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KD Law Alert: Excess Insurer's Rights to Equitable Subrogation

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A recent decision by California's Second Appellate District in *Ace American Insurance Company v. Fireman's Fund Insurance Company, 2016 Cal. App. LEXIS 647 (Cal. App. 2d Dist. Aug. 5, 2016), addressed a split in the California Divisional Courts. The Second Appellate District determined that, in addition to excess judgments, certain settlements in excess of primary policy limits could afford excess insurers with a viable cause of action for bad faith against a primary insurer.*

Ace American dealt with a film industry worker that was injured while on set. The worker's employer had a primary insurance policy with Fireman's Fund Insurance Company ("Fireman's") with a $2 million limit, and an excess insurance policy with Ace American Insurance Company ("Ace") with a $50 million limit. During the course of litigation, the worker made settlement demands within the $2 million limit of the Fireman's policy. The parties ultimately entered into a settlement "for an amount substantially in excess" of the Fireman's primary policy limits. At the time, Ace consented to the settlement and contributed towards it, but subsequently pursued Fireman's for equitable subrogation and breach of the covenant of good faith and fair dealing. Ace contended that it sustained damages as a result of Fireman's refusal to settle within its policy limits when those demands were made.

Relying on RLI Ins. Co. v. CNA Casualty of California, 141 Cal. App. 4th 75, 45 Cal. Rptr. 3d 667 (Cal. App. 2d Dist. 2006), Fireman's argued that "an excess insurer may only sue for equitable subrogation if there has been a judgment against the insured that exceeds the limits of the policy." Ace American at p. 4 (emphasis added). The Second Appellate District rejected Fireman's argument, citing to the decision in Fortman v. Safeco Ins. Co. 221 Cal. App. 3d 1394, 271 Cal. Rptr. 117 (Cal. App. 2d Dist. 1990), for the proposition that a cause of action exists when (1) an excess insurer suffered damages as a result of the primary insurer's actions, and (2) the damages were actually paid in a discernable sum by the excess insurer. Ace American at 8, citing Fortman, 221 Cal. App. 3d at 1401-1402. The Court noted that while a judgment is one example of reliable evidence of damages, it is not the only manner by which an excess insurer can prove its damages. A settlement can serve this purpose provided that it offers a reliable reflection of the damages at issue.

The Second Appellate District, however, acknowledged instances addressed in case law in which a settlement would not provide an insurer with a basis to assert a bad faith claim. While those cases were relied on by Fireman's in support of its position, the cases were distinguished by the Second Appellate District as being inapplicable to the case at hand. Specifically, Fireman's relied on cases in which a stipulated judgment was reached between a plaintiff and an insured, but those cases did not involve the insurers as part of the settlement which were entered into with an agreement that the plaintiff would not execute a judgment on the insured. The Second Appellate District found that type of settlement to not be satisfactory proof of an insurer's failure to settle within policy limits, as it did not represent a "reliable basis to establish damages." Id. at 19. The Second Appellate District noted that the Ace American case differed from those cases relied upon by Fireman's because Ace was a participant and contributor to the settlement in this matter. Because the Second Appellate District found that the settlement amount adequately reflected the damages, Ace could quantify the amount it was damaged by Fireman's alleged refusal to settle.

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