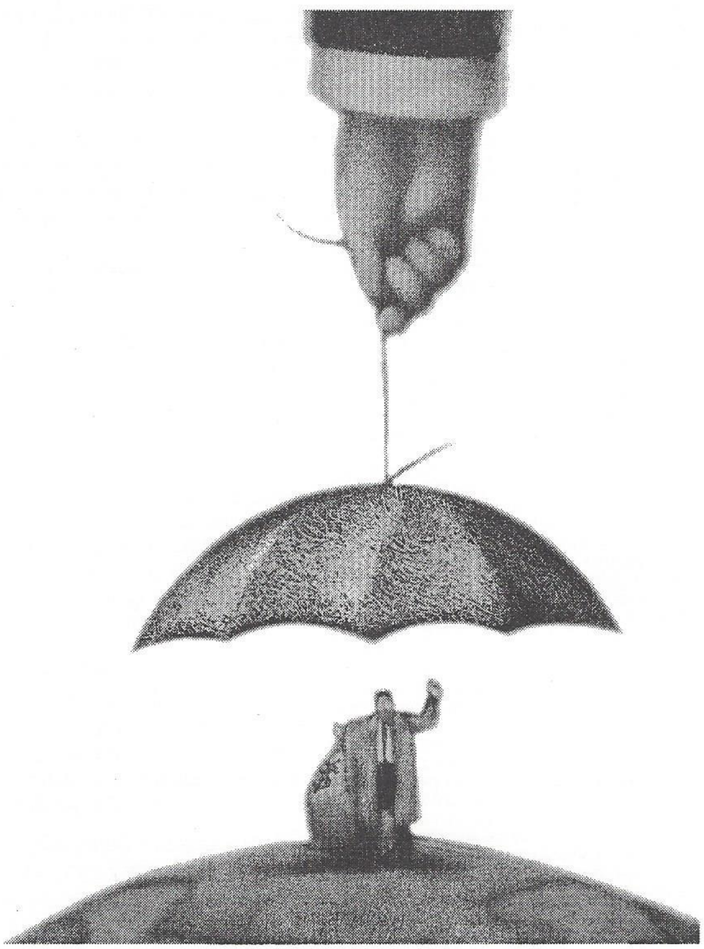
Primary Insurers' Duty to Exercise Good Faith Toward Excess-Insurance Carriers

By Beth Boggs and Daniel McLaughlin

A review of primary insurers' obligations to and duties toward excess-insurance carriers in settlement negotiations.



Illinois law has long recognized a cause of action for negligent or bad-faith refusal of liability insurers to settle underlying claims within policy limits when doing so exposes insureds to judgments in excess of their policy limits (for a very recent Illinois Supreme Court case on this issue, see *Haddick v Valor Insurance*[1]). Still unsettled is whether this duty, owed by insurers to their insureds, extends to excess-insurance carriers.

This article reviews Illinois and federal case law on the obligation of primary insurers to exercise good faith toward excess-insurance carriers in settlement negotiations.

I. Background

Generally, refusal to settle a claim within policy limits does not render an insurer liable per se to its insured.[2] The law typically does not oblige insurance companies to settle within policy limits, and failure to win a particular trial does not show bad faith.[3] However, an insurer must act as a fiduciary to its insured and may not act negligently or in bad faith toward the best interests of the insured.[4] Therefore, an exception to the general rule is that a duty to settle arises where the probability of an adverse finding on liability is great and where the amount of the probable recovery would greatly exceed policy coverage.[5]

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1. No 90226 (Ill Supreme Ct November 21, 2001).
2. *Kavanaugh v Interstate Fire and Casualty Company*, 35 Ill App 3d 350, 342 NE2d 116 (1st D 1975).
3. *Schal Bovis, Inc. v Casualty Insurance Company*, 314 Ill App 3d 562, 574, 732 NE2d 1082, 1092 (1st D 1999).
4. *California Union Insurance Company v Liberty Mutual Insurance Company*, 920 F Supp 908 (ND Ill 1996).
5. Id, 920 F Supp at 920-21.

Although case law is clear that a primary insurer has a duty to act in good faith toward its insured, the issue is not as clear with respect to excess-insurance carriers. Courts have long held that an insurer owes its insured a duty of good faith in the settlement of cases. Where the insured has purchased excess liability coverage, however, the excess carrier stands in the insured's shoes.

When a primary carrier defends its insured, it controls the entire defense. By controlling the defense of lawsuits against the insured, the primary carrier can significantly affect the excess insurer's exposure. When the primary insurer rejects a settlement offer within the primary policy's limits and suffers an adverse verdict in excess of those limits, the excess insurer may seek to hold the primary insurer liable for the excess verdict.[6] A number of jurisdictions have addressed this issue.[7]

In 1989, the federal district court for the northern district of Illinois struggled with this issue in *Ranger Insurance Co. v Home Indemnity Company.*[8] The court looked to Illinois case law but found little. Nevertheless, after reviewing other jurisdictions, the court concluded that "the Illinois Supreme Court would impose such a duty and allow an excess carrier to bring suit" to remedy a breach.[9]

In 1994, the seventh circuit recognized the principle of equitable subrogation under Illinois law,[10] and in 1999 the Illinois Court of Appeals also found that a primary insurer has a duty to exercise good faith to excess-insurance carriers in *Schal Bovis, Inc. v Casualty Insurance Company.*[11]

The equitable-subrogation theory allows an excess insurer to step into the shoes of the insured and pursue a claim against the primary insurer when it bears the expense of an adverse judgment.[12] The following section will review these seminal cases.

II. Creation of a Duty

Illinois courts have not always been receptive to requiring primary insurers to exercise good faith vis a vis excess insurers. The federal courts have laid the groundwork for this duty.

A. Ranger Insurance Company v Home Indemnity Company

In *Ranger*, the question before the district court was whether a primary insurer is liable to the excess carrier for post-judgment interest on the entire judgment where the primary tendered its portion of the judgment but not interest or costs. The court held that the primary carrier was responsible for post-judgment interest on the entire judgment assessed against the insured, including interest on the portion of the judgment covered by the insured's excess-insurance carrier.[13] In so doing, the court created a duty of good faith for primary insurers to excess carriers.

This case arose from a dispute between defendant Home Indemnity Company, the primary carrier of comprehensive liability for a general contracting company, and plaintiff Ranger Insurance Company, the excess carrier, over who should assume liability for the judgment and post-judgment interest assessed against the general contrac-

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6. Michael M. Marick, *Excess Insurance: An Overview of General Principles and Current Issues*, 24 Tort & Ins L J 715 (1989); Annotation, *Excess Carrier's Right To Maintain Action Against Primary Liability Insurer For Wrongful Failure To Settle Claim Against Insured*, 10 ALR 4th 879 (1981). For a recent case on timing for bad-faith purposes, see *Haddick v Valor Ins.*, No 90226 (Ill Supreme Ct, Nov. 21, 2001).

7. Jurisdictions which have recognized a duty are: *Peter v Travelers Ins. Co.*, 375 F Supp 1347 (CD Cal 1974) (Applying California law, the court held that a primary insurer has an obligation to its insured to settle a claim within the insured's primary policy limits when a prudent insurer without policy limits would have accepted a similar settlement offer. When insured has excess coverage, the excess carrier has a cause of action through the doctrine of equitable subrogation); *Phoenix Ins. Co. v Florida Farm Bureau Mut. Ins. Co.*, 558 So2d 1048 (Fla App 2d D 1990) (excess insurer stands in shoes of insured with respect to primary insurer's duty to defend, which requires insurer to investigate facts and to make a good faith offer to settle if a prudent person would do so); *Ranger Ins. Co. v Travelers Indem. Co.*, 389 So2d 272 (Fla App 1st D 1980) (when an excess carrier pays the excess liability, it is thereby subrogated to the insured's rights against the primary carrier); *Great Southwest Fire Ins. Co. v CNA Ins. Cos.*, 547 So2d 1339 (La App 3d Cir 1989) (although a primary insurer owes no independent direct legal duty to an excess insurer regarding the defense of settlement of claims on behalf of a mutual insured, an excess insurer, as the insured's subrogee, does have a right of action for damages against a primary insurer for alleged bad-faith failure to properly defend and/or settle a liability claim on behalf of such insured); *St. Paul Ins. Co. v AFIA Worldwide Ins. Co.*, 937 F2d 274 (5th Cir La 1991) (applying Louisiana law, the court found a primary carrier owes no independent duty to the excess carrier, but an excess carrier may become subrogated to the insured's rights against the primary insurer to assert bad-faith to settle a claim where such conduct results in the excess carrier making payment on behalf of the insured); *Hartford Casualty Ins. Co. v New Hampshire Ins. Co.*, 417 Mass 115, 628 NE2d 14 (1994) (Excess carriers may become subrogated to the rights of the insured when the primary carrier acts in bad-faith in settlement negotiations. Test is not whether reasonable insurer might have settled case within policy limits, but rather whether no reasonable insurer would have failed to settle case within policy limits); *Commercial Union Ins. Co. v Medical Protective Co.*, , 426 Mich 109, 393 NW2d 479 (1986) (Excess insurer may maintain cause of action against primary insurer for the latter's bad-faith failure to defend or settle within policy limits. The excess insurer is equitably subrogated to the position of insured and acquires no lessor or greater rights than those held by insured); *American Centennial Ins. Co. v Canal Ins. Co.*, 843 SW2d 480 (Tex 1992) (Where primary insurer's negligence has resulted in insured's liability for amount within excess insurer's coverage limits, insured has no motivation to seek redress from primary insurer, since insured is not exposed to personal liability. Primary insurer should not be relieved, by the fact that insured has obtained excess coverage, of consequences of its failure to meet its obligations to insured).

8. 714 F Supp 956 (ND Ill 1989); *California Mutual Insurance Company v Liberty Mutual Insurance Company*, 920 F Supp 908 (ND Ill 1996); *National Union Fire Insurance Company v Continental Illinois Corp.*, 673 F Supp 267 (ND Ill 1987); *American Home Assurance Company v Dykema, Gossett, Spencer, Goodnow & Trigg*, 625 F Supp 1052 (ND Ill 1985).

9. Id, 714 F Supp at 961.

10. *Twin City Fire Insurance Company v Country Mutual Insurance Company*, 23 F3d 1175 (7th Cir 1994).

11. 732 NE2d 1082.

12. *Twin City Fire Insurance Company*, 23 F3d 1175; *Schal Bovis, Inc.*, 732 NE2d 1082.

13. *Ranger Insurance Company*, 714 F Supp 956.

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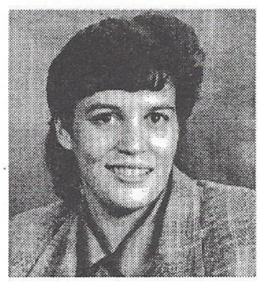

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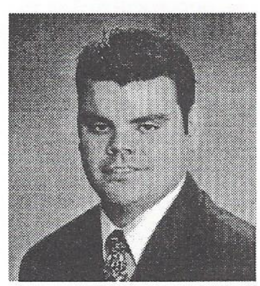

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tor in a personal injury action.[14] An employee of the general contractor fell through a catwalk while working at an Archer-Daniels-Midland Company (ADM) plant. The estate of the deceased employee sued the general contractor and ADM.

"When insureds purchase excess coverage beyond primary-coverage limits, the excess carrier effectively steps into the shoes of the insured in a claim against the primary."

ADM settled for $1.5 million and pursued contribution claims against the general contractor and another defendant contractor. At the time, the general contractor had primary-insurance coverage up to $500,000 and excess coverage. The primary carrier assumed full responsibility for the general contractor's defense. In a trial on ADM's contribution claims, a jury found the general contractor 48 percent at fault and entered a judgment in the amount of $788,989.

The general contractor appealed. Prior to the appellate court ruling, however, the primary insurer offered to settle at its policy limits of $500,000 without interest. ADM agreed to accept this payment and release the insured on the condition that the excess carrier pay the remaining $288,989. The excess carrier, optimistic about the chances of the appeal, refused and offered $145,000. ADM refused. The appellate court later reversed the jury verdict and remanded the case for retrial. Two years later, the Illinois Supreme Court reinstated the jury verdict.

Originally, this action was a dispute over how liability for post-judgment interest should be apportioned. The excess carrier claimed that the primary should be liable for the interest on the entire judgment, including the excess carrier's portion, because the primary's failure to engage in reasonable settlement negotiations with the deceased's estate violated its duties.[15] Thus, the court was faced with deciding whether a primary carrier owed a direct duty to the excess carrier to attempt to settle within the underlying coverage limits.[16]

The district court looked to Illinois cases but found little guidance. In essence, the Illinois courts had yet to address the issue. The court, however, did find that "Under Illinois law, a primary carrier has [an obligation and] duty to the insured to undertake settlement negotiations with care and in good faith with a potential judgment creditor in an effort to resolve the underlying dispute within policy limits."[17]

A vast majority of other jurisdictions have held and recognized that an excess carrier is equitably subrogated to the rights of the insured.[18] "Given that Illinois favors a liberal application of subrogation principles to [achieve] a just resolution of the parties' rights,"[19] the court believed the Illinois Supreme Court would have imposed such a duty and allowed an excess carrier to bring suit in its own right to remedy a breach of that duty.[20]

The court reasoned that the basic principles of tort law support the duty, despite the lack of contractual privity between primary and excess carriers.[21] "Illinois law imposes a duty of care when the following conditions are met: the alleged tortfeasor could have reasonably foreseen that its conduct would injure the plaintiff and policy considerations justify placing the risks and the burden of care on the defendant."[22]

The court found, first, that a primary insurer could reasonably foresee that its failure to settle within policy limits would cause a loss to an excess carrier. Second, public policy justifications for imposing a duty include encouraging "settlements when an offer exists at or near policy limits, discouraging gambling with the excess carrier's money, [keeping] excess liability insurance premiums low, reducing the [need] for the excess carrier to participate in the defense of the action to protect its rights," and requiring the "primary carrier to perform the duty it has delegated to itself," i.e., to provide primary coverage.[23]

That the insured bought excess coverage should not relieve the primary carrier of its settlement obligations. The scope of the primary carrier's duty, if appropriately defined, is not greater than that already owed to the insured.

B. California Union Insurance Company v Liberty Mutual Insurance Company

In *California Union*, a federal district court case, the action stemmed from an underlying personal injury suit against Central Telephone Company of Illinois (CTI), its parent company Centel Corporation, and others.[24] Liberty Mutual Insurance Company, defendant, was the primary-insurance carrier for Centel.[25] The plaintiff, California Union Insurance Company, provided excess coverage.

Following a multi-million dollar verdict requiring both insurance companies to contribute, excess carrier California Union sued the primary insurer, claiming that negligent and bad-faith refusal to settle the case within the primary insurer's policy limits obligated the primary carrier to pay the excess verdict.

1. The Facts

This suit was brought when a roofer sustained severe head injuries when he came in contact with a sagging 7,200 volt power line while inspecting a roof.[26] He lost his right ear and a portion of his skull, underwent cataract eye surgery in both eyes, and suffered severe electrical burns to his head, face and legs. He became a quadriplegic, was hospitalized for a little over a year, and was permanently disabled.

An amended complaint brought in, among others, CTI and Centel as defendants. The claim was that CTI had done work on the poles and had a general duty to warn of dangerous conditions when working in the area to either the power company or landowner.[27] Liberty

14. Id, 714 F Supp at 957.
15. Id, 714 F Supp at 957-58.
16. Id, 714 F Supp at 960.
17. Id.
18. Id; *Puritan Insurance Company v Canadian Universal Insurance Company*, 775 F2d 76 (3d Cir 1985); *Insurance Company of North America v Medical Protective Company*, 768 F2d 315 (10th Cir 1985).
19. Id; *Dworak v Tempel*, 17 Ill 2d 181, 161 NE2d 258 (1959).
20. Id, 714 F Supp at 960-61.
21. Id, 714 F Supp at 961.
22. Id, citing *Kirk v Michael Reese Hospital & Medical Center*, 117 Ill 2d 507, 513 NE2d 387 (1987).
23. Id.
24. *California Union Insurance Company v Liberty Mutual Insurance Company*, 920 F Supp 908, 911 (ND Ill 1996).
25. Id, 920 F Supp at 911.
26. Id, 920 F Supp at 912.
27. Id, 920 F Supp at 913.

Mutual, the primary insurer, provided primary coverage of $1 million as well as the first $1 million of excess coverage.[28] California Union, the excess carrier, provided the second layer of excess coverage up to $4 million. There were also several other layers of excess insurers beyond California Union. The primary insurer controlled the defense of Centel/CTI.

After four amended complaints, Centel/CTI were faced with three theories of negligence: (1) they removed a guy wire from one of the poles, (2) they improperly installed a guy wire on another pole causing it to lean, and (3) they had a general duty to warn of dangerous conditions.[29] In January 1989, the primary insurer's defense team decided that the case had a potential jury verdict range of $10 million to $20 million regardless of the liability of individual defendants but that liability remained uncertain. The excess insurer was notified in February 1989 that liability could reach into its layer of excess coverage. It immediately reserved $500,000 for the claim and hired monitoring counsel to watch the case, review discovery and depositions, and appear at pretrial conferences.

In July 1989, the primary insurer's defense attorneys analyzed the three theories and determined that there was not enough evidence to support the first theory and that the second theory could be refuted by expert testimony. The third theory, however, had jury appeal. Several factors led to the presence of CTI's work in the area prior to the accident. Furthermore, CTI issues an employees' manual requiring its employees to report all "non-standard trouble conditions" such as the type complained of here.[30]

About the same time, claims adjusters informed the primary insurer that although evidence was weak on the first two theories it was "'highly unlikely to get a complete pass' on liability."[31] They reaffirmed the value of the case and noted that CTI could be found responsible for 50 percent of that amount. They also noted that the defendants were fighting among themselves, decreasing the likelihood of joint efforts.

A letter from the primary insurer's home office in December 1989 to its adjuster indicated its awareness of Centel's potential negligence and requested all defendants to sit down and discuss the merits of the claim. A letter responding to the home office in March 1991 expressed no signs of cooperation among the defendants and quantified CTI's exposure at 30 percent.

The plaintiff was demanding $37.5 million and there was serious doubt that the case would settle for anything less than $20 million. Nonetheless, the adjuster recommended attempting to settle before trial to show the primary insurer's good faith, saying further that the primary insurer would have to "tender its policy limits of $1 million along with its excess policy of $1 million."[32] In May 1991, the adjuster wrote CTI that its primary insurer had no plans to tender its $2 million in policy limits toward settlement.

> **"Although only the first district has extended a primary insurer's fiduciary duty to excess carriers, primary carriers should assume the holding will be extended."**

In August 1991, the excess carrier raised its reserves to its policy limits, $4 million, at the advice of its monitoring counsel.[33] In September 1991, the primary insurer's motion for summary judgment was denied and a status memorandum indicated that although "[it is] believe[d] liability is arguable,... liability damages are serious and present substantial exposure."[34]

It was believed that one of the codefendants struck a deal and the insured and excess carrier were asking the primary insurer to tender its policy limits of $2 million in an effort to settle. Later that month, the plaintiff lowered his demand to $16 million from all defendants. The excess carrier's monitoring attorney demanded that the primary insurer make its $2 million available for settlement, but it refused.

Several times during that September, claims adjusters and defense counsel for the insured asked the primary insurer to review its decision to not tender for policy limits, because other defendants appeared ready to settle. Each time, they were informed that the primary insurer wanted to proceed to trial.[35] On September 30, 1991, all defendants except CTI had settled for $4.4 million.[36] The other layers of excess carriers wrote letters to the primary insurer urging it to settle. At this time, the primary carrier offered $400,000. Defense counsel advised the primary insurer that to reach a settlement, it would have to tender the full $2 million in policy limits and that contribution from the excess carriers would likely be required.

A final pretrial conference was scheduled in October. At that time, the primary insurer's claims adjuster had $800,000 in authority to settle. The judge advised the primary insurer that it would take its full policy limits to settle this matter. Counsel for the primary insurer advised the judge that its offer would not increase and reoffered $800,000, even with the understanding that it was possible that an offer of $1.6 million could settle the claim. The offer was refused and a trial date was set.[37] Sometime shortly thereafter, CTI wrote the primary insurer demanding it put up its entire $2 million in policy limits, stating that it was "unrealistic and unsound" to try this case.[38] CTI put the primary insurer on notice that it would seek to recover the excess if a jury verdict beyond CTI's policy limits was returned.

The plaintiff issued another written demand before trial, to which the primary insurer never responded.[39] The primary subsequently put together a high-low offer package and asked that the excess carrier offer up some of its excess policy limits.[40] Although the excess

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28. Id, 920 F Supp at 912.
29. Id, 920 F Supp at 913.
30. Id, 920 F Supp at 913-14.
31. Id, 920 at 914.
32. Id.
33. Id, 920 F Supp at 914-15.
34. Id, 920 F Supp at 915.
35. Id, 920 F Supp at 915-16.
36. Id, 920 F Supp at 916.
37. Id, 920 F Supp at 917.
38. Id.
39. Id. The plaintiff issued a written demand of $8 million to CTI which was the lowest formal demand before trial. Liberty Mutual never responded; CTI requested an explanation to which Liberty responded "[we] feel[] it is necessary to proceed to trial on this questionable liability case."
40. Id. In addition to the $4.4. million already offered by other defendants, this high-low package offered a low of $500,000 and a high of $4 million. This included $2 million from Liberty and $2 million from California Union. The case would be tried but the verdict restricted by the high-low package.

carrier believed this plan would backfire, it agreed to participate in the agreement under a reservation of rights to take action against the primary insurer for bad-faith refusal to settle.[41] The plaintiff refused, and a jury awarded the plaintiff $16,038,737.

2. The Holding: "Equitable Subrogation" Applies in Illinois

The district court considered all these facts and observed that Illinois courts recognize a cause of action for an insurer's negligent or bad-faith refusal to settle within policy limits when doing so exposes the insured to a judgment beyond the policy limits.[42] "Although Illinois courts have not conclusively addressed the viability of the equitable subrogation theory," the court noted that "the Seventh Circuit has held that Illinois law would permit an excess insurer to pursue a claim against the primary insurer based upon equitable subrogation."[43] The court found that "if a primary insurer breaches its duty to its insured or an excess insurer, the excess verdict itself constitutes" the damage required to support a claim.[44]

Because primary insurers typically control the defense against their insureds, the court wrote, primaries owe insureds a duty "to conduct the litigation so as to avoid harming the insured,"[45] including a duty not to forego reasonable opportunities to settle "on terms that will protect the insured against an excess judgment...Where the insurer fails to settle a case within policy limits through fraud, negligence or bad faith, this duty is breached."[46] The court wrote that the insurer may be held liable for the entire judgment including interest, as in *Ranger Ins. Co. v Home Indemnity Co.*, regardless of the policy limits.

"Illinois courts have generally formulated the duty owed by the [primary] insurer as requiring the insurer 'to give its insured's interests at least equal consideration with its own where the insured is a defendant in a suit in which the recovery may exceed policy limits'....If an opportunity appears to settle within the policy limits, thereby protecting the insured from excess liability, the insurer must faithfully consider it."[47]

The court also found that where the "'probability of an adverse finding on liability is great and the amount of probable damages would greatly exceed the [primary] coverage,' the insurer may owe a duty to initiate settlement negotiations if the plaintiff has not done so,"[48] listing factors to help primary insurers determine when this specific duty might apply.[49]

The court wrote that an excess-carrier's "bad faith" claim, like a negligence claim, "means being unfaithful to the duty owed."[50] A negligence claimant must show that a duty was owed and breached and that there was causation (legal and proximate) and damages. Accordingly, the court wrote, in a claim for bad faith "the excess carrier must show not only the duty to settle and a breach of that duty, but that the failure to settle within policy limits proximately caused the excess insurer harm by having to contribute money to the verdict or settlement."[51]

To establish proximate cause, the court found, the plaintiff must show that "the claim could actually have been settled within the policy limits."[52] That a demand within the primary insurer's policy limits was made is one, but only one, factor in that determination.

The court also discussed the primary insurer's contention that by hiring counsel to monitor a case, the excess insurer was estopped from complaining of the result obtained by the primary.[53] The court recognized that, while an excess carrier may be "estopped from recovery if its own actions induced the defendant to try the case,...the mere hiring of monitoring counsel does not create equitable estoppel." Instead, "a showing of some affirmative, misleading conduct" is required.[54]

C. Schal Bovis, Inc. v Casualty Insurance Company

The question of whether primary insurers owe excess-insurance carriers a duty to act reasonably and in good faith in attempting to settle claims within their policy limits was posed to the Illinois Appellate Court, First District, in 1999. The court found that an excess insurer is subrogated to the rights of its insured when the insured's primary insurer acts unreasonably and breaches its duty to settle the underlying claim within the policy limits.[55]

The underlying claim was a dispute between Schal Bovis, a general contractor, its excess-insurance carrier, Northbrook Property & Casualty Company, and four primary liability coverage carriers. Schal Bovis and Northbrook claimed that two of the primary insurers "vexatious[ly]" refused to defend and two others failed to act reasonably and in good faith in attempting to settle the underlying claim within their policy limits.[56]

This dispute arose from an accident that occurred during the construction of a building in downtown Chicago, for which Schal Bovis was the general contractor. Several subcontractors were added to the action between the general contractor and the injured employee. Schal Bovis tendered its defense to four of the subcontractors' primary-insurance carriers. Two of the primary insurers accepted tender, Wausau Insurance Company and Great American Insurance Company, one withdrew before trial and one rejected the defense altogether. The focus of this analysis is the actions of Wausau and Great American.

It was alleged that Wausau evaluated the potential verdict at over $2 million. Both Wausau and Great American had policy limits of $1 million and both refused to offer their policy limits toward a proposed settlement of $2 million. A jury verdict was returned against Schal Bovis in the amount of $2,892,500. Wausau contributed $1,049,583 and Great American contributed its $1 million, while Northbrook, the excess carrier contributed the remaining

41. Id.
42. Id, 920 F Supp at 918, citing *Twin City Fire Insurance Company*, 23 F3d at 1178-79. "Ordinarily, it is the insured who bears the cost of a verdict in excess of the amount of the primary insurance policy. Where, as here, the insured has excess insurance, however, it is the excess insurer who bears the cost of the excess verdict, and thus the excess insurer that may seek recovery for its losses. The theory that allows such a claim by an excess insurer is equitable subrogation, which allows an excess insurer to step into the shoes of the insured."
43. Id, citing *Twin City Fire Insurance Company*, 23 F 3d 1175.
44. Id, 920 F Supp at 919.
45. Id, 920 F Supp at 918.
46. Id, 920 F Supp at 918-19.
47. Id, 920 F Supp at 920, citing *Adduci v Vigilant Insurance Company*, 98 Ill App 3d 472, 424 NE2d 645 (1st D 1981).
48. Id, 920 F Supp at 920-21.
49. Id, 920 F Supp at 921.
50. Id, 920 F Supp at 919.
51. Id, 920 F Supp at 923, quoting *National Union Fire Insurance Company*, 673 F Supp 267, 273.
52. Id, 920 F Supp at 924.
53. Id, 920 F Supp at 919.
54. Id.
55. *Schal Bovis, Inc.*, 732 NE2d 1082.
56. Id, 732 NE2d at 1086.

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Schal Bovis and Northbrook brought suit against the primary insurers involved, alleging that they were exposed to a verdict in excess of the primary insurer's policy limits because of Wausau and Great American's refusal to settle.[57] Wausau and Great American sought summary judgment. The trial court granted the defendants summary judgment and dismissed the complaint with prejudice.

In so doing, the trial court found that under Illinois law there is no duty running from a primary insurer to its insured's excess carrier. The appellate court, however, rejected that ruling, reasoning that an excess-insurance carrier is subrogated to the rights its insured has against its primary insurer when forced to pay a claim. Under Illinois law, the court wrote, an insured may sue its primary insurer for bad-faith refusal to settle, and it follows that an excess carrier should be able to do the same because "by purchasing excess coverage, the insured has effectively substituted the excess insurer for itself."[58]

Even absent subrogation principles, the court wrote, "there is a duty which runs from [primary insurers to excess insurers] to act reasonably and in good faith in attempting to settle claims within their respective policy limits." A California case, *Transit Casualty Co. v Spink Co.* recognized that where there is an insured, a primary insurer, and an excess-insurance carrier, the relationship is not limited to the primary insurer and its insured.[59]

The court noted that a three-way relationship between the insured, primary insurer, and excess insurer is created when a claim threatens to exceed the primary coverage.[60] The possibility that the excess policy may be reached "creates a three-way duty of care to act reasonably and in good faith" toward one another "in settling meritorious claims within the policy limits," the court said.[61]

The argument against imposing such a duty upon primary insurers, put forth here by Great American, is that excess carriers factor in as a cost of doing business the possibility that a primary carrier might refuse to settle.[62] But the court rejected this approach as unsound public policy. If they had no such duty, primary insurers "would have no incentive to enter into a reasonable settlement...when its expected liability approaches the limits of the policy."[63] Imposing a duty thus encourages settlements at or near expected judgments, reduces litigation, and lowers insurance premiums for excess coverage, the court wrote.

III. Duties Among Multiple Primary Insurers

The Illinois Supreme Court recently touched upon the duties of primary carriers to each other in *John Burns Const. Co. v Indiana Ins. Co.*[64]

In *John Burns*, the court held that an insured who is covered under multiple policies can make a designation between carriers and that the duty to defend then falls solely to the selected carrier. Thereafter, that insurer may not seek equitable contribution from the nondesignated insurer, the court held.

The right to forego an insurer's involvement has long been recognized.[65]

IV. Conclusion

In general, the law does not impose a duty on insurance companies to settle claims within policy limits. That duty arises only where the probability of an adverse finding on liability is great and where the amount of the probable recovery would greatly exceed primary coverage. Should the primary decide not to settle, the mere fact that it is unsuccessful at trial does not establish bad faith.

Initially, Illinois courts did not recognize a cause of action between primary and excess carriers, but only between the insured and its primary insurer. Where an insured has only primary coverage and the primary acts in bad faith during settlement negotiations causing an excess verdict, Illinois courts recognize a cause of action by the insured against the primary insurer to recover the excess verdict.

However, some insureds do not limit their insurance coverage to primary insurance. They also purchase excess coverage to cover verdicts that exceed primary-coverage limits. In these cases, the excess carrier effectively subrogates to the rights of the insured. It steps into the shoes of the insured and asserts its claim against the primary insurer. A three-way relationship is formed. The primary insurer, the insured and the excess carrier all take on reciprocal duties to act in good faith in considering the others' interests when resolving disputes.

Extending an insurer's fiduciary duty to include an excess carrier is a logical step. Although only the first district has expressly done so, primary insurers would be wise to assume that *Schal Bovis* will be followed and extended. Exactly what constitutes bad faith will be defined and further developed as more courts address this issue. ■

57. Id, 732 NE2d at 1085-86.
58. Id, 732 NE2d at 1090.
59. Id, citing *Transit Casualty Company v Spink Company*, 94 Cal App 3d 124, 156 Cal Rptr 360 (3d D 1979).
60. *Transit Casualty Company*, 156 Cal Rptr at 366.
61. Id.
62. *Schal Bovis, Inc.*, 732 NE2d at 1091.
63. Id.
64. 189 Ill 2d 570, 727 NE2d 211 (2000).
65. See *Cincinnati Cos. v. West American Ins. Co.*, 183 Ill 2d 317, 701 NE2d 499 (1998).

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