

# California Court of Appeal Determines that Excess Insurer May Sue Primary Insurer for Unreasonable Refusal to Settle



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Friday, September 30, 2016

Insureds often have excess liability insurance policies to cover losses that exceed the limits of underlying primary insurance policies. Issues often arise, however, where a primary insurer refuses to settle a case within the limits of the primary policy, thereby implicating the excess policy.

In *Ace American Insurance Company v. Fireman's Fund Insurance Company*, the 2nd District of the California Court of Appeal addressed the issue of whether an excess insurer could pursue a primary insurer that initially refused to settle a case within the limits of the primary policy where the underlying case was resolved by settlement in excess of the primary policy limits as opposed to a judgment. This led to a situation in which the settlement demand increased above the primary limits and the excess insurer had to contribute.

In the underlying personal injury case, a film industry worker had been injured on a movie set. His employer had primary liability insurance with Fireman's Fund and an excess insurance policy with Ace. Fireman's Fund defended the underlying case and the injured worker initially offered to settle the case within the limits of the Fireman's Fund primary insurance policies. Fireman's Fund, however, rejected the

offer and litigation continued until the case settled *above* the limits of the Fireman's Fund policies (thereby implicating the Ace policy).

Ace then sued Fireman's Fund to recover its settlement funds paid under the doctrine of equitable subrogation, contending that Fireman's Fund's unreasonable rejection of the initial settlement offer within the limits of Fireman's Fund's policies unnecessarily forced Ace to contribute to the ultimate settlement. The trial court dismissed the case, determining that the absence of an *excess judgment* above the limits of the Fireman's Fund policies precluded Ace's claim under California law.

The Court of Appeal began its analysis with an explanation of the doctrine of equitable subrogation, under which an insurer that pays policy benefits essentially stands in the shoes of the insured and may pursue recovery from another insurer who was primarily responsible for the loss.

After considering a long history of cases on the issue, including conflicting decisions by different divisions of the 2nd District Court of Appeal, the court determined that no legitimate policy reason existed to require a judgment – as opposed to a settlement – in excess of policy limits before permitting an excess insurer to sue a primary insurer for unreasonable failure to settle within the limits of the primary policy. Instead, the court held that Ace's allegation that it was unnecessarily required to contribute to the settlement based on Fireman's Fund's unreasonable refusal to settle within the primary limits sufficed.

The *Ace v. Fireman's Fund* decision has important implications for California policyholders faced with primary insurers that are hesitant to settle underlying cases within policy limits. Whereas previously primary insurers might have felt "protected" in rejecting initial settlement offers within primary limits based on their belief that excess insurers would be forced to contribute to ultimate settlements in excess of the primary limits without any financial consequence to the primary insurers, the threat of claims by excess insurers relating to a primary insurer's unreasonable refusal to settle should motivate primary insurers to accept reasonable settlement demands within the primary limits.

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