EXCESS CARRIERS ARE EQUITABLY SUBROGATED TO INSURED'S CAUSE OF ACTION AGAINST PRIMARY CARRIERS FOR BREACH OF *STOWERS* DUTY: *American Centennial Insurance Co. v. Canal Insurance Co.*, 810 S.W.2d 246 (Tex. App.—Houston [1st Dist.] 1991, writ granted).

Glenda Russell and Linda McDonald died in an automobile accident.[1] At the time, they were riding in a car which Russell had rented from General Rent-A-Car International, Inc. ("General").[2] General was covered by three insurance policies from three separate carriers at the time of the accident.[3] The McDonald heirs brought a wrongful death action against General, whose primary carrier undertook its defense.[4] The attorney retained by the primary carrier admitted General's liability in an answer to a request for admissions.[5] The excess carriers, therefore, demanded that the primary carrier settle the claim out of its own funds.[6] When the primary carrier refused to settle, the excess carriers settled for $3.7 million.[7] The excess carriers then sued the primary carrier for breach of its duty of good faith and fair dealing.[8] In granting the defendants' motions for summary judgment, the trial court ruled that primary carriers do not owe a duty of good faith and fair dealing to excess carriers.[9] The First District Court of Appeals reversed as to the primary carrier's duty, holding that "an excess carrier is equitably subrogated to an insured's cause of action against the primary carrier for breach of the *Stowers* duty."[10]

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1. American Centennial Ins. Co. v. Canal Ins. Co., 810 S.W.2d 246, 249 (Tex. App.—Houston [1st Dist.] 1991, writ granted).
2. *Id.*
3. *Id.*
4. *Id.*
5. *Id.*
6. *Id.*
7. *Id.* at 250.
8. *Id.*
9. *Id.*
10. *Id.* at 252.

I. Evolution of the Excess Carrier's Cause of Action for Breach of Good Faith

A. The Recognition of a Cause of Action by an Excess Carrier

The federal courts were first to recognize the existence of an excess carrier's cause of action for breach of good faith by the primary carrier. The Tenth Circuit was the first court to address whether the excess carrier had a cause of action against the primary carrier for bad faith or negligence in handling a claim.[11] In *American Fidelity & Casualty Co. v. All American Bus Lines, Inc.*[12] the Tenth Circuit Court of Appeals held that an excess carrier may recover against a primary carrier for bad faith refusal to settle a claim.[13] In *American Fidelity*, the insured was covered by two policies.[14] The primary insurer, American Fidelity & Casualty Company ("American"), covered All American Bus Lines, Inc. ("Bus Lines"), up to $10,000 for injury to any one person.[15] Security Mutual Casualty Company ("Security") covered Bus Lines from $10,000 up to $100,000 for injury to any one person.[16] Bus Lines was sued for $30,500 as a result of an accident involving one of its buses.[17] American, as the primary insurer, assumed Bus Lines' defense.[18] Prior to trial, American rejected the plaintiff's offer to settle for $5,000.[19] The case proceeded to trial, resulting in a verdict for the plaintiff of $25,000.[20] While awaiting appeal, the parties settled for $17,500.[21] American paid its policy limit of $10,000.[22] Bus Lines paid the balance, and was reimbursed by Security.[23]

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11. *See* William E. Knepper, *Relationships Between Primary and Excess Carriers in Cases Where Judgment or Settlement Value Will Exhaust the Primary Coverage*, 20 Ins. Couns. J. 207, 211 (1953).
12. 190 F.2d 234 (10th Cir.), *cert. denied*, 342 U.S. 851 (1951).
13. *Id.* at 238.
14. *Id.* at 235-36.
15. *Id.*
16. *Id.* at 236.
17. *Id.*
18. *Id.*
19. *Id.*
20. *Id.*
21. *Id.*
22. *Id.*
23. *Id.*

Relying on the subrogation provision in its policy, Security had Bus Lines sue American for bad faith in failing to accept the $5,000 settlement offer.[24] The trial court entered a $7,500 judgment against American.[25] The Tenth Circuit sustained, holding that "as between [American and Security], it would be just and equitable for American to bear the loss occasioned by its own misconduct."[26]

Later that year, the Tenth Circuit addressed a similar issue in *St. Paul-Mercury Indemnity Co. v. Martin*,[27] in which the plaintiff agreed to settle for $1,000 over the primary policy limit.[28] The excess carrier tried to force the primary carrier to accept this settlement.[29] The court clarified its holding in *American Fidelity*, finding that, while the primary carrier could not be compelled to settle,[30] it did owe the excess insurer "the duty to exercise an honest discretion at the risk of liability beyond its policy limits."[31] The court cited *American Fidelity* to support the proposition that the primary insurer had a duty to the excess carrier to exercise good faith in deciding whether to accept a settlement offer.[32]

In 1960, the Tenth Circuit relied upon both *American Fidelity* and *St. Paul-Mercury* to establish the duty of a primary carrier to the excess carrier in handling claims.[33] In *United States Fidelity and Guaranty Co. v. Tri-State Insurance Co.*,[34] a primary carrier settled all claims which arose out of an automobile accident.[35] Covenants not to sue were executed, but did not protect a defendant who was covered by an excess policy.[36] The excess carrier sued the primary

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24. *Id.*

25. *Id.* The primary issue on subsequent appeal was whether Security was the real party in interest. *Id.*

26. *Id.* at 238.

27. 190 F.2d 455 (10th Cir. 1951). The main issue in *St. Paul-Mercury* was whether an excess carrier could force the primary insurer to pay its full policy limit in settlement on threat of liability for full amounts if the settlements are refused. *Id.* at 457.

28. *Id.* at 456.

29. *Id.*

30. *See id.* at 457.

31. *Id.*

32. *See id.*

33. *See* United States Fidelity & Guar. Co. v. Tri-State Ins. Co., 285 F.2d 579, 581 (10th Cir. 1960).

34. 285 F.2d 579 (10th Cir. 1960).

35. *Id.* at 581.

36. *Id.*

carrier for breach of the duty of good faith.[37] In finding the primary carrier liable, the Tenth Circuit held that:

> An insurance carrier has the duty to use the utmost good faith in the disposition of claims made against its insured . . . [a]nd this duty is not lessened by the existence of excess insurance but is extended to include the excess carrier within the shelter of the obligation. . . . Lack of good faith in this regard may extend the primary carrier's obligation beyond the stated policy limit and extend the point at which the secondary liability of the excess carrier attaches.[38]

B. The Equitable Subrogation Theory

The New York Appellate Division was among the first state courts to hold that an excess carrier has a cause of action against a primary carrier for bad faith in failing to settle a claim.[39] In *Home Insurance Co. v. Royal Indemnity Co.*,[40] the excess carrier (Home) brought suit against the primary carrier (Royal) to recover the amount it contributed in payment of the judgment.[41] Home asserted that Royal "acted negligently and in bad faith in refusing reasonably to negotiate a settlement within the limits of [its] policy."[42]

The court held that Home became "an equitable assignee or subrogee of [the insured's] rights" as to Royal when it paid off the insured's obligation.[43] The court reasoned that by negotiating a settlement in excess of the primary policy, Royal "was negotiating with Home's money."[44] Royal, therefore, had the duty to negotiate in good faith.[45]

The United States District Court for the Central District of California was presented with the same issue in *Peter v. Travelers Insurance Co.*[46] In *Peter*, the court found that the primary insurer

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37. *Id.*
38. *Id.* (citations omitted).
39. *See* Home Ins. Co. v. Royal Indem. Co., 327 N.Y.S.2d 745, 748 (N.Y. Sup. Ct.), *aff'd*, 332 N.Y.S.2d 1003 (N.Y. App. Div. 1972).
40. 327 N.Y.S.2d 745 (N.Y. Sup. Ct.), *aff'd*, 332 N.Y.S.2d 1003 (N.Y. App. Div. 1972).
41. *Id.* at 747.
42. *Id.*
43. *Id.* at 748.
44. *Id.*
45. *See id.*
46. 375 F. Supp. 1347 (C.D. Cal. 1974).

("Travelers") breached its duty to settle within policy limits.[47] The court then had to determine whether Travelers was liable to the excess carrier for this breach.[48] The district court, acknowledging the Tenth Circuit line of cases, held that "a primary insurer does have a duty to an excess insurer,"[49] explaining that "the duty owed an excess insurer is identical to that owed the insured."[50] The court reasoned that it was Travelers who caused the excess carrier's loss,[51] and, therefore, it as the primary carrier should be liable for that loss.[52]

The Supreme Court of Michigan, in *Commercial Union Insurance Co. v. Medical Protective Co.*,[53] allowed an excess carrier recovery for the primary carrier's bad faith under an equitable subrogation theory.[54] The court reasoned that the excess carrier bears the burden of the primary carrier's bad faith and thus should have a cause of action against the primary carrier.[55] Citing the California case, *Commercial Union Assurance Cos. v. Safeway Stores, Inc.*[56] as the basis of its holding, the court explained that the excess carrier " 'who discharged the insured's liability as a result of this tort, stands in the shoes of the insured and should be permitted to assert all claims against the primary carrier which the insured himself could have asserted.' "[57]

The court in *Medical Protective* determined that allowing the excess carrier to assert a bad faith claim would not increase the scope of the primary carrier's duty.[58] The court reasoned that the excess carrier will acquire only those rights which the insured would be able to assert,[59] and, further, agreed that since the excess carrier would

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47. *Id.* at 1349.

48. *Id.* Travelers covered up to $250,000, and Valentine covered over $250,000. *Id.* at 1348. The plaintiff won a judgment of $407,000. *Id.* Previously, the plaintiff had tendered a settlement offer within Travelers' policy limit, but, as a result of confusion within Travelers' organization, the offer was refused. *Id.*

49. *Id.* at 1349.

50. *Id.* at 1350.

51. *Id.*

52. *See id.*

53. 393 N.W.2d 479 (Mich. 1986).

54. *Id.* at 483.

55. *Id.* at 482.

56. 610 P.2d 1038 (Cal. 1980).

57. 393 N.W.2d at 482 (quoting 610 P.2d at 1041).

58. *Id.* at 483.

59. *Id.*

bear the loss, it would have greater incentive to enforce the primary carrier's duty.[60]

Moreover, the Michigan court recognized that allowing the excess carrier to recover from the primary carrier would stabilize excess insurance premiums.[61] The court explained that the primary carrier's refusal to settle forces the excess carrier to settle in order to minimize its losses.[62] By settling, the excess carrier then would cover both primary and excess liability.[63] Consequently, excess carriers would have to raise their premiums to make up for their increased liability.[64]

Finally, the court in *Medical Protective* recognized that equitable subrogation facilitates settlement negotiations by the primary carrier.[65] The court reasoned that whenever settlement value is at or near the primary policy limit, the primary carrier has little or no reason not to proceed to trial.[66] The court explained that the primary carrier is, in effect, gambling with the excess carrier's money.[67] The court found that judicial economy is served by more fair and reasonable settlements.[68]

Thus, in equitable subrogation jurisdictions, the excess carrier is placed in the shoes of its insured.[69] Whenever a policy holder has a cause of action against his primary carrier, the excess carrier may enforce that right.[70]

C. *The Direct Duty Theory*

Courts have allowed an excess carrier to sue a primary carrier without having to rely upon the insured having a cause of action. In *Estate of Penn v. Amalgamated General Agencies*,[71] the New Jersey Superior Court addressed the issue of "whether a primary carrier owes to an excess carrier the same positive duty to take the

60. *Id.* at 482.
61. *Id.* at 483.
62. *Id.*
63. *See id.*
64. *See id.*
65. *Id.*
66. *See id.*
67. *See id.*
68. *Id.*
69. *See* 16 GEORGE J. COUCH, COUCH ON INSURANCE 2d § 62.53 (rev. ed. 1983).
70. *See id.*
71. 372 A.2d 1124 (N.J. Super. Ct. App. Div. 1977).

initiative and attempt to negotiate a settlement with the policy coverage that it owes to its assured."[72] *Estate of Penn* dealt with a primary carrier's refusal to settle, resulting in a verdict in excess of the primary policy limit.[73] The excess carrier responded by refusing to contribute to the appeal bond.[74] The insured sued both carriers for the amount of the excess verdict.[75] The excess carrier argued that the primary carrier was solely liable for the excess verdict since it violated its good faith duty to settle.[76] On cross-motions for summary judgment, the trial court held that the excess carrier "was solely liable for the verdicts in excess of the primary coverage. . . ."[77] The trial court was not presented with an excess carrier's suit against a primary carrier but rather an insured's suit against both carriers.[78]

The court relied on the equitable subrogation rationale in recognizing that the primary carrier had a direct duty to the excess carrier.[79] Therefore, the excess carrier was not liable for the excess verdict.[80]

In *American Centennial Insurance Co. v. American Home Assurance Co.*,[81] the direct duty issue arose when the excess carrier sued the primary carrier for negligently failing to settle.[82] Making no mention of an equitable subrogation theory,[83] the excess carrier alleged that the primary carrier owed it a fiduciary duty, which the primary carrier had breached by failing to settle.[84] The district court held that "a primary carrier does owe a direct duty of care to an excess carrier. . . ."[85] The court cited several public policy reasons

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72. *Id.* at 1125.
73. *Id.*
74. *Id.* at 1126.
75. *Id.*
76. *Id.*
77. *Id.*
78. *See id.*
79. *See id.* at 1126-27.
80. *See id.* at 1127.
81. 729 F. Supp. 1228 (N.D. Ill. 1990).
82. *Id.* at 1230.
83. *Id.* at 1230 n.1.
84. *Id.*
85. *Id.* at 1232. The court did not recognize a fiduciary duty; instead, the court found that the excess carrier did not really try to recover for a breach of fiduciary duty. *See id.* at 1233. The court found that the "use of the word 'fiduciary' . . .[is] merely careless mischaracterizations of the reasonableness-based duty of care. . . ." *Id.*

for establishing a direct duty on the primary carrier.[86] Furthermore, the court stated that "there are no policy reasons why a primary carrier who knows of an excess carrier's existence should not be held to a direct duty to settle a claim against the insured within its policy limit when a reasonable primary insurer would do so."[87]

The New York court in *Hartford Accident and Indemnity Co. v. Michigan Mutual Insurance Co.*,[88] allowed recovery under a direct duty theory when the excess carrier might not have an equitable subrogation claim available.[89] The *Hartford* court permitted the excess carrier to sue the primary carrier in its own capacity.[90] The court held that the primary carrier "owed a primary obligation to its assured and to the excess insurer to exercise good faith in handling the defense and to safeguard the rights and interest of the excess carrier."[91]

The insured in *Hartford* was injured on the job.[92] The primary carrier covered the painting contractor (DeFoe), a subsidiary (L.A.D.), and the insured's employer (D.A.L.).[93] The excess carrier covered all three parties under separate policies.[94] The insured sued DeFoe and L.A.D., leaving the employer out of the suit.[95] The excess carrier claimed that the primary carrier failed to name the employer in a third party action in order to minimize its own liability.[96] While the court did not determine whether the excess carrier had a right of subrogation against the employer,[97] it held that the excess carrier had a direct cause of action.[98]

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86. *Id.* at 1232. These policies are "'encourag[ing] . . . settlements when an offer exists at or near the policy limits, discouraging gambling with the excess carrier's money, [and helping] to keep excess liability insurance premiums low . . . .'" *Id.* (quoting Ranger Ins. Co. v. Home Indem. Co., 714 F. Supp. 956, 961 (N.D. Ill. 1989) (citing ROWLAND H. LONG, THE LAW OF LIABILITY INSURANCE, § 5.63, at 5-472 (1980))).

87. *Id.*

88. 462 N.Y.S.2d 175 (N.Y. App. Div. 1983), *aff'd*, 463 N.E.2d 608 (N.Y. 1984).

89. *See id.* at 178.

90. *See id.* at 179. The excess carrier may have been barred due to its relation with the insured's employer. *See id.* at 178. "Whether [the excess carrier] is barred from [equitable subrogation] by reason of the fact that it is also [the employer's] excess insurer is not now before us." *Id.*

91. *Id.* at 178.

92. *Id.* at 176.

93. *Id.*

94. *Id.*

95. *Id.*

96. *Id.* As the employer's workers' compensation carrier, the primary carrier would have paid a greater share of the judgment, thereby reducing the excess carrier's liability. *See id.*

97. *See id.* at 177.

98. *Id.* at 178.

In *Twin City Fire Insurance Co. v. Superior Court*,[99] the Arizona Supreme Court refused to recognize a direct duty when the excess carrier had equitable subrogation available to it.[100] In *Twin City*, the excess carrier sued the primary carrier for breach of the duty of good faith and fair dealing under both an equitable subrogation theory and a direct duty theory.[101] The trial court granted the primary carrier's motion to dismiss the direct duty issue but allowed the excess carrier to continue under equitable subrogation.[102] On appeal, the Arizona Supreme Court recognized the excess carrier's right to sue under an equitable subrogation theory but refused "to go a step further and hold that a primary insurance carrier, independent of its obligation under the doctrine of equitable subrogation, owes a direct duty of good faith and fair dealing to an excess insurance carrier."[103]

The *Twin City* court recognized that those courts which had allowed the direct duty theory did so because equitable subrogation failed to protect the excess carrier's interests.[104] However, the court reasoned that this excess carrier had an adequate remedy under equitable subrogation[105] and could have protected itself with appropriate language in its policy.[106] Although indicating that given different facts it might be willing to allow a direct duty theory,[107] in this case, the Arizona limited the primary carrier's duty to that of giving the insured's interests equal consideration when faced with an offer to settle.[108]

D. Triangular Reciprocity: The Rise and Fall

In *Transit Casualty Co. v. Spink Corp.*,[109] a California court held that the duty among the insured, the primary carrier, and the

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99. 792 P.2d 758 (Ariz. 1990) (en banc).
100. *Id.* at 759.
101. *Id.*
102. *Id.*
103. *Id.*
104. *Id.*
105. *See id.*
106. *See id.* at 760. "For instance, an excess insurer can provide in its contract that it may control the defense whenever potential for excess liability exists. In addition [it] can require notice of all lawsuits . . . [and] reserve to [itself] the right to approve all settlement offers." *Id.*
107. *See id.* "We decline in this case and at this time to recognize a direct duty running from the primary insurer to the excess insurer." *Id.*
108. *See id.*
109. 156 Cal. Rptr. 360 (Cal. Ct. App. 1979).

excess carrier was one of "triangular reciprocity."[110] This theory provided a means by which the court could avoid the "undesirable, all-or-nothing results" of equitable subrogation.[111] The *Transit Casualty* court found the insured liable for wrongful refusal to settle,[112] explaining that under equitable subrogation the excess carrier's rights inure from the insured's rights. Therefore, an insured without clean hands would bar the excess carrier's claim against a primary carrier.[113]

The court in *Transit Casualty* reasoned that a "theory of liability resting upon a direct duty-of-care promotes sharing of the loss according to the measure of each party's comparative fault."[114] The result of the holding was to extend a duty to the insured to consider the excess carrier's interests.[115] The court reasoned that this "three-way" duty would facilitate settlements, since each party would know "that a jury may ultimately pass upon the reasonableness of its conduct."[116]

The duty imposed by *Transit Casualty* was overruled by *Commercial Union Assurance Cos. v. Safeway Stores, Inc.*,[117] less than one year later.[118] In *Commercial Union*, the California Supreme Court recognized that "equity requires fair dealing between the parties to an insurance contract."[119] The court was unwilling to extend a duty to "require an insured contemplating settlement to put the excess carrier's financial interests on at least an equal footing with his own."[120] The *Commercial Union* court reasoned that "[t]he object of the excess insurance policy is to provide additional resources should the insured's liability surpass a specified sum. . . . The protection of the insurer's pecuniary interests is simply not the object of the bargain."[121] After *Commercial Union*, the direct duty and equitable subrogation theories were the only means by which an

110. *Id.* at 365-67.
111. *Id.* at 366.
112. *Id.* at 365 n.2.
113. *See id.* at 365.
114. *Id.* at 367 (citing American Motorcycle Ass'n v. Superior Court, 578 P.2d 899, (Cal. 1978) (en banc)).
115. *See id.* at 366.
116. *Id.* at 367.
117. 610 P.2d 1038 (Cal. 1980).
118. *See id.*
119. *Id.* at 1043.
120. *Id.*
121. *Id.* at 1041-42.

excess carrier could recover for a primary carrier's breach of its duty of good faith.[122]

II. The Evolution of the Breach of Good Faith Cause of Action in Texas

A. The Duty of the Insurer

In *G.A. Stowers Furniture Co. v. American Indemnity Co.*,[123] a Texas court first recognized that an insurance carrier has a duty to exercise "that degree of care and diligence which a man of ordinary care and prudence would exercise in the management of his own business."[124] In *Stowers*, the policy holder sued his insurer for negligently failing to accept a settlement offer within the policy limits.[125] The suit arose from an automobile accident involving a truck owned by G.A. Stowers Furniture Company (Stowers Furniture).[126] Mamie Bichon sued Stowers Furniture, seeking damages of $20,000, and American Indemnity Company (American) undertook its defense.[127] Prior to trial, Bichon offered to settle for $4,000,[128] but American refused to pay more than $2,500.[129] The trial court entered judgment in favor of Bichon for $12,207.[130] Stowers Furniture paid a total of $14,107.50, including interest and costs, and then brought suit against American.[131]

In holding that a policy holder has a cause of action against his insurance carrier,[132] the *Stowers* court explained that:

> [t]he provisions of the policy giving the indemnity company absolute and complete control of the litigation, as a matter of law, carried with it a corresponding duty and obligation, on the part of the indemnity company, to exercise that degree of care that a person of ordinary care and prudence would exercise under the

122. *See id.* at 1043.
123. 15 S.W.2d 544 (Tex. Comm'n App. 1929, holding approved).
124. *Id.* at 548.
125. *Id.* at 545.
126. *Id.*
127. *Id.*
128. *Id.*
129. *Id.*
130. *Id.*
131. *Id.*
132. *See id.* at 547.

> same or similar circumstances, and a failure to exercise such care and prudence would be negligence on the part of the indemnity company.[133]

The court determined that if a reasonably prudent policy holder would have accepted the settlement offer, an insurer who does not is liable for breach of its good faith duty.[134]

In *Ranger County Mutual Insurance Co. v. Guin*,[135] the Texas Supreme Court expanded the *Stowers* duty to include "the full range of the agency relationship."[136] *Ranger* arose from an automobile accident involving a dump truck owned by Peden and driven by Guin.[137] Ranger County Mutual Insurance Company (Mutual) undertook Peden and Guin's defense to a cross-claim brought by the owner and driver of the other truck involved in the accident.[138] Mutual refused an offer to settle for an amount $500 below its policy limit.[139] At trial, Guin was found to be at fault, and judgment was entered for a total of $263,232.25.[140]

Peden and Guin sued Mutual for breach of the *Stowers* duty.[141] At trial, Peden and Guin claimed that Mutual did not inform them of the settlement offer,[142] and the trial court rendered judgment against Mutual for $450,000.[143] Mutual contended that the offer was not unconditional and, therefore, did not fall within the *Stowers* duty.[144] The court held that "[a]n insurer's duty to its insured is not limited to the narrow boundaries contended by [Mutual]. . . ."[145] The court explained that this duty "includes investigation, preparation for defense of the lawsuit, trial of the case and reasonable attempts to settle."[146] After *Ranger*, a policy holder has a cause of action when his insurance carrier negligently handles a case.[147]

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133. *Id.*
134. *See id.*
135. 723 S.W.2d 656 (Tex. 1987).
136. *Id.* at 659.
137. *Id.* at 657.
138. *See id.*
139. *See id.* at 659. The policy covered up to $20,000, and the plaintiff offered to settle for $19,500. *Id.* at 659-60.
140. *Id.* at 658.
141. *Id.*
142. *Id.* at 659.
143. *Id.* at 658.
144. *Id.*
145. *Id.* at 659.
146. *Id.* Justice Gonzalez, in his dissent, argued that "failure to inform an insured about

B. The Insurer's Right of Equitable Subrogation in Texas

It is well settled that an insurance carrier is subrogated to its insured's rights against the party which caused the insured's loss.[148] The Beaumont Court of Appeals was the first Texas court to hold that an indemnity insurer has a right of subrogation, even though the policy does not so provide.[149] In *Magnolia Pipe Line Co. v. Security Union Insurance Co.*,[150] an insurer sued the party who caused the loss to its policy holder.[151]

Magnolia arose when an automobile owned by J. L. Mapes collided with a truck owned by Magnolia Pipe Line Company (Magnolia).[152] Security Union Insurance Company (Security) covered the loss to Mapes under an indemnity policy.[153] Security paid for the repairs to Mapes' car, and then sued Magnolia for the $777.03 repair bill.[154] Magnolia argued that Security had no right to recover since Mapes did not assign his right to sue to Security.[155]

The *Magnolia* court held that an insurer is subrogated to the policy holder's rights whether or not the policy so provides.[156] The court reasoned that this holding would prevent a double recovery on the part of the policy holder.[157] The court also recognized that allowing an insurer to be subrogated to the policy holder's rights would prevent a wrongdoer from denying liability on the ground that the loss was covered by insurance.[158]

In *Ortiz v. Great Southern Fire & Casualty Insurance Co.*,[159] the Amarillo Court of Civil Appeals addressed the question of whether

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a settlement offer can be the basis of liability under *Stowers* but *only if there was an unconditional offer to settle.*" *Id.* at 662 (Gonzalez, J., dissenting) (emphasis in the original).

147. *See id.* at 659.

148. *See generally* 46 TEX. JUR. 3d *Insurance Contracts and Coverage* § 564 (1986) (discussing insurer's right of subrogation).

149. *See* Magnolia Pipe Line Co. v. Security Union Ins. Co., 37 S.W.2d 1062, 1063 (Tex. Civ. App.—Beaumont 1931, no writ).

150. 37 S.W.2d 1062 (Tex. Civ. App.—Beaumont 1931, no writ).

151. *Id.* at 1063.

152. *Id.*

153. *Id.*

154. *Id.*

155. *Id.*

156. *See id.*

157. *See id.*

158. *See id.*

159. 587 S.W.2d 818 (Tex. Civ. App.—Amarillo 1979, *rev'd on other grounds*, 597 S.W.2d 342 (Tex. 1980)).

an insurer is equitably subrogated to the policy holder's rights against the party who caused the loss.[160] *Ortiz* involved a fire in the Ortiz home,[161] which was covered for $8,500 against loss to the real property by Great Southern Fire & Casualty Insurance Co. (Great Southern).[162] The policy did not cover loss to Ortiz' personal property.[163] Great Southern paid Ortiz $4,000 for repairs to the house,[164] and Ortiz then sued the party who allegedly caused the fire.[165] Great Southern intervened, claiming a subrogation right to the $4,000 it had paid.[166] All parties settled for $10,000.[167] The settlement agreement did not specify whether the settlement covered real property or personal property damage.[168] The trial court awarded Great Southern $4,000 of the $10,000 settlement.[169]

In affirming, the court of appeals held that "[u]pon payment of a loss under a policy, the insurer acquires the right to be subrogated pro tanto to any cause of action the insured may have against any third person who caused the loss."[170] The court explained that this right is given to prevent a double recovery by the policy holder.[171]

III. *American Centennial Insurance Co. v. Canal Insurance Co.*

Glenda Russell and Linda McDonald died in an automobile accident involving a car rented from General Rent-A-Car, which was covered by a primary policy and two excess policies.[172] The primary carrier undertook General's defense.[173] When the attorney retained by the primary carrier admitted General's liability, the excess carriers

160. *Id.* at 820.
161. *Id.* at 819.
162. *Id.* at 819.
163. *Id.*
164. *Id.*
165. *Id.*
166. *Id.*
167. *See id.*
168. *See id.*
169. *Id.* at 820.
170. *Id.* (citing 37 S.W.2d at 1063).
171. *See id.* The Texas Supreme Court held that Great Southern was not entitled to the entire $4,000 since the insured was not fully reimbursed for his loss. *See* Ortiz v. Great S. Fire and Casualty Ins. Co., 597 S.W.2d 342, 343-44 (Tex. 1980).
172. American Centennial Ins. Co. v. Canal Ins. Co., 810 S.W.2d 246, 249 (Tex. App.—Houston [1st Dist.] 1991, writ granted).
173. *Id.*

demanded that the primary carrier settle out of its own funds.[174] After the primary carrier refused to settle, the excess carriers settled within the excess policy limits.[175] The excess carriers subsequently brought an action against the primary carrier for breach of its duty of good faith and fair dealing.[176] The trial court granted the defendants' motions for summary judgment, thus finding that the primary carrier did not owe a duty of good faith and fair dealing to an excess carrier.[177] The First District Court of Appeals reversed as to the *Stowers* duty,[178] holding that an excess carrier is equitably subrogated to the rights of its insured against the primary carrier.[179]

A. One Small Step for a Court

This was a case of first impression in Texas.[180] While it is well-settled that an insurance carrier is subrogated to its insured's rights against the party which caused the insured's loss,[181] no Texas court had yet addressed the question of whether an excess carrier had a corresponding cause of action against a primary carrier.[182] However, courts in other jurisdictions have widely accepted a breach of good faith cause of action by an excess carrier.[183]

Although the court in *American Centennial* had the benefit of persuasive authority to support its holding, the decision was a natural extension of well-settled Texas law. In addition to recognizing that an insurance carrier is subrogated to its insured's rights against the one who caused the loss,[184] Texas courts have also recognized a policy holder's cause of action against its insurer for breach of good faith and fair dealing.[185] Therefore, allowing an excess carrier a cause of

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174. *Id.*
175. *Id.* at 250.
176. *Id.*
177. *Id.*
178. *Id.* at 256.
179. *Id.* at 252.
180. *See id.* at 251 n.1.
181. *See supra* part II. B.
182. *See* 810 S.W.2d at 251 n.1.
183. *Id.* at 253. *See supra* Part I.
184. *See* Ortiz v. Great S. Fire & Casualty Ins. Co., 587 S.W.2d 818, 820 (Tex. Civ. App.—Amarillo 1979), *rev'd on other grounds*, 597 S.W.2d 342 (Tex. 1980).
185. *See* G.A. Stowers Furniture Co. v. American Indem. Co., 15 S.W.2d 544, 546 (Tex. Comm'n App. 1929, holding approved).

action against a primary carrier is a logical extension of *Ortiz* and *Stowers*.

B. One Giant Leap for Excess Carriers: Preemptive Settlements

The test set down in *American Centennial* is straightforward and consistent with that of other jurisdictions.[186] An excess carrier must first show that it indemnified a loss incurred by its insured.[187] Second, the excess carrier must show that the primary carrier's breach of its *Stowers* duty caused the loss.[188] When applied to the facts of *American Centennial*, this test results in an inequity to the primary carrier. The first part of the test will arise in one of two ways. An excess carrier may pay the amount of a judgment in excess of the primary policy limit,[189] or it may also settle prior to trial with its own funds.[190] This preemptive settlement is inequitable to the primary carrier. Allowing an excess carrier to settle against the wishes of the primary carrier contravenes the contract between the primary carrier and the policy holder.[191] The primary carrier bargains for the sole right to settle or defend all covered claims against its policy holders.[192] Generally, a policy holder who settles a claim may not recover from his insurer.[193] By allowing the excess carrier to settle against the wishes of the primary carrier, the court in *American Centennial* gives the excess carrier greater rights than those of the policy holder.[194] Under a subrogation theory, the insurer only acquires those rights which the insured has.[195]

The *American Centennial* court relied on the Minnesota decision, *Continental Casualty Co. v. Reserve Insurance Co.*,[196] to support the

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186. *See supra* Part I.B.

187. *See* American Centennial Ins. Co. v. Canal Ins. Co., 810 S.W.2d 246, 252 (Tex. App.—Houston [1st Dist.] 1991, writ granted).

188. *See id.*

189. *See* American Fidelity & Casualty Co. v. All Am. Bus Lines, Inc., 190 F.2d 234 (10th Cir.), *cert. denied*, 342 U.S. 851 (1951).

190. *See* 810 S.W.2d at 250.

191. *See* Gary M. Bloom, *Recovery Against Primary Insurer by Excess Carrier for Bad Faith or Negligent Failure to Settle*, 36 INS. COUNS. J. 235, 236 (1969).

192. *See id.*

193. *See id.*

194. The court claimed that the duty is identical but then allowed an excess carrier to settle. *See* 810 S.W.2d at 252.

195. *See* Peter v. Travelers Ins. Co., 375 F. Supp. 1347, 1350 (C.D. Cal. 1974).

196. 238 N.W.2d 862 (Minn. 1976).

proposition that an excess carrier may settle first and then bring a *Stowers* suit.[197] In *Continental Casualty*, the excess carrier settled for an amount within the primary policy limits,[198] and the primary carrier was held liable for an amount which it had agreed to cover.[199] In *American Centennial*, the primary carrier was held liable for an amount far in excess of that for which it had bargained.[200] The court explained that its holding would stabilize excess rates without destabilizing primary rates.[201] However, when primary carriers find themselves liable for settlements which have been executed by excess carriers and which exceed their policy limits, they will certainly pass the cost on to policy holders.

The excess carrier's right to settle for amounts exceeding the primary policy limit, combined with the *Stowers* duty as expanded in *Ranger*, will also work an inequity on the primary carrier. The court in *American Centennial* held that the primary carrier could be liable for "tortious conduct in the handling of a claim."[202] The excess carrier was allowed to oversee the handling of the case and step in and settle when the primary carrier made a mistake.

The primary carrier may soon find that preemptive settlements by excess carrier eliminate its best weapon to force a settlement on its terms—the threat of a protracted trial and appeal process. Furthermore, if the excess carrier then proves a breach of the expanded *Stowers* duty, the primary carrier will be liable for the entire settlement.[203]

C. The Test is Applied

In *American Centennial*, the primary policy covered losses not exceeding $100,000, while the excess policies covered losses ranging from $100,000 to $4 million.[204] If the original plaintiff won a judg-

197. *See* 810 S.W.2d at 252-53.
198. 238 N.W.2d at 864.
199. *See id.* at 865.
200. *See* 810 S.W.2d at 254.
201. *Id.* at 253.
202. *Id.* at 254.
203. *See* G.A. Stowers Furniture Co. v. American Indem. Co., 15 S.W.2d 544, 546 (Tex. Comm'n App. 1929, holding approved) ("We are of the opinion that the plaintiff's petition states a cause of action against the [insurer] for the [excess judgment].").
204. *See* American Centennial Ins. Co. v. Canal Ins. Co., 810 S.W.2d 246, 249 (Tex. App.—Houston [1st Dist.] 1991, writ requested).

ment of $4 million, the primary carrier would lose $100,000 plus litigation costs, and the excess carriers would lose $3,900,000. By settling for $3,700,000, the excess carriers potentially saved $200,000. If they could prove that the primary carrier breached its expanded *Stowers* duty, the entire settlement amount would shift to the primary carrier. If the excess carriers could *not* prove a breach of the *Stowers* duty, they still would have the $200,000 savings less the cost of their suit against the primary carrier.[205]

If the excess carrier is allowed to step in too soon, the primary carrier may be unjustly over-exposed. On the other hand, if the excess carrier does not step in soon enough and settle, it could be subject to a suit by the insured for breach of the *Stowers* duty.[206] The court did not address this problem in *American Centennial*; its reliance on *Continental Casualty* is inadequate to support allowing the excess carrier to recover more than the primary policy limit for pretrial settlements.[207] The court went too far by allowing an expanded breach of *Stowers* duty cause of action in a case where the excess carrier settled for more than the primary policy limit before the entry of judgment.

Justice Wilson, in a dissenting opinion, attacked the majority without addressing the merits of allowing such a cause of action.[208] Justice Wilson argued that this question is best left to the legislature, or at least to the Texas Supreme Court.[209] He explained that "permitting a new cause of action from wholecloth, without legislative intervention or warning or guidance by supreme court decisions, would tend to create confusion in the industry, and deny the type of risk-reward predictability necessary for appropriate business decision making."[210] Justice Wilson's argument, however, is flawed in two respects. First, the court relied on two supreme court decisions, *Ortiz* and *Stowers*, to establish a basis for its decision.[211] Second,

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205. This amounts to a gamble even the most conservative excess insurance carrier should be willing to make.

206. The excess carrier also has a duty to settle within its policy limits. *See* Continental Casualty Co. v. Reserve Ins. Co., 238 N.W.2d 862, 865 n.4 (Minn. 1976).

207. *Continental Casualty* involved an excess carrier who settled for an amount greater than the primary policy limit but only sought to recover the primary policy limit. 238 N.W.2d at 864.

208. *See* 810 S.W.2d at 257 (Wilson, J., dissenting).

209. *See id.* at 258.

210. *Id.*

211. *See id.* at 250-52.

predictability is not affected since the primary carrier ostensibly owes the same duty to the excess carrier as it owes to the policy holder.[212]

The *American Centennial* court established a much-needed and equitable rule[213] and then misapplied the rule. Prior to this court's decision, the excess carrier was at the mercy of the primary carrier.[214] The primary carrier could gamble with the excess carrier's money at will. The *American Centennial* court has shifted too much of the burden to the primary carrier. Now, the primary carrier will have to consider the very real possibility of a preemptive settlement, followed by a *Stowers* suit by the excess carrier whenever it decides not to settle a claim. The *American Centennial* rule, as stated, will result in a greater number of fair settlements by primary carriers. The rule, as applied, however, will result in settlements by excess carriers in an attempt to shift the entire loss to the primary carrier.

III. CONCLUSION

In *American Centennial Insurance Co. v. Canal Insurance Co.*,[215] the First District Court of Appeals held that an excess carrier is equitably subrogated to the rights of its insured against the primary carrier.[216] The court relied upon decisions from jurisdictions which had previously allowed such a cause of action.[217] It also relied upon the well-settled right of insurance carriers to be subrogated to their policy holders' rights against the one who caused the loss.[218] Although there may be a question as to whether this was a proper fact pattern in which to adopt a right of equitable subrogation, the *American Centennial* decision should help to realign the previously unequal balance of power, which allowed primary carriers to gamble with excess carriers' money.[219]

by David M. Bays

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212. *See id.* at 252.
213. *See* Bloom, *supra* note 191, at 235.
214. *See* Knepper, *supra* note 11, at 208.
215. 810 S.W.2d 246 (Tex. App.—Houston [1st Dist.] 1991, writ requested).
216. *See id.* at 252.
217. *See id.*
218. *See id.*
219. *See* Knepper, *supra* note 11, at 208.