Duties Owed to the Excess Insurer by the Insured and the Primary Insurer, and Theories of Recovery Upon Breach of Those Duties

By:

DEBORAH M. MINKOFF, ESQUIRE
LAUREN A. TULLI, ESQUIRE

Cozen O'Connor
1900 Market Street
Philadelphia, PA 19103
dminkoff@cozen.com
ltulli@cozen.com
(215) 665-2000

Deborah Minkoff and Lauren Tulli are both members of the law firm Cozen O'Connor, a national and international law firm with 21 offices in North America and two international offices in London, England and Toronto, Canada. Ranked among the 100 largest law firms in the United States, Cozen O'Connor offers legal services in dozens of practice areas to various corporations and organizations throughout the world, serving business, insurance, and private clients.

The authors practice in the Insurance Litigation Department in the Philadelphia office. Ms. Minkoff represents primary and excess insurers in third party coverage litigation. Ms. Tulli's practice areas include insurance coverage and bad faith litigation.

I. INTRODUCTION

The duties and obligations undertaken by a primary insurer on behalf of its insured, such as the duties to defend and indemnify, are contractual and commonly known. Less clear are the duties and obligations existing between the primary insurer and the excess insurer that has contracted with the insured. The primary insurer and the excess insurer both have a contract with the insured, but not with each other. For this reason, duties and obligations among the primary and excess insurers are implied. Nevertheless, these implied duties are confirmed by case law to such an extent that breach of the implied duties is actionable.

The excess insurer enjoys a right to cooperation from both its insured and the primary insurer. This specifically includes, among others, the excess insurer's right to receive notice. While many insureds believe notice is required only if it perceives a potential that the excess layer will be reached, an insured's contractual obligations under its excess policy may call for a more timely notice. With respect to the primary insurer, courts recognize an implied duty to advise the excess insurer of potential excess exposure, and to fairly and in good faith handle and negotiate the settlement of a claim within the primary limits.

The contractual and implied obligations, when breached, support an action by the excess insurer. The bases for such an action against the primary insurer typically include allegations that the primary insurer failed to settle the claim within the primary limits, or caused a premature or improper exhaustion of the primary limits. In at least one jurisdiction, an excess insurer is also permitted to bring a cause of action for bad faith against its own insured. Turning the table, the excess insurer can be exposed to bad faith allegations from both the primary insurer and the insured.

Section I of this paper discusses the duties and obligations owed to the excess insurer, with an emphasis on the right to cooperation owed by both the insured and the primary insurer to an excess insurer. Section II addresses the extra-contractual theories of liability in the event those duties are breached and the excess layer is exposed, as well as the potential, albeit less likely, extra-contractual exposure for the excess insurer.[1]

[1] The following sources were relied upon substantially in preparing this paper: McGuire, J. and McMahon, K., *Bad Faith, Excess Liability and Extra Contractual Damages: Counsel for the Excess Carrier Looks at the Issues*, 72 U. Det. Mercy L. Rev. 49, Fall 1994; Butler, Jr., P. and Potter, Jr., R., *The Primary Carrier Caught in the Middle with Bad Faith Exposure*

II. RIGHT OF COOPERATION OWED BY THE INSURED AND THE PRIMARY INSURER.

Primary and excess liability policies typically require the insured to cooperate in the investigation and settlement of a claim. This duty of cooperation is the jumping off point for additional duties not stated expressly in the contract, yet implied by courts on all or specific parties.

A. The Duty of Good Faith and Fair Dealing, Generally

Under the law of virtually every jurisdiction, a primary liability insurer owes its insured the duty of good faith and fair dealing, which duty includes the obligation to act in good faith in claims handling and effecting settlements on behalf of its insured. This obligation of good faith translates, in practice, into keeping the insured informed, by providing impressions of the probable outcome of the litigation, potential exposure, any settlement offers or opportunities, the possibility of implicating the excess layer, and strategy to avoid an excess judgment. Although the excess insurer owes no duty to either the primary insurer or the insured to defend or participate in settlement negotiations, the excess insurer does have a similar reciprocal obligation to act in good faith toward all parties.

B. Duties Owed by the Primary Insurer to the Excess Insurer

Because the insured contracts separately with the primary insurer and the excess insurer, no contractual privity exists between the primary and excess insurers. Despite this absence, courts have found an implied duty of good faith and fair dealing owed by the primary insurer to the excess insurer in connection with the handling of the underlying claim. Hartford Accident & Indemnity, 61 N.Y. 2d 569 (1984); U.S. Fire Ins. Co. v. Royal Ins. Co., 759 F.2d 306 (3rd Cir. 1985). This good faith obligation on the part of the primary insurer derives from the assumption that, in most instances, the primary insurer is best able to assess the severity of the loss or predict when excess coverage may be implicated because it, and not the excess insurer, is preparing the defense and negotiating the settlement on the insured's behalf. See FN 1, *supra*.

(..continued)

to its Insureds, Excess Carriers and Reinsurers, 24 Tort & Ins. L.J. 118, Fall 1998; and Gordon, T. and Andersen, S., *Duties Owed by Primary Insurers to Excess Insurers and Vice Versa*, DRI Excess and Reinsurance Seminar, November 1996.

The implied duty of good faith owed to the excess insurer further includes the primary insurer's obligation to keep the excess insurer informed of all significant facts during the investigation, handling and negotiation of the claim. The duty of a primary insurer to notify an excess insurer of a loss stems from the implied duty of good faith and fair dealing. U.S. Fire Ins. Co. v. Royal Ins. Co., 759 F.2d 306 (3rd Cir. 1985).

1. The Duty to Provide Notice of Potential Excess Exposure

By contract, a primary insurer is obligated to provide notice of the potential for an excess judgment to its insured, and the insured is similarly contractually obligated to provide notice of that potential to its excess insurer. No similar contract language imposes that duty upon a primary insurer to provide notice to the excess; however, it is clear that a primary insurer is obligated to provide notice of any potential for an excess judgment. In American Centennial Insurance Company v. Warner-Lambert Company, 293 N.J.Super. 567 (1995), the New Jersey Superior Court held that the primary insurer had a duty to notify the excess insurer of an underlying claim, an obligation that it owes to the excess insurer as a result of the distinctive relationship between the two insurers. Id., at 575. This relationship exists because the excess insurer "relies" on the primary insurer to act in good faith in processing and settling claims. Because the actions of the primary insurer affect the rights of the excess insurer, the court held it was reasonable for the excess insurer to rely on the primary insurer. Id.; F.B. Washburn Candy Corp. v. Fireman's Fund, 373 Pa.Super.479 (1988)(while the interests of a primary insurer are virtually unaffected by the existence of excess coverage, the interests of an excess insurer are very much affected by the actions taken by the primary insurer).

The New York Supreme Court similarly found, albeit with a more stringent standard, that the primary insurer has a duty to notify the excess insurer of the potential for an excess verdict or liability. Monarch Cortland v. Columbia Casualty Company, 626 N.Y.S.2d 426 (1995). The Monarch court stated, "duties owed by a primary insurer to an excess insurer, pursuant to either equitable subrogation or a direct duty, are 'derived from the duty owed [by the primary insurer to] the insured, one of those duties being the distinctly recognized contractual duty to defend with care.'" Id. at 430 (citing Russo v. Rochford, 472 N.Y.S.2d 954, 123 Misc.2d 55 (1984). This obligation "springs from and is implied" in the primary insurer's contractual duty to defend with care. Id., at 431. On appeal, the Appellate Division reversed in part and held that in order to find the primary insurer breached its duty of good faith when it failed to notify the excess insurer, there must be facts supporting that the primary insurer *acted in bad faith*. Id., (emphasis added). This stringent standard protected the primary insurer, as there were no facts to support a "gross disregard" on behalf of the primary insurer, or evidence that the primary insurer acted deliberately or recklessly. Thus, the court concluded that the primary insurer's assumption about the potential exposure to the excess layer did not constitute bad faith. Id.

2. Guiding Principles Relating to Notice

The "Guiding Principles for Insurers of Primary and Excess Coverage" ("Principles") were enacted in 1974 as an attempt to "reduce the incidents of controversy between primary and excess insurers." Monarch, 626 N.Y.S.2d at 430. The Principles specifically address the obligation to notify, stating as follows:

> Principle Five:
>
> If at any time, it should reasonably appear that the insured may be exposed beyond the primary limit, the primary insurer shall give prompt written notice to the excess insurer, when known, stating the results of investigation and negotiation, and giving any other information deemed relevant to a determination of the exposure, and inviting the excess insurer to participate in a common effort to dispose of the claim.

In Monarch, the New York court accepted the position that if an insurance company is not a signatory to the Principles it cannot be held to the policies of the Principles. The court did, however, reference the Principles as an "indication of a practice or a goal of the insurance industry." Id. The Principles might apply even if the parties do not affirmatively execute them. See American Centennial Insurance, 293 N.J.Super. 567, 577 (1995) (Principles establish a standard of care in the insurance industry).

Stemming from the implied duty of good faith, numerous jurisdictions have accepted the fact that the primary insurer has the duty to notify the excess insurer of potential excess exposure. However, it may be the case that the failure to provide notice must be found to be in "bad faith" to be actionable. Monarch. In other jurisdictions, the excess insurer may be required to show prejudice to bring suit for failure to notify.

3. Duty to Settle

Although not expressly provided by policy language, most jurisdictions recognize the primary insurer's duty to settle, as it is the primary insurer who controls the litigation and is in the best position to accomplish that end. Twin City Fire Ins. Co. v. Country Mut. Ins. Co., 23 F.3d 1175 (7th Cir. 1994). If not recognized as a separate implied duty, some courts have considered this duty one which falls under the ambit of the duty of good faith and fair dealing. Camelot by the Bay Condominium Owners' Association, Inc. v. Scottsdale Ins. Co., 27 Cal.App.4th 33, 32 Cal. Rptr.2d 354 (1994). If a primary insurer is faced with a reasonable opportunity to settle within policy limits, it has a duty to accept that settlement offer. American Physicians Ins. Exchange v. Garcia, 876 S.W.2d 842 (Tex. 1994).

C. Duties Owed by the Excess Insurer to its Insured

Consistent with the reciprocal duty of good faith among all parties, some courts have placed an onus on the excess insurer to alert its insured and the primary insurer if it perceives the primary insurer's defense to be inadequate. PHICO Ins. Co., Inc. v. Aetna Cas. and Sur. Co. of America, 93 F. Supp. 2d 982 (S.D. Ind. 2000); *Liability Insurance: Excess Carrier's Right of Action Against Primary Carrier for Improper or Inadequate Defense of Claim*, 49 A.L.R. 4th 304 (1986). While this is an obligation seemingly owed to an insured, it affects the excess insurer's own rights. In PHICO, the court further found that failure to speak up will constitute acquiescence of that defense, preventing the excess insurer from objecting to the defense thereafter. Id.

Additionally, as a general rule, when an insured carries both primary and excess liability insurance, the insured "can expect the excess insurer to respond to settlement offers with the same good faith required of primary carriers." Ashley, *Bad Faith Actions: Liability And Damages*, § 6:21 (1984); See also Kelley v. British Commercial Ins. Co., 221 Cal. App. 2nd 554, 34 Cal.Rptr. 564 (1963)(fact that liability insurer occupied position of secondary or excess carrier and took no active part in defense of action did not relieve insurer of duty to exercise good faith to insured in considering any offer of compromise within policy limits).

III. BAD FAITH

Many jurisdictions have adopted bad faith statutes which provide a cause of action against insurers for bad faith denials of coverage. Although the language of the various state statutes differs, the statutes generally require a showing that the insurer lacked a reasonable basis for its denial of the claim. Bad faith claims also typically involve allegations that an insurer handled the insured's claim in a reckless manner, delayed the investigation of the claim, or failed to pay benefits owed pursuant to an insurance policy.

A. Excess Insurer's Right to Recover for Bad Faith From Primary Insurer

Historically, where an excess insurer argued that the primary insurer failed to settle a claim within primary limits or improperly or prematurely exhausted the primary limits, courts found that lack of privity prevented the excess insurer from recovering. Several theories have since emerged which enable an excess insurer to recover damages from a primary insurer.

Many excess insurers use an assignment clause to bring a bad faith action against the primary insurer. Under an assignment clause, an insured may assign a cause of action to any other party, as the insured's right of action against the primary insurer is not personal to the insured. <u>Keith v. Comco Ins. Co.</u>, 574 So. 2d 1270 (Ct.App.La. 1991). The insured's assignment enables an excess insurer to make claim against the primary insurer for any amount beyond policy limits.

Beyond assignment, the most widely accepted of the theories of recovery, subrogation, provides an avenue for an excess insurer to bring action against a primary insurer for breach of a duty owed by that primary insurer to its insured. Some insurers pave the way for subrogation by incorporating such a right into the language of the policy. In the absence of contractual subrogation language, equitable subrogation has been an effective tool, permitting an excess insurer to stand in the shoes of the insured and bring claim against the primary insurer for bad faith handling of the insured's claim. <u>See</u> FN 1, *supra.*

More recently, a few courts have considered the relationship, duties and obligations among the insured, the primary insurer, and the excess insurer, and recognize new theories of direct liability for breach of those duties and obligations.

1. Equitable Subrogation

Many jurisdictions hold that an excess insurer's right to challenge a primary insurer's conduct is based on equitable subrogation. Persons, R. and Brownlee, K., *Excess Liability: Rights and Duties of Commercial Risk Insureds and Insurers* § 6:4 (4th ed. 2002). As a consequence, an excess insurer acquires only those claims an insured has against its primary insurer. Because privity of contract exists between the insured and the primary insurer, an excess insurer acquires whatever rights, contractual and implied, an insured has against its primary insurer. Commercial Union Ins. Co. v. Liberty Mut. Ins. Co., 393 N.W.2d 161, 166 (Mich. 1986), Hartford Accident & Indem. Co. v. Aetna Casualty & Sur. Co., 164 Ariz. 286, 792 P.2d 749 (Ariz. 1990) (the right to equitable subrogation is premised on the contract between the insured and the primary insurer).

The predicate for subrogation is payment of the insured's debt by the excess insurer. The excess can then initiate suit against the primary insurer and recover that which is available to the insured, but may only allege the breaches of duties which could have been asserted by the insured against the primary insurer. Importantly, the subrogating excess insurer will also be subject to all of the defenses held by the primary insurer against its insured.

Twin City Fire Ins. Co. v. Burke, 63 P.3d 286 (Ariz. 2003) is representative. In that case, an excess insurer instituted an action against a primary insurer for bad faith refusal to settle a wrongful death case within the primary insurer's policy limits. In the bad faith action, the court held, "an excess insurer's right to bring an action for bad faith refusal to settle is premised on the notion that the 'excess insurer should not have to pay a judgment if the primary insurer caused the excess judgment by a bad faith failure to settle within primary limits.'" Twin City, 63 P.3d at 286 (quoting Hartford Accident & Indem. Co. v. Aetna Cas. & Sur. Co., 792 P.2d 749 (Ariz. 1990)).

To prove bad faith in settling a claim, the Twin City court stated that a plaintiff must demonstrate that in the investigation, evaluation, and processing of the claim, the insurer acted unreasonably and either knew or was conscious of the fact that the conduct was unreasonable. Id. (quoting Zillisch v. State Farm Mut. Auto. Ins. Co., 995 P.2d 276, 280 (Ariz. 2000)). A primary insurer is permitted to go to trial to defend those claims that can be characterized as "fairly debatable," but in doing so, it must exercise reasonable care and good faith. Twin City, 63 P.3d at 286 (quoting Zillisch, 995 P.2d at 279). This is because an "insurer owe[s] its insured 'some duties of a fiduciary nature,' including 'equal consideration, fairness and honesty.'" Id. (quoting Rawlings v. Apodaca, 726 P.2d 565 (Ariz. 1986)). In reaching this conclusion, the court remanded the matter for a determination of whether the primary insurer "made a good faith evaluation and acted properly in rejecting the settlement offer." 63 P.3d at 287.

A primary insurer can defend an equitable subrogation claim alleging bad faith by showing that the excess insurer had knowledge of excess exposure but failed to participate in the underlying litigation. In PHICO Ins. Co., Inc. v. Aetna Cas. and Sur. Co. of America, 93 F. Supp. 2d 982 (S.D. Ind. 2000), the court examined the extent to which an excess insurer could assert claims against a primary insurer for bad faith or negligent defense of the insured. PHICO was the excess insurer and Aetna provided, as the primary insurer, the defense to the insured. During the litigation, Aetna provided status reports to PHICO and informed PHICO that total damages could exceed the primary limits. Subsequent to settlement, PHICO brought suit against Aetna, seeking the sums it paid to settle, alleging it was "handicapped in final negotiations" by Aetna's negligence. The court noted that "to allow PHICO to recover against Aetna given the facts and circumstances of this case would be inequitable and unjust." Id. at 991. Specifically, the court reasoned that PHICO was well aware that the claims exceeded Aetna's policy limits, yet "simply chose not to participate in that defense until Aetna tendered its policy limits." Id. PHICO had the right to associate with Aetna and to participate in the defense of the underlying claim. Yet, PHICO "waited in the wings, electing not to participate in the defense of the insureds until it was too late." Id. at 992. The court found this delay "inexcusable because PHICO knew full well that its policy was implicated by the underlying claims." Id. As such, the court held PHICO was barred from bringing an action against Aetna, stating that "Aetna should not bear the cost of PHICO's failure to protect its own rights and interests." Id. at 995.

2. Alternate Theories of Bad Faith Liability

In addition to equitable subrogation rights, a few jurisdictions find that an excess insurance carrier has an independent and direct cause of action against both the primary insurer and the insured for failure to act in good faith in settling a claim. *Excess Liability: Rights and Duties of Commercial Risk Insureds and Insurers* § 6:5 (citing cases in California, Colorado, Illinois, Arizona, Louisiana, New York, North Carolina, and Wisconsin). Two additional theories merit brief discussion, although neither is widely accepted.

a. Direct Duty

The "direct duty" theory permits an excess insurer to bring a direct action for inadequate defense of a claim or negotiation of settlement against the primary insurer. This theory is premised on the implied duty of good faith owed by the primary to the excess insurer, despite the lack of contractual privity. New England Ins. Co. v. Healthcare Underwriters Mut. Ins. Co., 352 F.3d 599 (2nd Cir. 2003)(under New York law, the primary carrier owes the excess carrier the same duty of good faith which it owes to its insured); American Centennial, 293 N.J.Super. 567 (1995)(primary insurer owes excess insurer a direct duty to handle a claim in good faith, which includes protecting the interests of the excess insurer).

In Hartford Accident & Indemnity Co. v. Michigan Mutual Insurance Co., 61 N.Y.2d 569, 463 N.E.2d 608 (1984), the New York Court of Appeals found that a primary insurer acts as a fiduciary, and is obligated to extend the "utmost good faith" toward the excess insurer. By violating this duty and placing its own interest above that of the excess insurer, the primary insurer exposed the excess insurer to liability beyond its policy limits. The independent and direct duty owed to the excess insurer created a cause of action not premised on the equitable subrogation theory. See also Commercial Union Ins. Co. v. Medical Protective Co., 136 Mich. App. 412, 356 N.W. 2d 648 (1984)(acknowledging the validity of a direct action by an excess carrier against a primary carrier despite the presence of a contractual obligation).

A California court permitted the excess insurer to bring a direct action against both the primary insurer and the insured when the excess established that the two conspired to commit fraud. The court found that their conduct amounted to a breach of their respective duties of good faith and fair dealing. Kaiser Foundation Hospitals v. North Star Reinsurance Corp., 153 Cal. Rptr. 678 (Cal. App. 1979); See also FN 1, *supra*.

In Schal Bovis Inc. v. Casualty Ins. Co, 732 N.E.2d 1082 (Ill. 1999), the court recognized an excess insurer's independent tort cause of action against a primary insurer. The court found that "by purchasing excess coverage, the insured has effectively substituted the excess insurer for itself," therefore supporting the logical conclusion that the excess insurer can bring suit against its insured's primary insurer. Id. When a claim threatens to exceed the primary coverage or it is reasonably foreseeable that the claim may reach the excess policy, there is a three-way duty of care between the policyholder, the primary insurer, and the excess insurer. Id. The Schal court reasoned that providing a separate claim would promote judicial economy, good-faith settlements close to the amount of the expected verdict, less litigation, and lower insurance premiums for excess coverage.

b. Triangular Reciprocity

Another theory of liability which recognizes an excess insurer's right to pursue a bad faith action is called Triangular Reciprocity. This theory focus on the duties shared among the insured, the primary insurer and the excess insurer, which create reciprocal obligations of reasonable care owed by all. The doctrine was first introduced in Transit Casualty v. Spink Corp., 156 Cal. Rptr. 360 (Ct. App. 1979). In that case, the court was wary to adopt the premise that a direct duty was shared by the three parties, but rather found that a general duty of care was owed by all. The court reasoned "triangular reciprocity" to be a better alternative than equitable subrogation, concluding that loss should be shared by all three parties, based on a determination of each party's comparative fault. See FN 1, *supra.*

While not as commonly accepted as an equitable subrogation theory, the alternate theories of direct liability discussed here offer advantages. Primarily, no payment is required by the excess insurer as is the case with subrogation. Of equal practical consequence, because the excess insurer is not required to stand in the shoes of the insured to bring the action, the primary insurer is not armed with the defenses it may have had against its insured when defending an action brought by the excess insurer. Id.

B. Excess Insurer's Right to Recover for Bad Faith From its Insured

A bad faith action by an excess insurer against its insured is premised conceptually on the implied covenant of good faith and fair dealing present in every contract. The court extended this obligation to impose a reverse duty on the insured in favor of its excess insurer in Liberty Mutual Insurance Co. v. Altfillisch Construction Co., 139 Cal.Rptr. 91 (Ct. App. 1977). This theory that the duty of good faith runs both ways has not been widely accepted, and in most instances, has been refused by courts.

C. Excess Insurer's Exposure to Bad Faith Damages

Unlike the insured's action against a primary insurer, insureds and primary insurers may bring a claim for extra-contractual damages against an excess insurer. In this scenario, courts have considered the excess insurer a joint tortfeasor along with the primary insurer. In that instance, the excess insurer would have to so significantly participate in the investigation, claim handling and negotiation of settlement in concert with the primary insurer that the court could find the excess insurer ratified the conduct of the primary insurer.

This scenario can arise in the context of reinsurance, when a reinsurer engages in a "joint enterprise" with its reinsured, thereby exposing itself to bad faith damages. Peerless Ins. Co. v. Mutual Ins. Co., 251 F.2d 696 (4th Cir. 1958). Joint enterprise liability depends heavily upon a factual analysis of the parties' interactions. If the reinsurer actively participated in the handling of the underlying claim, either the reinsured or the policyholder may be able to establish that the reinsurer has entered into a joint enterprise with its reinsured such that the tortious acts of the reinsured are imputed to the reinsurer.

In Peerless, the court found that the reinsurer was so intimately involved in the claims handling process that it essentially endorsed the conduct of the reinsured. The degree of interaction between the parties in Peerless was significant, including joint decisions among the reinsured and reinsurer with regard to settlement. The court focused on the reinsurer's knowledge of, and ability to control, the underlying litigation, which created a "joint enterprise" subjecting the reinsurer to a proportionate share of extra-contractual damage exposure.

Peerless is factually distinguishable because reinsurers and their reinsureds typically have a formal agreement in place that controls their respective obligations, unlike a primary and excess insurer. However, the court's rationale should serve as caution for excess insurers to consider their level of influence and participation with the claims handling decisions of the primary insurers when assessing their bad faith exposure. In most instances, an excess insurer's conduct is largely irrelevant prior to the point when the primary limits are exhausted. Its pre-settlement conduct may be scrutinized, however, if it interfered with the settlement of the claim against the insured or misinformed the insured. Continental Cas. Co. v. Royal Ins. Co., 219 Cal. App. 3d 111, 268 Cal.Rptr. 193 (1990).

Another potential area for bad faith exposure for the excess insurer involves delay in payment. No cases specifically address, with precision, whether an excess insurer may be liable for bad faith it if delays payment or contribution by investigating the reasonableness of a settlement or underlying coverage. However, several courts have generally discussed the allegation of "delay" in claims handling. These decisions reflect that delay is a relevant factor in determining whether bad faith has occurred. A long period of time between demand and settlement does not, on its own, necessarily constitute bad faith. Williams v. Hartford Cas. Ins. Co., 83 F.Supp.2d 567, 571 (E.D. Pa. 2000); Kosierowski v. Allstate Ins. Co., 51 F.Supp.2d 583, 589 (E.D. Pa. 1999)(rejecting an insured's bad faith claim because legitimate delays are an ordinary party of legal and insurance work); See also FN 1, *supra.*

IV. CONCLUSION

Despite the lack of contractual obligations that delineate the duties impliedly owed by primary insurers to excess insurers, the case law makes clear that all parties have reciprocal duties to act in good faith. The primary insurer owes several implied duties to an excess insurer during the investigation, handling and settlement of the underlying claim. In particular, the primary insurer must cooperate with the excess insurer by providing notice if a claim has the potential to reach the excess layer and by settling the claim within policy limits. While the primary insurer is most vulnerable, as it has the central task of negotiating settlements within the primary limits, bad faith exposure is present for all parties.

Throughout the claims handling process and settlement negotiation, the primary insurer should give good faith consideration to both the insured and the excess insurer, and be wary of actions which may be construed as placing its own interests above those of its insured or the excess insurer. In those cases where primary insurers have successfully defended bad faith claims brought by excess insurers, the evidence of good faith consideration of the excess insurer has been a determinative factor by the court.