

ALLOCATION OF DEFENSE COSTS BETWEEN PRIMARY AND EXCESS CARRIERS: EXHAUSTION VS. EQUITIES

Lawsuits involving multiple insurers often give rise to disputes between primary and excess carriers as to the allocation of defense costs where exposure is potentially beyond that of the primary carriers' policy limits. The majority or traditional view is that excess insurers are not required by the language of the insurance policy to contribute to defense expenses, as long as the primary insurers are still required to defend, *i.e.*, that the primary insurers' policy limits have not yet been exhausted.¹ This rule excusing excess insurers from contributing to defense costs prior to the exhaustion of primary limits is upheld even when an excess insurer ultimately contributes to the liability recovery.² According to one Texas court, "to require the excess insurer to reimburse a primary carrier for amounts that were paid before exhaustion of the underlying policy limits would overturn the reasonable expectations of the parties."³ However, once the primary insurers have properly exhausted their policy limits, *i.e.*, by paying a judgment or settlement or by tendering its limits to the court (where allowed), the primary insurer is no longer responsible for the costs of defending the claim.⁴

Following from the majority view is the equitable subrogation action, which allows excess insurers that have born the costs of a defense where the primary insurer failed to provide a defense have been able to recover these costs from primary insurers.⁵ In particular, equitable subrogation allows an excess insurer that paid defense costs to be placed in the insured's position to pursue a full recovery from another insurer who was primarily responsible for the loss.⁶

A minority of courts overlook the express language of the insurance policy and hold that regardless of the primary insurers' duty to defend, excess insurers may be required to contribute to the costs of defense if the amount of the underlying claim or demand appears to be or likely is

¹ See Kajima Construction Services, Inc. v. St. Paul Fire and Marine Insurance Co., 356 Ill. App. 3d 665, 856 N.E.2d 452 (1st Dist. 2006) (see cases cited therein); American Casualty Company of Reading, PA v. General Star Indemnity Co., 125 Cal. App. 4th 1510, 24 Cal. Rptr. 3d 34 (2005); American Indemnity Lloyd's v. Travelers Property & Casualty Insurance Co., 335 F.3d 429 (5th Cir. (Tex.) 2003); United States Fidelity and Guaranty Co. v. Federated Rural Electric Insurance Corp., 37 P.3d 828, 2001 OK 81 (2001); National Union Fire Insurance Company, of Pittsburgh, Pennsylvania v. Travelers Insurance Co., 214 F.3d 1269 (11th Cir. (Fla.) 2000); Community Redevelopment Agency of the City of Los Angeles v. Aetna Casualty and Surety Co., 50 Cal. App. 4th 329, 57 Cal. Rptr. 2d 755 (1996).

² Signal Cos. v. Harbor Insurance Co., 27 Cal. 3d 359, 612 P.2d 889 (1980).

³ Texas Employers Insurance Association v. Underwriting Members of Lloyd's, 836 F. Supp. 398 (D. Tex. 1993).

⁴ Compare National Union Insurance Company of Washington, D.C. v. Phoenix Assurance Company of New York, 301 A.2d 222 (D.C. Ct. App. 1973) (allowing primary insurers to pay their limits to the court and walk away from the defense of the insured), with BBL-McCarthy, LLC v. Baldwin Paving Co., 285 Ga. App. 494, 646 S.E.2d 682 (Ct. App. Ga. 2007) (prohibiting primary insurers from paying their limits to the court and walking away from the defense of the insured).

⁵ Fireman's Fund Insurance Co. v. Maryland Casualty Co., 65 Cal. App. 4th 1279, 77 Cal. Rptr. 2d 296 (1998).

⁶ Travelers Casualty and Surety Co. v. American Equity Insurance Co., 93 Cal. App. 4th 1142, 113 Cal. Rptr. 2d 613 (2001).

significantly greater than the primary carriers' policy limits.⁷ This approach arguably encourages joint action and an effective defense such that "the insured will not be cast adrift as a result of the insurers' inability to agree upon their respective responsibilities."⁸ Similarly, where the recovery actually exceeds the primary carriers' policy limits, the minority approach allows recovery by the primary insurers of a *pro rata* share of all of the defense costs.⁹

It has also been held, albeit rarely, that an excess insurer who agrees to provide a defense to its insured when the primary insurer fails to do so, is unable to recover these costs from the primary insurer, even when the judgment was within the primary limits.¹⁰

⁷ MetLife Capital Corp. v. Westchester Fire Insurance Co., 224 F. Supp. 2d 374 (D. Puerto Rico 2002). If the excess insurer should expect that the primary policy limits will be exhausted, based upon equitable principles, the excess insurer cannot avoid contributing to the costs of defense.

Kansas courts have presented conflicting views on the issue. First, in American Fidelity Insurance Co. v. Employers Mutual Casualty Co., 3 Kan. App. 2d 245, 593 P.2d 14 (Ct. App. Kan. 1979), the Court of Appeals of Kansas recognized that excess insurers may be liable for a *pro rata* share of the defense costs where the claim is over the limits of the primary policy. Later, the Tenth Circuit Court of Appeals in Insurance Company of North America v. Medical Protective Co., 768 F.2d 315 (10th Cir (Kan.) 1985), denied the primary carrier any reimbursement for defense costs from the excess carrier, even though the excess carrier ultimately contributed to the judgment.

Michigan courts also have offered conflicting views on the issue. First, in Celina Mutual Insurance Co. v. Citizens Insurance Company of America, 133 Mich. App. 655, 349 N.W.2d 547 (Ct. App. Mich. 1984), it was held that excess and primary carriers must share defense costs when the excess carrier should realize that the claim will exceed the primary limits. However, without expressly overruling Celina, the Supreme Court in Frankenmuth Mutual Insurance Company, Inc. v. Continental Insurance Co., 450 Mich. 429, 537 N.W.2d 879 (1995), criticized the approach of requiring excess carriers to participate in the insured's defense where the primary limits have not yet been exhausted.

⁸ Guaranty National Insurance Co. v. American Motorists Insurance Co., 758 F. Supp. 1394 (D. Montana 1991).

Columbia Casualty Co. v. United States Fidelity & Guaranty Co., 178 Ariz. 104, 870 P.2d 1200 (Ct. App. Ariz. 1994). "The ability to seek contribution equitably from one [insurer] or another ought not to turn on an artificial timetable as to who has the primary responsibility for defense at that time. Instead, eligibility for contribution should turn on whether the expenses were undertaken for the common purpose of minimizing the exposure of the insured to the injured parties."

⁹ American Excess Insurance Co. v. MGM Grand Hotels, Inc., 102 Nev. 601, 729 P.2d 1352 (1986).

If allocation is ordered, virtually all of the courts apply a *pro rata* allocation method. Still, some apply an equal shares approach. *E.g.*, Universal Underwriters Insurance Co. v. Travelers Insurance Co., 669 A.2d 45 (Del. 1995).

¹⁰ Iowa National Mutual Insurance Co. v. Universal Underwriters Insurance Co., 276 Minn. 362, 150 N.W.2d 233 (1967), noting that the obligation of the excess insurer to defend is separate from that of the obligation owed by the primary insurer.

Also note the following cases do not recognize an equitable subrogation action: General Motors Acceptance Corp. v. Nationwide Insurance Co., 4 N.Y.3d 451, 828 N.E.2d 959 (2005); Institute of London Underwriters v. First Horizon Insurance Co., 972 F.2d 125 (5th Cir. (La.) 1992).

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