The Legal Intelligencer
THE OLDEST LAW JOURNAL IN THE UNITED STATES 1843-2018
PHILADELPHIA, APRIL 12, 2018
An ALM Publication

Excess Insurer's Rights Against a Primary Insurer Under Pennsylvania Law

The relationship between primary and excess liability insurers has been characterized as "unusual."

BY KENNETH PORTNER

The relationship between primary and excess liability insurers has been characterized as "unusual," as in *Physicians Insurance v. Callahan*, 648 A.2d 608, 615-16 (Pa. Cmwlth. 1994), *citing Puritan Insurance v. Canadian Universal Insurance*, 775 F.2d 76 (3rd Cir. 1985).

When the insured is faced with a claim whose value hovers on the border between the primary and excess limits the relationship can become contentious. The primary insurer, which typically has the duty to defend, may be tempted to try a case that could be settled in the hope of saving some or all of its policy limit. Conversely, the excess insurer's interests are served by having the primary insurer settle the case within the primary limits. Where the primary fails to settle within its limits or conducts the defense in a fashion that results in an excess verdict, an excess insurer will sometimes seek to pursue the primary insurer for the amount in excess of the primary limit.

This raises the question of the excess insurer's rights against the primary. There is no direct contractual relationship between the primary and excess. And often the primary insurer is not even aware of the excess insurer's existence, making a third-party beneficiary theory problematic. Accordingly, excess insurers sometimes argue that the primary insurer owes a direct duty to the excess.

The U.S. Court of Appeals for the Third Circuit interprets Pennsylvania law to limit an excess insurer's rights against a primary carrier to subrogation via the insured. A primary insurer owes no duty to an excess insurer, see *United States Fire Insurance v. Royal Insurance*, 759 F.2d 306, 307 (3d Cir. 1985); *Puritan Insurance v. Canadian Universal Insurance*, 775 F.2d 76 (3d Cir. 1985). Pennsylvania state courts have not addressed the question of either a direct right but have recognized a right of equitable subrogation.

In *F.B. Washburn Candy v. Fireman's Fund*, 541 A.2d 771 (Pa. Super. 1988) an omnibus insured under was sued for an auto accident. The vehicle's insurer, Fireman's Fund, denied the defense tender. The defendant-insured's own insurer, Zurich, defended the case through trial. At trial a verdict was entered in an amount less than the limits of Firemen's Fund's coverage. Zurich paid the judgment and then sued Fireman's Fund to recoup the cost of defense and indemnity. The trial court held that Fireman's Fund owed coverage on a primary basis and that Zurich's coverage was excess. However, the trial court also held that Fireman's Fund did not need to reimburse Zurich for the cost of defending because

Kenneth Portner of Weber Gallagher Simpson Stapleton Fires & Newby.

Pennsylvania law did not recognize a duty running from a primary insurer to an excess insurer.

On appeal the Superior Court observed that fairness dictates that excess insurers have a remedy against a primary insurer where the primary carrier wrongfully refuses to defend. Accordingly, the court held that where a primary insurer wrongfully refuses to defend and the excess carrier defends instead, the doctrine of equitable subrogation applies. The court thus held that Zurich was in fact entitled to recover the costs of defense and indemnify of the tort action.

Thus, Pennsylvania law recognizes a claim for equitable subrogation between an excess insurer and a primary insurer. However, the claim doctrine is not available in all circumstances, as in *American States*

Insurance v. Maryland Casualty, 628 A.2d 880 (Pa. Super. 1993).

In *American States* the insured was covered under a primary policy and an umbrella policy. When the insured was sued, initially both the insurers denied coverage and refused to defend. Later, the primary agreed to defend pursuant to non-waiver agreement. During the course of the litigation the tort plaintiff made settlement demand within the primary limits. The primary refused to settle. The tort case went to trial and resulted in a verdict against the insured in excess of the combined limits. The case was settled after verdict for the combined policy limits.

The umbrella insurer sued the primary under *Cowden v. Aetna Casualty & Surety*, 134 A.2d 223 (Pa. 1957), which holds that where insurer unreasonably fails to settle a claim within limits it is liable for an excess verdict. The umbrella carrier invoked equitable subrogation as the basis for its claim. The Superior Court found that both the primary and umbrella insurers had a duty to defend the insured. Because the umbrella insurer had failed to fulfill its obligation to defend, it could not invoke equity to prosecute a bad faith claim against the primary insurer.

In many cases equitable subrogation provides an adequate remedy for an excess insurer. However, there are circumstances where equitable subrogation is ineffective because as a subrogee the excess insurer's right rise no higher than those of the insured. Where the insured has consented to the primary insurer's conduct subrogation is futile. In these situations if an excess insurer cannot bring a direct claim, it in effect has no remedy.

While Pennsylvania's appellate courts have not recognized an excess insurer's direct right of action against a primary insurer, Judge Albert Sheppard of the Philadelphia Court of Common Pleas recognized such a right in *United States Fire Insurance v. American National Fire Insurance*, 53 Pa. D. & C.4th 474, 489 (C.P. 2001).

In that case a general contractor was covered as an additional insured under primary and excess policies issued to its subcontractor. The primary policy was written by Liberty Mutual and had a $2 million limit and the excess was written by American States and had a $20 million limit. The insured was sued in 1996 for an injury that occurred at the construction site and Liberty Mutual assumed the defense. Liberty Mutual, which was aware of the excess policy, did not notify the excess carrier until September 1998. Liberty Mutual settled the claims $4 million and paid its $2 million limits, but American refused to contribute, claiming that it was relieved of its coverage obligation by the allegedly late notice. The general contractor's insurer paid the balance and sued American States under breach of contract and equitable subrogation theories. American States joined Liberty Mutual as a third party defendant claiming that Liberty was liable over to American States due to its failure to timely notify American States of the suit.

Judge Sheppard acknowledged that Pennsylvania courts have not expressly endorsed the concept of direct primary/excess insurer duties. However, he found implicit support for imposition of such a duty in the concern Pennsylvania cases have shown for the "skewed" relationship between primary and excess insurers and observed that equitable subrogation was insufficient to rectify the situation.

Citing a New Jersey decision, *American Centennial Insurance v. Warner-Lambert*, 681 A.2d 1241 (N.J. Super. 1995) as persuasive, Judge Sheppard observed that it was reasonable to impose a duty to notify the excess insurer because only the primary insurer has both the information concerning the claim and the expertise necessary to evaluate that information and to determine if the excess policy is likely to be implicated. Further, in the absence of a direct duty, the excess insurer's risk will increase, leading to a corresponding rise in excess insurance premiums. Judge Sheppard thus concluded that Pennsylvania law supports and is best served by the principle that a primary insurer that is aware of an excess policy bears the responsibility for notifying the excess insurer that its policy may be implicated.

The Common Pleas Court's opinion rejected the Third Circuit's conclusion in *Puritan*. The Judge noted that Puritan reached its conclusions without any discussion, reasoning or analysis. and that *Puritan* was decided before the emergence of the "modern trend for courts and legislatures to impose duties of good faith and fair dealing on the relationship between primary and excess carriers, *United States Fire Insurance*, 53 Pa. D. & C.4th at 492. The court declined to follow *Puritan* and instead held that a primary carrier that is aware of an insured's excess policy owes a direct duty to the excess insurer to notify it of claims that may implicate the excess policy.

Kenneth Portner, *a partner at Weber Gallagher Simpson Stapleton Fires & Newby based in the firm's Philadelphia office, advises counsels and represents insurance companies. His insurance practice includes coverage and bad faith avoidance matters and E&O matters.*

kportner@wglaw.com