessive insurance coverage on the premises.³⁶ As is common to most fire policies, Gruenberg was required to submit to an examination under oath. He refused, citing the pending criminal charges. The insurers' counsel rejected Gruenberg's attorney's suggestion that the exam be continued until after the preliminary hearing on the criminal charges. When Gruenberg failed to appear, the insurers' counsel, by letter, denied liability on behalf of the insurers, citing Gruenberg's "failure to submit to the exam under oath and to produce documents."³⁷

Later, the charges against Gruenberg were dropped for want of probable cause; nevertheless, the insurers refused Gruenberg's offer to submit to an exam and continued to abide by their position that there was no coverage.³⁸

The supreme court, recognizing that the great body of bad faith precedents involved excess judgments in a third party context, sought to bridge the gap between these two branches of bad faith. It stated:

These are merely two different aspects of the same duty. That responsibility is not the requirement mandated by the terms of the policy itself—to defend, settle, or pay. It is the obligation, deemed to be imposed by the law, under which the insurer must act fairly and in

Id. at 245, 102 Cal. Rptr. at 556 (emphasis in original). CAL. CIV. CODE § 3294 (West 1970) provides as follows:

In an action for the breach of an obligation not arising from contract, where the defendant has been guilty of oppression, fraud, or malice, express or implied, the plaintiff, in addition to the actual damages, may recover damages for the sake of example and by way of punishing the defendant.

See also Note, Contracting For Punitive Damages: Fletcher v. Western National Life Insurance Company, 4 LOY. L.A.L. REV. 208 (1971).

32. 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973).

33. *Id.* at 570, 510 P.2d at 1034, 108 Cal. Rptr. at 482.

34. *Id.* The arson charge was made under CAL. PENAL CODE § 448a (West 1970).

35. 9 Cal. 3d at 570, 510 P.2d at 1034, 108 Cal. Rptr. at 482. CAL. PENAL CODE § 548 (West 1970) provides:

Every person who willfully burns or in any other manner injures, destroys, sequesters, abandons, or disposes of any property which at the time is insured against loss or damage by fire, or theft, or embezzlement, or any casualty with intent to defraud or prejudice the insurer, whether the same be the property or in the possession of such person or any other person, is punishable by imprisonment in the state prison for not less than one year and not more than 10 years.

36. 9 Cal. 3d at 570, 510 P.2d at 1034, 108 Cal. Rptr. at 482.

37. *Id.* at 571, 510 P.2d at 1035, 108 Cal. Rptr. at 483.

38. *Id.* at 570-71, 510 P.2d at 1034-35, 108 Cal. Rptr. at 482-83.

good faith in discharging its contractual responsibilities. Where in so doing, it fails to deal *fairly and in good faith* with its insured by refusing, without proper cause, to compensate its insured for a loss covered by the policy, such conduct may give rise to a cause of action in tort for breach of an implied covenant of good faith and fair dealing.³⁹

Defense counsel took the position in *Gruenberg* that the plaintiff's failure to appear at the scheduled examination under oath on December 12, 1969, amounted to a breach of the plaintiff's obligation under the fire policy, thereby relieving the insurer of its concomitant duty of good faith and fair dealing.⁴⁰ In response, the court delineated what is undoubtedly the ultimate extension of a good faith obligation in the non-third party area:

While it might be argued that defendants would be excused from their contractual duties (e.g., obligation to indemnify) if plaintiff breached his obligations under the policies, we do not think that plaintiff's alleged breach excuses defendants from their duty, implied by law, of good faith and fair dealing. *In other words, the insurer's duty is unconditional and independent of performance of the plaintiff's contractual obligations.*⁴¹

The court also concluded that "the duty of good faith and fair dealing on the part of the defendant insurance companies is an absolute one."⁴²

Thus, a post-loss breach of the insurance contract terms would not relieve the insurer of the overriding duty of good faith; albeit, the insurer could in appropriate circumstances still deny liability and ultimately refuse to indemnify. Consequently, the thrust of the decision is aimed at regulating an insurer's behavior when the facts attendant to a loss suggest a real possibility of no coverage under the policy terms. The court rather obliquely implies that, given the insurer's understandable belief that arson had been committed, it nevertheless had an obligation to continue its "good faith" conduct, mindful of the assured's possible economic and emotional vulnerability.⁴³ In *Gruen-*

39. *Id.* at 573-74, 510 P.2d at 1037, 108 Cal. Rptr. at 483.

40. *Id.* at 576-77, 510 P.2d at 1039, 108 Cal. Rptr. at 487. The insurer contended that the plaintiff's appearance at the examination was a condition precedent to any action on the assured's part toward recovery under the policy.

41. *Id.* at 578, 510 P.2d at 1040, 108 Cal. Rptr. at 488 (emphasis added).

42. *Id.*

43. *Gruenberg* alleged: "As a 'direct and proximate result of the outrageous conduct and bad faith of the defendants,' plaintiff suffered 'severe economic damages,' 'severe emotional upset and distress,' loss of earnings and various special damages." 9 Cal. 3d at 572, 510 P.2d at 1035, 108 Cal. Rptr. at 483. The court stated the general rule to be: "[A] plaintiff who as a result of a defendant's tortious conduct *loses*

berg, the insurers were required to give the assured the benefit of the doubt regarding the pending criminal charges. Moreover, the decision implies that the insurer must act in good faith even when confronted with an assured's flagrant post-loss non-cooperation. Finally, the decision required the insurers at least to accommodate Gruenberg by providing an alternative date for the examination under oath that would not conflict with the pending criminal proceedings and to refrain from affirmative conduct calculated to produce a coverage defense.

Despite extensive litigation, the courts have yet to lucidly define the basis for the bad faith cause of action. Instead, the law in this area has developed on a piecemeal basis. In characterizing conduct as exhibiting bad faith, the courts generally have tested the facts in each case with three questions. First, would the insurer have settled had the policy limits been unlimited?⁴⁴ Second, did the insurer give as much consideration to the assured's interests as it did its own?⁴⁵ And finally, did the insurer keep the assured apprised of the negotiations regarding settlement?⁴⁶

his property and suffers mental distress may recover not only for pecuniary loss but also for mental distress." *Id.* at 579, 510 P.2d at 1041, 108 Cal. Rptr. at 489 (emphasis in original). While recognizing that the insurer's conduct caused substantial economic loss apart from mental distress, it concluded that "the complaint is sufficiently pleaded with respect to the latter element of damages" thus allowing damages for emotional distress. *Id.* at 580, 510 P.2d at 1042, 108 Cal. Rptr. at 490.

The result is that an insurer, in pre-assessing its own conduct toward its assured, must weigh the assured's economic and emotional vulnerability since its conduct may cause economic damage to the assured which in turn may give rise to damages for emotional distress.

44. *Kinder v. Western Pioneer Ins. Co.*, 231 Cal. App. 2d 894, 42 Cal. Rptr. 394 (1965). The assured in that case rear-ended a vehicle causing the death of two people and personal injury to three others. The assured possessed liability coverage of \$20,000. The company set its policy reserves for the two deaths at a total of \$4,500, and for the personal injuries at \$11,500. These reserves were never changed. The plaintiff offered to settle on two occasions for \$9,500. Both offers were refused. The insurance defense counsel wrote to the company and advised that in his opinion, the company should accept the offer and concluded that "if judgment were awarded, it could very well exceed the policy limit." At trial, the plaintiff made a third and final offer of \$8,000, and the company responded with a counter offer of \$7,500. A verdict of \$30,000 was returned against the assured. *See also* *Davy v. Public Nat'l Ins. Co.*, 181 Cal. App. 2d 387, 5 Cal. Rptr. 488 (1960) (The plaintiff in a personal injury action made demand for the \$5,000 policy limit, and the insurer counter offered \$4,500. Naturally, the injury brought in an excess verdict).

45. *Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 659, 328 P.2d 198, 201 (1958); *Ivy v. Pacific Auto. Ins. Co.*, 156 Cal. App. 2d 652, 660, 320 P.2d 140, 146 (1958).

46. *Kinder v. Western Pioneer Ins. Co.*, 231 Cal. App. 2d 894, 42 Cal. Rptr. 394 (1965). There, the court commented:

The lawyer, although selected by the company, was the lawyer for the insured

In light of the fact that the *Gruenberg* court bridged the gap between the first and third party bad faith suits, a corollary has been added to these considerations. The court will also analyze the totality of the circumstances surrounding the case to determine if the insurer dealt fairly with the assured and took into account his economic and emotional vulnerability.⁴⁷

It is evident that if "bad faith" is extended to the primary-excess insurance relationship, the first three considerations would be easily adaptable as determinations of a bad faith violation, but the underlying policy reasons for adding the *Gruenberg* corollary in the first and third party context may be missing in the primary-excess context. Unlike the first and third party relationship, wherein economic and emotional vulnerability may be extreme, in the primary-excess context the vulnerability is one which the excess carrier has received premiums to accept. Although this element is a factor that courts will consider in determining if a bad faith violation has occurred in situations where it is already established that the good faith requirement exists, in the primary-excess context it may serve as a means to defeat the adoption of a duty of good faith in the first place.

III. EXCESS V. PRIMARY INSURERS

The primary-excess relationship may be formed in either of two ways. First, an individual may purchase two insurance policies, designating from the outset which provides primary and which provides excess coverage.⁴⁸ Or, secondly, an assured may purchase but one pol-

as well. He was also engaged by the company to defend the other claims arising from the accident, and, presumably, had knowledge of the entire factual situation. Scoggins [the insured] was the client and had a right to have information, protection, guidance and advice from the lawyer. His interests should not have been determined by the judgment of the claims manager, which, unknown to him, was at variance with that of the lawyer.

Id. at 901, 42 Cal. Rptr. 2d at 398. See also *Ivy v. Pacific Auto. Ins. Co.*, 156 Cal. App. 2d 652, 660, 320 P.2d 140, 146 (1958); cf. *Palmer v. Financial Indem. Co.*, 215 Cal. App. 2d 419, 30 Cal. Rptr. 204 (1963). In addition, there are other factors entering into the court's determination of bad faith. In *Shapero v. Allstate Ins. Co.*, 14 Cal. App. 3d 433, 92 Cal. Rptr. 244 (1971), the court reasoned that the insurer was not guilty of bad faith failure to settle where the facts indicated that the insured-decedent's estate had left no assets that could be subject to an excess liability from the judgment. In *Garner v. American Mut. Liberty Ins. Co.*, 31 Cal. App. 3d 843, 107 Cal. Rptr. 604 (1973), the court's finding of bad faith appeared to hinge on the fact that the insurer had relinquished its obligation to make a full and independent investigation of all factors relevant in determining potential liability.

47. See note 43 *supra* and accompanying text.

48. This type of coverage is more common among the rather large, sophisticated clients who are exposed to substantial liability. In fact, many of these clients will remain

icy which provides that it shall apply as excess insurance over any other similar insurance that is available on a primary basis.⁴⁹ There is no contractual relationship between the primary and excess insurance carriers in either of these situations; their only link lies with the common assured.

Although there may be variations, generally the primary insurer is usually responsible for the defense and/or settlement of the lawsuit, as well as the duty to indemnify up to a designated amount. The excess insurer's only obligation is to indemnify above the limits of the primary insurer's coverage. In effect, the excess carrier provides "umbrella" coverage against the larger losses that the assured may suffer.

uninsured or self-insured up to a designated amount with umbrella coverage for anything above this figure. Generally, this is because the incidence of small claims are so high that full coverage premiums would be prohibitive.

49. A typical example of this situation is that of an assured operating a "non-owned" vehicle at the time of the accident. As a general rule, the insurer of the automobile is deemed the primary insurer, and the driver's automobile insurer is deemed the excess carrier. Unlike the normal excess-primary relationship, these carriers are linked to the assured nonconsensually, *i.e.*, merely by the fortuitous collision.

The type of insurance provision governing this situation where two policies apply to a single loss is called an "other insurance" clause. The "Travelers Personal Automobile Policy," Policy Forms 100, 102, and LP (2d ed.); Policy Forms 101, at 8 provision reads:

If the insured has other insurance against any damages or loss covered by Part I [liability portion] of this policy the company shall not be liable under this policy for a greater proportion of such damages or loss than the applicable limit of liability stated in the declarations bears to the total applicable limit of liability of all valid and collectible insurance against such damages or loss

This type of "other insurance" clause is known as a "proration" clause, because if both policies apply, the insurers pay in the proportion their respective policy limits bear to the loss. A true excess policy will provide:

[T]he insurance . . . shall apply only as excess insurance over any other similar insurance available to such insured and applicable to such automobile as primary insurance, and this insurance shall then apply only in the amount by which the limit of liability for this coverage exceeds the applicable limit of liability of such other insurance.

Id. However, the insurer must be careful not to word the "other insurance" clause so as to constitute an "escape" provision, *i.e.*, where the other insurer is able to avoid payment altogether by virtue of the policy terms. "Escape" clauses are not favored by the court and should the court so construe the clause, that insurer will be deemed primary. *See, e.g.*, *Fireman's Fund Am. Ins. Cos. v. State Farm Mut. Auto. Ins. Co.*, 273 Cal. App. 2d 445, 78 Cal. Rptr. 38 (1969); *Peerless Cas. Co. v. Continental Cas. Co.*, 144 Cal. App. 2d 617, 301 P.2d 602 (1956); *Air Transp. Mfg. v. Employers' Liab. Assurance Corp.*, 91 Cal. App. 2d 129, 204 P.2d 647 (1949).

Nevertheless a line of cases holds that where there are multiple insurance policies covering the same loss, one with a proration clause and the other naming itself as an excess policy, the policy with the proration clause will be treated as the primary policy. *See, e.g.*, *Pacific Employers Ins. Co. v. Maryland Cas. Co.*, 65 Cal. 2d 318, 419 P.2d 641, 54 Cal. Rptr. 385 (1966).

As with bad faith cases in the third-party context,⁵⁰ the problems between primary and excess insurers involve conflicting interests. For example, if a lawsuit involving significant injuries and borderline liability has been filed against a common assured, the primary insurer with low policy limits may be disposed to pursue a trial on the liability question rather than settle within the policy limits. Simply stated, the primary insurer gambles with the excess insurer's funds in the hope of successfully defending the action.

A conflict of interest can also be manifested in the situation where a trial has ended in an adverse judgment above the primary insurer's policy limits and within the excess insurer's coverage. The primary insurer then either moves for a new trial or files an appeal, and the plaintiff's attorney offers to settle the matter for less than the jury's award if the insurer will forego the new trial or appeal. Since the primary insurer is likely to save little, if anything, on the settlement, it may be persuaded to take its chances on a new trial or appeal to the detriment of the excess insurer.

Situations such as these focus the attention of the insurer on the critical need for a judicial definition of the duties, if any, existing between the two insurance carriers. Is this simply a risk the excess carrier has assumed in avoiding the expense of defending the assured, or is there inherent in the relationship between excess and primary carriers a basic obligation of fairness? If there is a basic obligation of fairness, is it an absolute one as outlined in the first-party context arising from a contractual basis,⁵¹ or is it an independent duty imposed from some other basis? Lastly, if a duty of fairness does exist, is a breach of that duty determined by the strict liability of the three-prong test⁵² as amended by the consideration of the assured's economic and emotional vulnerability⁵³ in the first party context? For the most part, these questions have not been answered in California.

The application of a duty of good faith in the excess-primary relationship was unsuccessfully attempted in *Universal Underwriters Insurance Co. v. Dairyland Mutual Insurance Co.*,⁵⁴ and *Rocky Mountain Fire & Casualty Co. v. Dairyland Insurance Co.*⁵⁵ These two cases, applying Arizona law, illustrate the problems that California courts must consider.

50. See text accompanying note 6 *supra*.

51. See text accompanying notes 39-42 *supra*.

52. See text accompanying notes 44-46 *supra*.

53. See text accompanying note 43 *supra*.

54. 433 P.2d 966 (Ariz. 1967).

55. 452 F.2d 603 (9th Cir. 1971).

In *Universal*, a vehicle owned by one Meyer was involved in an automobile accident while being driven by a garage employee. The garage-keeper's policy with Universal was deemed excess, and Meyer's \$10,000 policy with Dairyland was deemed primary.⁵⁶ When Dairyland refused to defend a lawsuit filed against its insured, Universal provided a defense and subsequently settled the matter for \$30,000.⁵⁷ Universal then brought an action to recover the judgment plus attorneys' fees and costs. It argued that Dairyland's refusal to defend and indemnify constituted bad faith and, therefore, required the primary insurer to be liable for the entire judgment, even though it exceeded its own policy limits.⁵⁸ Although Universal was granted a contribution from Dairyland of \$10,000, the court rejected its cause of action for bad faith:

Without doubt Dairyland owed good faith to its insured, which may or may not have been here exercised, a question we find unnecessary to answer. There is no [*privity*] of contract between these two insurance companies nor is there any principle of law which we are aware that would give Universal such a windfall because of Dairyland's mistreatment of its assured. The principle applicable is that, where two companies insure the same risk and one is compelled to pay the loss, it is entitled to a contribution from the other.⁵⁹

An identical conclusion was reached in *Rocky Mountain*. There, Rocky Mountain was the excess carrier and Dairyland, the primary carrier, defended. An excess judgment resulted.⁶⁰ Dairyland then moved for a new trial, and the plaintiff responded with an offer to settle below the jury award, but still in excess of Dairyland's primary limits.⁶¹ Rocky Mountain urged Dairyland to accept the offer, and even offered to contribute to the settlement above Dairyland's limits.⁶² Dairyland refused, and a new trial resulted in a verdict larger than the first.⁶³

Rocky Mountain alleged that:

(1) Dairyland owed a duty of good faith to the excess insurer and breached that duty by refusing to offer to pay its policy limits in settle-

56. 433 P.2d at 968.

57. *Id.* at 967.

58. *Id.* at 968.

59. *Id.* (emphasis added).

60. 452 F.2d at 603.

61. *Id.*

62. *Id.*

63. *Id.*

ment, and (2) Rocky Mountain, as *subrogee of . . .* [the assured's] *rights*, can recover for Dairyland's alleged breach of its duty to . . . [the assured] to negotiate in good faith.⁶⁴

The court, relying solely on *Universal*, summarily rejected both bases of the complaint.

Universal and *Rocky Mountain* demonstrated three significant questions an excess carrier seeking reimbursement from a primary carrier must consider: privity of contract; the doctrine of subrogation; and a *direct* duty of good faith between the two insurers. Ultimately, the success of these legal avenues, as a means by which the excess carrier can sue on a bad faith cause of action, will depend on whether or not the California courts conclude that the existence of such a remedy for excess carriers is in furtherance of some public policy.

A. Privity of Contract

It is clear that the bad faith cause of action arises out of the creation of a contract. As the court indicated in *Comunale*, "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."⁶⁵ Ostensibly, no privity exists between the primary and excess insurers since they both deal independently with the assured.

Two California cases, *Lysick v. Walcom*⁶⁶ and *Gruenberg v. Aetna Insurance Co.*,⁶⁷ have examined the question of bad faith in conjunction with contractual privity. In *Lysick*, the plaintiff argued that the obligation of good faith and fair dealing ran in favor of the assured from defense counsel, as well as from the carrier. The court responded:

It is apparent that the foregoing rule [of good faith] is one that applies to the insurance company and the insured, and not to the attorney for either of them, since it finds its genesis in the contractual relationship between the insurer and the insured which gives rise to the implied covenant imposing the duty described by the rule.⁶⁸

64. 452 F.2d at 603 (9th Cir. 1971) (emphasis added). The trial jury award was for \$12,500. Plaintiff offered to settle for \$12,000, and Rocky Mountain offered to contribute \$2,000 toward the demand if Dairyland would drop its motion for a new trial. A new trial was granted and it ended with a jury award of \$21,500. *Id.*

65. 50 Cal. 2d at 658, 328 P.2d at 200. See text accompanying note 16 *supra*.

66. 258 Cal. App. 2d 136, 65 Cal. Rptr. 406 (1968).

67. 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973).

68. 258 Cal. App. 2d at 149, 65 Cal. Rptr. at 415.

Instead, the court concluded that the attorney's standard of conduct is prescribed by "established standards of professional ethics."⁶⁹

The same point was emphasized in *Gruenberg*. In that case the insured alleged, *inter alia*, a breach of the implied covenant of good faith and fair dealing.⁷⁰ He named as defendants the three insurance companies who insured the destroyed building, the insurance adjuster and adjusting firm, and the insurance defense firm, including one of its attorneys. While upholding the validity of the complaint as to the insurance companies, the California Supreme Court perfunctorily dismissed the complaint as to the other named defendants:

[S]ince the remaining defendants were not subject to the implied duty arising from the contractual relationship, we conclude that the complaint does not state sufficient facts to constitute a cause of action against them⁷¹

Although not dealing with the primary-excess relationship directly, it is evident that California courts are reluctant to apply the bad faith concept in the absence of privity. Consequently, if California courts are to recognize bad faith in the primary-excess context, they are likely to rely on concepts other than those arising from the contractual agreement.

B. *Equitable Subrogation*

The general rule of equitable subrogation is that "an insurer, on paying a loss, is subrogated in a corresponding amount to the insured's right of action against any other person responsible for the loss."⁷² Only a few bad faith cases have dealt with this issue. Significant among these is a New York case, *Home Insurance Co. v. Royal Indemnity Co.*⁷³ There, the underlying personal injury action resulted in a verdict of \$1,250,000. Royal, the primary insurance carrier, had policy limits of \$500,000, while Home assumed the risk for everything from \$500,000 to \$1,500,000. While an appeal was pending, plaintiff's counsel offered to settle for \$700,000 and then \$900,000.

69. *Id.*

70. 9 Cal. 3d at 573, 510 P.2d at 1036, 108 Cal. Rptr. at 484.

71. *Id.* at 581, 510 P.2d at 1042, 108 Cal. Rptr. at 490.

72. 6A APPLEMAN, *supra* note 11, § 4051, at 103 (footnote omitted). The doctrine of subrogation does not arise from the terms of the contract. Instead, [i]t has its origin in general principles of equity, and the nature of the contract of insurance. In fact it would be applied or not according to the dictates of equity and good conscience, and considerations of public policy, resting as it does, upon the maxim that no one should be enriched by another's loss.
Id. (citation omitted).

73. 327 N.Y.S.2d 745 (Sup. Ct. 1972).

Home, understandably disturbed by the high trial court judgment, had already communicated to Royal that it would seek indemnity for anything that it would be forced to pay.⁷⁴ The primary insurer rejected the plaintiff's settlement offer. Eventually, the appeal reduced the award to \$749,111.53, with Home contributing \$200,000. Thereafter, Home brought an action to recover its contribution, alleging that Royal had "acted negligently and in bad faith" in refusing to accept an offer of settlement within its policy limits.⁷⁵ Royal counterclaimed, asserting that Home's refusal to cooperate with the post-trial settlement arrangement was in bad faith. The court concluded:

Home, once it paid so much of . . . [the assured's] obligation under the judgment as it was required to do by its insurance contract, became the equitable assignee or subrogee of . . . [the assured's] rights with respect thereto. In this case, vis-a-vis Royal, it is an insured—not an insurer—and its rights and obligations must be viewed in that context. Just as Royal owed Home the duty of negotiating in good faith so Home owed Royal the contractual duty of cooperation and the common law duty to mitigate damages.⁷⁶

Thus, without discussion, the *Home* court applied the concept of equitable subrogation to the benefit of an excess insurance carrier.

As the court described it, equitable subrogation allows the insurer to stand in the shoes of its assured and assume whatever rights or obligations the assured may have had.⁷⁷ The subrogating insurer's

74. *Id.* at 747. The basis for Home's claim was failure to settle within the policy limits and negligence in defense.

75. *Id.*

76. *Id.* at 748 (citations omitted). While the court mentioned both equitable subrogation and equitable assignment, other courts have indicated that there is little difference between the two concepts:

While subrogation and assignment have certain technical differences, each operates to transfer from one person to another a cause of action against a third, and the reasons of policy which make certain causes of action nonassignable would seem to operate as forcefully against the transfer of such causes of action by subrogation.

Fifield Manor v. Finston, 54 Cal. 2d 632, 640, 354 P.2d 1073, 1078, 7 Cal. Rptr. 377, 382 (1960). Regardless of the label, the ultimate effect is to pass title to a cause of action to another person. See 6A APPLEMAN, *supra* note 11, § 4054, at 142-46.

77. 327 N.Y.S.2d at 748. The barriers to subrogation are public policy, equitable principles, and statutory construction. See *American Ins. Co. v. City of Milwaukee*, 187 N.W.2d 142, 146 (Wis. 1971).

One author commented:

The origin and basis of subrogation is stated to be in the nature of things; that is, it grows out of natural justice demanded by the facts of the situation. Subrogation was judicially stated to be merely the doctrine of the square deal, it is enforced only in favor of a superior equity, and it is for the equity court to say who, in good conscience, should bear the loss. The doctrine is not regarded as an inflexible legal concept, but is simply an exercise of equitable powers carried out in the exercise of proper equitable discretion, with a due regard for the legal

(subrogee) rights are strictly limited to those rights possessed by the assured (subrogor).⁷⁸ Subrogation is permitted in order to shift the loss to the real wrongdoer.⁷⁹ Additionally, it is designed to prevent the assured from procuring double recovery against the tort-feasor and insurers.⁸⁰ Generally, subrogation is only allowed in forms of indemnity insurance, *i.e.*, when the assured's loss is liquidated.⁸¹

The doctrine of equitable subrogation can only be effective if used in conjunction with the Collateral Source Rule, a rule that denies the wrongdoer credit for reparation made to the injured party from sources other than the wrongdoer.⁸² For example, if an assured's home burns down, he is reimbursed by his premises' insurer. The insurer then subrogates to the assured's cause of action against the individual responsible for the loss. However, because of the Collateral Source Rule, the responsible party *cannot* assert as a defense the fact that the assured has already been compensated for the loss by the assured's insurance coverage and is, therefore, not damaged. Without the application of the Collateral Source Rule, the insurer's subrogation rights would be useless.

As to the propriety of the subrogation remedy in California, two important cases have rigidly confined the circumstances in which subrogation will be countenanced.⁸³ The first of these cases was *Patent*

and equitable rights of others.

11 APPLEMAN, *supra* note 11, § 6502, at 294 (footnotes omitted). *See, e.g.*, Federal Ins. Co. v. Allen, 13 Cal. App. 3d 648, 650, 92 Cal. Rptr. 125, 126 (1970); Agricultural Ins. Co. v. Smith, 262 Cal. App. 2d 772, 777-78, 69 Cal. Rptr. 50, 54 (1968); Employers Mut. Liab. Ins. Co. v. Pacific Indem. Co., 167 Cal. App. 2d 369, 376, 343 P.2d 658, 662 (1959).

78. Fleming, *The Collateral Source Rule and Loss Allocation in Tort Law*, 54 CALIF. L. REV. 1478 (1966) [hereinafter cited as Fleming]. *See* R. HORN, SUBROGATION IN INSURANCE THEORY AND PRACTICE (1964); Kimball & Davis, *The Extension of Insurance Subrogation*, 60 MICH. L. REV. 841 (1962) [hereinafter cited as Kimball].

79. Fleming, *supra* note 78, at 1483.

80. *Id.*

81. Kimball, *supra* note 78, at 844-48. *See, e.g.*, Fifield Manor v. Finston, 54 Cal. 2d 632, 354 P.2d 1073, 7 Cal. Rptr. 377 (1960); Block v. California Physicians' Serv., 244 Cal. App. 2d 266, 53 Cal. Rptr. 51 (1966); Peller v. Liberty Mut. Fire Ins. Co., 220 Cal. App. 2d 610, 34 Cal. Rptr. 41 (1963) (wherein a medical payments subrogation claim was voided); KEETON, *supra* note 18, at 147-53; 8 U.C.L.A.L. REV. 668, 672 (1961).

82. For a discussion of the Collateral Source Rule, *see* Maxwell, *The Collateral Source Rule in the American Law of Damages*, 46 MINN. L. REV. 669 (1962); Schwartz, *The Collateral Source Rule*, 41 B.U.L. REV. 349 (1961).

83. Mid-Century Ins. Co. v. Hustel, 10 Cal. App. 3d 1065, 89 Cal. Rptr. 421 (1970); Patent Scaffolding v. William Simpson Constr. Co., 256 Cal. App. 2d 506, 64 Cal. Rptr. 187 (1967).

*Scaffolding Co. v. William Simpson Construction Co.*⁸⁴ Simpson, a general contractor, contracted with the California Institute of Technology to construct a building. Simpson then contracted with Patent Scaffolding, a sub-contractor, to furnish scaffolding and other equipment. The contract between Simpson and Patent Scaffolding provided that the general contractor would procure insurance protecting Patent Scaffolding's equipment without cost to Patent Scaffolding. A fire destroyed certain equipment of Patent Scaffolding's, and their insurers were forced to indemnify. Patent Scaffolding's insurer then proceeded by way of equitable subrogation in an attempt to recover from Simpson on the theory that Simpson had breached its promise to provide insurance.⁸⁵ They contended that having indemnified Patent Scaffolding for the fire loss, they were subrogated to Patent Scaffolding's right of action for breach of a contract to provide insurance against Simpson.⁸⁶ The court reasoned that an insurer's loss cannot be substituted for an assured's loss if the insurer's loss was not proximately caused by Simpson's act or omission.⁸⁷ The court concluded:

The insurers' loss was not caused by Simpson's failure to get insurance or to indemnify Patent. The insurers' loss was caused by the fire, the very risk which each assumed, and Simpson's [*sic*] failure to perform its contractual duty had nothing to do with the fire.⁸⁸

In addition, the court held that the subrogating insurer could not claim the benefit of the Collateral Source Rule in meeting the defendant's contention that the assured (subrogor) had not, in fact, been damaged,⁸⁹ concluding that the application of the Collateral Source Rule would be inappropriate because again the loss had been occasioned not by the breach of the contract, but by the fire itself.⁹⁰

By analogy, in the excess-primary context, the primary carrier might take the position that the assured has, in fact, not been damaged, since the judgment above the primary policy limits was covered within the excess carrier's policy limits. The subrogating excess carrier might then claim that the Collateral Source Rule prevented the primary carrier from raising the pre-existence of compensation. The primary car-

84. 256 Cal. App. 2d 506, 64 Cal. Rptr. 187 (1967).

85. *Id.* at 507-09, 64 Cal. Rptr. at 189-91.

86. *Id.* at 511, 64 Cal. Rptr. at 192.

87. *Id.*

88. *Id.* at 512, 64 Cal. Rptr. at 192.

89. *Id.* at 514, 64 Cal. Rptr. at 193. For a discussion of the Collateral Source Rule, see note 82 *supra* and accompanying text.

90. 256 Cal. App. 2d at 514, 64 Cal. Rptr. at 193.

rier, relying on *Patent Scaffolding*, could counter by arguing that the application of the Collateral Source Rule would be inappropriate to the situation, for the proximate cause of the loss would not be the primary carrier, but the negligent assured.

Basically, *Patent Scaffolding* recognizes that (aside from subrogation designed to properly place the burden for the underlying loss on the party at fault) no public policy is served by shifting losses between insurers.⁹¹ In the primary versus excess insurer context, the assured's cause of action for bad faith against the primary carrier is just a fiction to provide a vehicle for subrogation, since the assured has suffered no real loss. *Patent Scaffolding* suggests that in cases where the insurers have been required to pay for a risk compensated by premiums, the denial of subrogation prevents an insurer from receiving a wind-fall.⁹²

A similar conclusion was reached in *Mid-Century Insurance Co. v. Hutsel*.⁹³ There, an insurance agent negligently failed to procure an insurance renewal for his client's automobile. The vehicle was being used by the owner's step-son with the permission of the owner when an accident occurred. The permissive user was insured with Mid-Century Insurance. Mid-Century sought reimbursement through the doctrine of equitable subrogation.⁹⁴ The court, relying on *Patent Scaffolding*, rejected this approach, stating: "Any loss Mid-Century may sustain will not be caused by Hutsel's [the agent's] failure to procure insurance . . . [but because] Leakes, its insured, negligently caused an automobile accident."⁹⁵

Subrogation by insurers has been traditionally allowed only in respect to property and indemnity insurance policies. It is not entirely clear why subrogation is thus limited to the exclusion of other types of insurance. Suffice it to say that subrogation is a peculiar equitable creature and that some compelling public policy rationale will be required before the California courts will allow an excess carrier to subrogate against a primary carrier. For example, a strong case could be asserted for allowing subrogation if the insurer could demonstrate that recoveries by virtue of subrogation had entered into the premium calculations, but there is little evidence that subrogation has a serious impact on premium schedules. One writer in the field commented:

91. *Id.* at 515-16, 64 Cal. Rptr. at 194.

92. *Id.*

93. 10 Cal. App. 3d 1065, 89 Cal. Rptr. 421 (1970).

94. *Id.* at 1070, 89 Cal. Rptr. at 424.

95. *Id.*

"Subrogation is a windfall to the insurer. It plays no part in rate schedule or only a minor one; and no reduction is made in insuring interests."⁹⁶

In *Comunale* and *Brown*, the courts recognized the validity of the assured's assignment of his cause of action for bad faith to the judgment creditor.⁹⁷ Obviously, the assignment vehicle could be equally applicable in the excess-primary context, but the propriety of either legal vehicle (equitable subrogation or assignment) depends upon whether the assured possesses a cause of action for bad faith to begin with. In both instances, the subrogating carrier or assignee is strictly limited to the rights possessed by the assured and can only pursue a bad faith cause of action if the assured has one.

In *Home*,⁹⁸ the assured suffered no real damage by the primary carrier's failure to settle within the policy limits since it possessed excess coverage with Home. *Home* accepted without comment the dubious conclusion that an assured has a cause of action for bad faith against a primary carrier even though the assured's personal assets are not threatened.⁹⁹

There is some support in California for the position that where the assured's personal assets are not threatened by the insurer's conduct, there is no bad faith cause of action.¹⁰⁰ *Shapero v. Allstate Insurance Co.*¹⁰¹ presented a unique situation where the deceased assured, defendant to a bodily injury action, left an estate with no assets other than a liability insurance policy. Although there was no demand to settle within the policy limits, the case was tried and resulted in an excess verdict. The estate then assigned its cause of action for bad faith to the judgment creditor. All parties were cognizant that the defendant's estate was judgment-proof.

In deciding that the estate's insurer was not guilty of bad faith, the court commented:

Allstate could not be found guilty of bad faith for accepting as a working hypothesis the fact which was also assumed by the personal representative of its assured—that the estate had no interest, no financial

96. E. PATTERSON, ESSENTIALS OF INSURANCE LAW 151 (2d ed. 1957).

97. 50 Cal. 2d at 661-62, 328 P.2d at 202 (assignment by judgment creditor); 155 Cal. App. 2d at 692-96, 319 P.2d at 77-79 (assignment by trustee in bankruptcy).

98. See notes 73-77 *supra* and accompanying text.

99. 327 N.Y.S.2d at 748.

100. *Shapero v. Allstate Ins. Co.*, 14 Cal. App. 3d 433, 438, 92 Cal. Rptr. 244, 247-48 (1971).

101. *Id.*

stake in the outcome of the litigation, and no assets which would be exposed to risk by a failure of Allstate to settle.¹⁰²

In sum, the court concluded that an insurer, in considering settlement, must weigh the competing interests of the insurance company and the assured; and, that in the instant case, "there was no breach of the implied covenant because there was no interest to be damaged."¹⁰³ But the court mentioned that cases where the assured was "alive" with no assets were distinguishable, since the insurer must consider the assured's interest and his "future solvency and credit standing."¹⁰⁴

In addition, in *Merritt v. Reserve Insurance Co.*¹⁰⁵ the court acknowledged that when an insurer is evaluating a settlement offer, "the carrier is theoretically required to assume that its assured can respond in damages to the full amount of the claim."¹⁰⁶ Nonetheless, the court stated that the financial status of the assured was a "critical element" and that "in each instance the carrier is required to give serious and careful consideration to the *true* position and interests of its assured."¹⁰⁷

In any event, whether the assured is alive or dead, if there is excess insurance involved, in reality the assured's financial interests are not endangered, and there is, in effect, no conflict presented to the carrier. Absent an endangered interest, no bad faith cause of action attaches, and there is nothing to which the excess carrier can be subrogated.

C. Direct Duty

It is conceivable that the California courts could dictate a covenant of good faith and fair dealing between excess and primary insurers notwithstanding lack of privity and independent of the equitable subrogation theory. There are cases which have done this; however, to date all of them have come from the Tenth Circuit.

In *St. Paul-Mercury Indemnity Co. v. Martin*,¹⁰⁸ a declaratory relief

102. *Id.* at 438, 92 Cal. Rptr. at 247-48.

103. *Id.* at 439, 92 Cal. Rptr. at 248.

104. *Id.* at 438 n.1, 92 Cal. Rptr. at 248 n.1.

105. 34 Cal. App. 3d 858, 110 Cal. Rptr. 511 (1973).

106. *Id.* at 874, 110 Cal. Rptr. at 522, citing *Kinder v. Western Pioneer Ins. Co.*, 231 Cal. App. 2d 894, 42 Cal. Rptr. 394 (1965).

107. 34 Cal. App. 3d at 875, 110 Cal. Rptr. at 522 (emphasis added).

108. 190 F.2d 455 (10th Cir. 1951). Also in *American Fidelity & Cas. Co. v. All American Bus Lines, Inc.*, 190 F.2d 234 (10th Cir. 1951) the Tenth Circuit clearly indicated that an excess carrier was entitled to equitable subrogation to the assured's bad

action was brought by a primary insurer against an excess insurer to determine whether or not an excess insurer can force a primary insurer to pay its entire policy limits in settlement of a lawsuit involving questionable liability. The court, in concluding that an excess carrier could not, stated, in dictum:

As the primary insurer, St. Paul was required under its relationship to its insured and the excess insurer, to exercise good faith in determining whether an offer of compromise of settlement should be accepted or rejected.¹⁰⁹

The court's dictum plainly states that a duty of good faith exists between primary and excess carriers. The court's rationale for this position is not explicitly enunciated, but further in the opinion the court makes an observation which provides a clue: "If [the primary insurer] acts in good faith and without negligence in refusing the proffered settlement, it has fulfilled its duty to its insured, and those in privity with it."¹¹⁰

This language suggests that the duty of good faith is somehow linked with contractual privity (a position accepted by the California courts),¹¹¹ but the court does not explain how it was able to find privity between the carriers.

The only case to openly recognize that a duty of due care and good faith exists, despite the patent lack of privity, is *United States Fidelity & Guaranty Co. v. Tri-State Insurance Co.*¹¹² In dictum,¹¹³ the court

faith cause of action against the primary carrier. *Id.* at 238. In an earlier trial, Security, the excess carrier, pursuant to its subrogation clause, had requested the assured to assert a bad faith action against American Fidelity, the excess carrier, for failure to settle within the policy limits. The holding only involved peripherally the equitable subrogation concept, dealing in the main with the propriety of Security's substitution in the action. Nonetheless, ostensibly, the case supports the use of equitable subrogation by the excess carrier.

109. 190 F.2d at 457. See generally Bloom, *Recovery Against Primary Insurer By Excess Carrier For Bad Faith or Negligent Failure to Settle*, 36 INS. COUNSEL J. 235, 237 (1969) [hereinafter cited as Bloom]; and Knepper, *Relationships Between Primary and Excess Carriers in Cases Where Judgment or Settlement Value Will Exhaust the Primary Coverage*, 20 INS. COUNSEL J. 207 (1953) [hereinafter cited as Knepper].

110. 190 F.2d at 458.

111. See notes 65-71 *supra* and accompanying text.

112. 285 F.2d at 579 (10th Cir. 1960).

113. The court in this case felt that the excess carrier was not entitled to contribution from the primary insurer for expenses incurred in the successful defense of a third-party action, although the primary carrier had breached its obligation to defend. The court concluded: "The duty to defend is personal to each insurer. The obligation is several and the carrier is not entitled to divide the duty nor require contribution from

commented:

The obligation to the excess carrier is not contractual and is based only upon the duty of the primary carrier to perform the obligation which it alone has assumed, that is, provide primary coverage.¹¹⁴

The court concluded that the primary carrier was obligated to exercise good faith in handling third-party actions against the insured: "And this duty is not lessened by the existence of excess insurance but is extended to include the excess carrier within the shelter of the obligation."¹¹⁵

In recognition of this Tenth Circuit extension, one author has stated that:

If the primary carrier violates this duty by failing to exercise good faith or ordinary care, *whatever may be the rule*, it probably will be held liable to repay to the excess carrier such sums as it has been required to pay as the result of the misconduct of the primary carrier.¹¹⁶

A similar conclusion was reached by another author who adduced: "[T]heoretically no legal reason or bar exists why an excess carrier cannot recover from the primary carrier."¹¹⁷

These commentators, while offering no demonstrable reason for such an extension, suggest that since there is "no legal reason or bar" in opposition, the bad faith cause of action should be adopted. This reasoning is both circuitous and erroneous. The underlying basis for implying bad faith is contractual privity. Absent that, the question which must be raised is whether or not there is a persuasive policy reason for adopting the bad faith cause of action which negates the lack of privity and requires such an application in contravention of established contract law. From this perspective it seems clear that, even in the Tenth Circuit which has recognized bad faith in the primary excess relationship, sufficient policy reasons have not been formulated.

CONCLUSION

Undoubtedly the California courts will not be enthused by the fact that the creation of such a cause of action would increase the already

another absent a specific contractual right." *Id.* at 582. *Contra*, *Continental Cas. Co. v. Zurich Ins. Co.*, 57 Cal. 2d 27, 366 P.2d 455, 17 Cal. Rptr. 12 (1961).

114. 285 F.2d at 581.

115. *Id.* Note, however, that the court did recognize that no contractual privity existed between the two insurers and therefore implied no subrogation rights.

116. Knepper, *supra* note 109, at 211 (emphasis added).

117. Bloom, *supra* note 109, at 238.

prolific amount of insurance litigation in both the trial and appellate levels in the state. Perhaps this negative factor could be outweighed by the possibility that the creation of such a cause of action might increase the amount of lawsuits that are *settled* by primary insurers before trial in situations with an excess carrier waiting in the wings. Currently, the California primary carrier is not required to settle such cases, since there have been no bad faith cases against primary insurers where an excess carrier provided coverage. Theoretically, such a cause of action could decrease the number of cases going to trial, and perhaps offset the increased number of bad faith suits filed between primary and excess carriers. But surely any change premised on this hypothesis should be supported by something beyond theoretical speculation.

In the final analysis, there is a genuine controversy as to the complexion this new found duty of good faith should assume. Essentially, the courts will have to grapple with the question of whether or not an excess carrier should benefit from the stringent duty of good faith and fair dealing that a primary insurer currently owes to its assured.¹¹⁸ Whether the California courts utilize equitable subrogation or an independent adaptation of bad faith to subvert the privity problem, the excess carrier would benefit, thus being exculpated from the liability for which it accepted premiums. Moreover, the ultimate subsidizer of litigation between primary and excess carriers would be the assured through the medium of higher premiums, and yet the assured has *no* interest in *which* one of the carriers pays the bill. There is simply no persuasive policy reason why an excess carrier should receive a "windfall" from a newly formulated application of the standard of good faith, and absent such a policy rationale, California should not extend the bad faith cause of action to the primary-excess carrier suit.

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118. Obviously, this will be the result if the court sanctions the equitable subrogation approach. It has been suggested that this approach may not be appropriate. In light of the sophistication of the excess carrier, the court should be inclined to force the insurer to take steps to protect its own interests. Knepper, *supra* note 109, at 208.