Defense Cost Apportionment and Reimbursement among Insurers

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DEFENSE COST APPORTIONMENT AND REIMBURSEMENT
AMONG INSURERS

In 1961, the California Supreme Court decided *Continental Casualty Company v. Zurich Insurance Company*. The case involved a controversy among three insurers over liability for an injury to the driver of a lumber truck, incurred while the truck was being loaded. Although the truck was insured by Zurich Insurance Company, the lumber company by General Insurance Company, and the independent logger who had hired the truck by Continental Casualty Company, only Continental defended the suit and discharged the resulting adverse judgment. Subsequently, Continental brought this declaratory relief action to determine the respective liabilities of the three insurers for the amount of the judgment and the costs of the defense. On appeal, the California Supreme Court held that the Zurich policy, covering the truck, provided primary insurance coverage and that the General and Continental policies provided excess coverage. Accordingly, Zurich was liable for the loss to the extent of the limits of its policy, while the other two insurers were liable for the excess. The supreme court also held that all three insurers were liable for the defense costs on a pro rata basis. It is to the issues of the apportionment and reimbursement of defense costs among insurers that this note is directed.

Basis of California Defense Cost Apportionment

Prior to 1961

Before the *Continental v. Zurich* decision, there was a division of authority in California with respect to defense cost apportionment among two or more insurers covering the same loss. Some courts prorated the defense costs among such insurers. Other California courts treated the defense obligation of an insurer as a personal duty.

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2. To prorate is to distribute or divide proportionately. *Black's Law Dictionary* 1385 (4th ed. 1951).
3. “Reimbursement” is used in this note only in the sense of restoration or making whole, *Black's Law Dictionary* 1452 (4th ed. 1951), and not in the sense of the direct right of a surety against his principal in the law of suretyship.
to the insured. The courts following this latter line of authority refused to permit an insurer to be reimbursed for the discharge of a personal obligation and, therefore, also denied apportionment of defense costs even though one insurer had defended a claim alone for which two or more other insurers were liable.

1961: Continental v. Zurich

This divergence of authority was recognized and settled by the California Supreme Court in Continental v. Zurich. The court expressly rejected those cases that denied recovery of defense costs because the duty to defend was a personal obligation, and instead prorated the defense costs among the three carriers.

In reaching its decision, the supreme court relied on the doctrine of equitable subrogation. It noted that in California an insured was entitled to repayment for defense costs incurred in a lawsuit that his insurer had wrongfully refused to defend. From that proposition

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5 E.g., Financial Indem. Co. v. Colonial Ins. Co., 132 Cal. App. 2d 207, 281 P.2d 883 (1955): "The agreement to defend is not only completely independent of and severable from the indemnity provisions of the policy, but is completely different. Indemnity contemplates merely the payment of money. The agreement to defend contemplates the rendering of services." Id. at 211, 281 P.2d at 885. Columbia S. Chem. Corp. v. Manufacturers & Wholesalers Indem. Exch., 190 Cal. App. 2d 194, 11 Cal. Rptr. 762 (1961): "Neither [insurer] is excused to any extent from its full duty to defend regardless of what course is taken by the other, so that the duty to defend is entirely personal to each particular insurer. It has no legal power to divide its obligation with the other, nor compel contribution from the other." Id. at 205, 11 Cal. Rptr. at 769.

6 A further justification for nonreimbursement was that the nondefending insurers were held liable for adverse judgments even though they had relinquished all control over the defense. See Columbia S. Chem. Corp. v. Manufacturers & Wholesalers Indem. Exch., 190 Cal. App. 2d 194, 204, 11 Cal. Rptr. 762, 768 (1961).


9 The court stated: "Any services contemplated by the agreement to defend are not personal in the sense that the services of any specifically named individual would be personal." 57 Cal. 2d at 37, 366 P.2d at 461, 17 Cal. Rptr. at 18.

10 57 Cal. 2d at 37-38, 366 P.2d at 461-62, 17 Cal. Rptr. at 18-19, quoting
the court reasoned that an insurer that deliberately breached its defense obligation should not be permitted to profit at the expense of either the insured or another insurer that had faithfully discharged its obligation.11

Under general principles of equitable subrogation . . . it is our view that all obligated carriers who had refused to defend should be required to share in costs of the insured's defense, whether such costs were originally paid by the insured himself or by fewer than all of the carriers. A contrary result would simply provide a premium or offer a possible windfall for the insurer who refuses to defend, and thus, by leaving the insured to his own resources, enjoys a chance that the costs of defense will be provided by some other insurer at no expense to the company which declines to carry out its contractual commitments.12

Since Continental v. Zurich, the subrogation theory has been utilized extensively by insurers in California to obtain reimbursement of defense costs.13 Consequently it is essential that the concept itself be considered.

Equitable Subrogation

Although the doctrine of subrogation was at first strictly limited by the courts of equity to suretyship situations,14 its application has been extended to include every instance in which one party, not acting as a volunteer,15 “pays a debt for which another is primarily


11 57 Cal. 2d at 38, 366 P.2d at 461, 17 Cal. Rptr. at 18.

12 Id.


14 Estate of Kemmerrer, 114 Cal. App. 2d 810, 814, 251 P.2d 345, 347 (1952). It should be noted that the remedy of subrogation is unavailable in California in suretyship situations. When a surety discharges an obligation, he may not be subrogated to the rights of the creditor against the principal. This is due to the judicial construction of section 1473 of the Civil Code, which reads: “Full performance of an obligation, by the party whose duty it is to perform it, or by any other person on his behalf, and with his assent if accepted by the creditor, extinguishes it.” CAL. CIV. CONS § 1473. The California courts have construed this statute to mean that payment by a surety extinguishes the obligation, so that there are no rights to which the surety has an action for reimbursement directly against the principal. Yule v. Bishop, 133 Cal. 574, 62 P. 68 (1901); Berrington v. Williams, 244 Cal. App. 2d 130, 52 Cal. Rptr. 772 (1966); Johnson v. Mortgage Guar. Co., 117 Cal. App. 416, 4 P.2d 208 (1931). But see Sanders v. Magill, 9 Cal. 2d 145, 150, 70 P.2d 189, 161-62 (1937); Union Bank v. Gradsky, 265 A.C.A. 48, 53, 71 Cal. Rptr. 64, 68 (1968). This construction of section 1473 has been limited to suretyship cases and, although the language of the statute is broad, the California courts have not extended their interpretation of it to indemnity situations. Therefore, in California, the traditional rules of subrogation are applicable to indemnity situations.

15 “Volunteer” is defined as “[o]ne who intrudes himself into a matter
answerable, and which, in equity and good conscience, should have been discharged by the latter.\(^6\) Essentially, its application entails the substitution of the subrogee\(^7\) to the rights of the person to whom the debt or duty had been owed in order to provide a means by which the subrogee might obtain reimbursement\(^8\) from the party primarily liable.\(^9\) But before the remedy can be applied, two important conditions must be met.\(^10\)

One condition which must be fulfilled is that the party seeking reimbursement must not be a volunteer.\(^11\) Instead, the party must which does not concern him, or one who pays the debt of another without request, when he is not legally or morally bound to do so, and when he has no interest to protect in making such payment.” \textit{Black's Law Dictionary} 1747 (4th ed. 1951).


\(^{11}\) A “subrogee” is defined as “one who succeeds to the rights of another by subrogation.” \textit{Black's Law Dictionary} 1596 (4th ed. 1951).

\(^{12}\) Randall v. Duff, 107 Cal. 33, 35, 40 P. 20 (1895): “[Subrogation] is allowed when justice requires it, and the securities which a person so obtains are held by him merely to insure reimbursement. He will not be permitted to make a speculation out of it.”


\(^{14}\) It is recognized that the California courts generally prescribe five prerequisites for a proper application of subrogation. They are: “(1) Payment must have been made by the subrogee to protect his own interest. (2) The subrogee must not have acted as a volunteer. (3) The debt must be one for which the subrogee was not primarily liable. (4) The entire debt must have been paid. (5) Subrogation must not work any injustice to the rights of others.” Grant v. deOtte, 122 Cal. App. 2d 724, 728, 265 P.2d 952, 955 (1954). For the purposes of this note the first two requirements have been consolidated. See text accompanying notes 22-27 infra. With regard to the fourth requirement, it is assumed that the entire defense is undertaken by the insurer. The fifth requirement, that subrogation must not work any injustice to the rights of others, is met in defense cost apportionment, since reimbursement will not work an injustice upon an insurer that has failed to fulfill its defense obligation. See text accompanying notes 11 & 12 supra.

\(^{15}\) Stein v. Simpson, 37 Cal. 2d 79, 84, 230 P.2d 816, 819-20 (1951); Brown v. Rouse, 125 Cal. 645, 651, 58 P. 267, 269-70 (1899); Guy v. Du Uprey, 16 Cal. 196, 200 (1860). In Fuller v. Harwell, 126 Cal. App. 654, 15 P.2d 562 (1932), the plaintiff had paid a senior lien on property in the honest belief that he was a junior lien holder. Even though it was later determined that he had no interest in the property, he was nevertheless subrogated to the rights of the senior lien holder and entitled to reimbursement. The court held that be-
have performed a contractual duty or a duty imposed by law, or performed some other obligation in order to protect his own right or interest. In California, the determination of whether an insurer has been a volunteer in providing a defense for an insured is controlled by the case of *Gray v. Zurich Insurance Company*. This case held that an insurer has a duty to defend its insured in any damage suit where the insurance policy has reasonably led the insured to expect such a defense, or where the claim might potentially fall within the policy coverage. Failure to fulfill the duty would make the insurer liable for any adverse judgment suffered by the insured. Accordingly, in most cases where an insurer defends its insured, it is not acting as a volunteer, but rather is protecting its own interests.

The other important prerequisite for a valid application of subrogation is that the party seeking reimbursement must be one who has discharged an obligation for which another is primarily liable.


23 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1968). In this case the insured was sued in an assault action in which he claimed to have acted in self-defense. Although he had a comprehensive personal liability contract with Zurich, the latter refused to defend him claiming that under section 533 of the Insurance Code: "[a]n insurer is not liable for a loss caused by the willful act of the insured . . . ." CAL. INS. CODE § 533. The insured was held liable for assault. In this action for breach of the defense obligation, the supreme court on appeal held that the purpose of the statute is to prevent encouragement of wilful torts; an obligation to defend an insured upon the mere accusation of an intentional tort does not encourage such conduct. In holding the insurer liable for defense costs and the adverse judgment, the court observed that the insurer could reserve the right to assert the noncoverage defense later, in which case it would not be bound by the judgment. This was accomplished in Centennial Ins. Co. v. Miller, 264 F. Supp. 431, 436 (E.D. Cal. 1967). See generally Crocker, The Continuing Importance of *Gray v. Zurich*, 43 LOS ANGELES B. BULL. 239 (1968).


27 Kenney v. Kenney, 97 Cal. App. 2d 60, 62, 217 P.2d 151, 154 (1950);
In particular, as to the problem under consideration, subrogation may not be utilized legitimately to obtain reimbursement for the defense costs of an insurer where both the defending and nondefending carriers shared equally the defense obligation.\textsuperscript{28}

Where these two conditions are met—that is, when one party has discharged an obligation for which another is primarily liable, and when that discharge was not the act of a volunteer—subrogation can be validly employed.\textsuperscript{29} Whether it has been applied properly by the California courts in apportioning defense costs among insurers will be considered in the remainder of this note. But before this subject can be approached, the basis for distributing the loss itself in such a situation should be understood.

**Basis For Apportionment of the Loss:**

**“Other Insurance” Clauses\textsuperscript{30}**

Generally speaking, most modern insurance policies contain clauses which regulate the distribution of liability among insurers when an insured suffers a loss which is within the coverage of more than one insurance policy;\textsuperscript{31} these provisions are commonly referred to as “other insurance” clauses. Although the procedure used by the California courts in determining the respective liabilities of each insurer, through reconciliation of each policy’s “other insurance” clause, is not within the scope of this note, it should be recognized that there are three basic types of “other insurance” clauses that courts might

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\textsuperscript{29} Of course in order for subrogation to be considered the liability policies must cover the same risk. Ohio Cas. Ins. Co. v. Harbor Ins. Co., 259 A.C.A. 204, 215, 66 Cal. Rptr. 340, 347 (1968).


be called upon to construe: (1) pro rata clauses[^32] that attempt to apportion the loss with other valid and collectible insurance; (2) excess clauses[^33] that attempt to provide coverage only after the liability of other valid and collectible insurance has been exhausted;[^24] and (3) escape clauses[^35] that attempt to avoid all liability when other valid and collectible insurance covers the loss.[^38] Of course, an insurance policy may not contain an "other insurance" clause.

In reconciling these clauses, the California courts have arrived at one of two results. Either they have found that one insurer is liable on a loss to the limits of its liability as a primary insurer and a second insurer is liable for an amount above the coverage as an excess insurer[^37] or they have found that each of the insurers bears a proportionate amount of the liability as coinsurers.[^38] As they apply to defense cost apportionment, both results will be considered.

[^32]: A typical pro rata clause would be: "If the insured has other insurance against a loss covered by this policy the company shall not be liable under this policy for a greater proportion of such loss than the applicable limit of liability stated in the declaration bears to the total applicable limit of liability of all valid and collectible insurance against such loss." Continental Cas. Co. v. Zurich Ins. Co., 57 Cal. 2d 27, 34, 366 P.2d 455, 459, 17 Cal. Rptr. 12, 16 (1961).

[^33]: An example would be: "[T]he applicable insurance afforded by this policy shall be excess over and above such other available insurance. . . ." Continental Cas. Co. v. Zurich Ins. Co., 57 Cal. 2d 27, 34, 366 P.2d 455, 459, 17 Cal. Rptr. 12, 16 (1961).

[^34]: An "other insurance" clause often incorporates the characteristics of both a pro rata clause and an excess clause. E.g., Athey v. Netherlands Ins. Co., 200 Cal. App. 2d 10, 11, 19 Cal. Rptr. 89, 89-90 (1962), which construed the following "other insurance" clause: "If the insured has other insurance . . . the company shall not be liable under this policy for a greater proportion of such loss than the applicable limit of liability stated in the declaration bears to the total applicable limit of liability of all valid and collectible insurance against such loss; provided, however, the insurance with respect to a temporary substitute automobile or non-owned automobile shall be excess insurance over any other valid and collectible insurance."

[^35]: An escape clause was present in Air Transp. Mfg. Co. v. Employers' Liab. Assurance Corp., 91 Cal. App. 2d 129, 130, 204 P.2d 647, 648 (1949): "If other valid insurance exists protecting the Insured from liability for such bodily injury . . . this policy shall be null and void with respect to such specific hazard otherwise covered, whether the Insured is specifically named in such other policy or not. . . ."


Apportioning Defense Costs Between Primary and Excess Insurers

Apportionment When the Loss Does Not Exceed the Primary Coverage

In any case where a judgment against an insured for a loss does not exceed the primary insurer's coverage, California courts hold that the primary insurer alone must discharge the judgment and pay all expenses involved in defending the insured. Consequently, when an excess insurer sustains expenses in defending an insured, the California courts have utilized the doctrine of subrogation in securing reimbursement for the excess insurer from the primary insurer.

In these cases, it is evident that subrogation is the proper vehicle for seeking reimbursement. First, the excess insurer is obligated to provide a defense for the insured under the doctrine of Gray v. Zurich; the insurer, therefore, is not a volunteer. Second, in providing the defense, the excess insurer is performing a duty that is the principal obligation of the primary insurer. This is because the policy of the excess insurer does not come into effect unless the loss exceeds the primary coverage. In short, both conditions precedent to a

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39 Primary and excess insurance situations are most often found in cases where a permissive user of an automobile causes damage. E.g., American Auto. Ins. Co. v. Republic Indem. Co., 52 Cal. 2d 507, 341 P.2d 675 (1959), where the insurance policy covering the driver of a borrowed automobile included a provision similar to that set out in note 34 supra, while the insurance policy of the owner of the automobile contained a pro rata "other insurance" clause. In deciding that the latter policy provided primary coverage, the court reasoned that the excess clause in the driver's policy was effective, so that that coverage was not "other insurance" within the meaning of the owner's policy. Thus the pro rata clause in the owner's policy could not be applied.

Although this approach had been criticized as being circular, depending on which policy was read first, see Oregon Auto. Ins. Co. v. United States Fidelity & Guar. Co., 195 F.2d 958 (9th Cir. 1952), the court nevertheless held that this was the only construction that would give meaning to either clause. The California approach to determining primary and excess insurers is in accord with the majority. See cases collected in American Surety Co. v. Canal Ins. Co., 258 F.2d 934 (4th Cir. 1958).

40 See cases cited note 37 supra.


42 See cases cited note 41 supra.

43 Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966). See text accompanying notes 24 & 25 supra. When an insured is covered by an excess policy, it is probable that he has been led to expect such defense, or, if the amount asked for is in excess of the policy limits of primary coverage, the loss could potentially fall within the coverage of the excess policy.

valid application of subrogation are met, and the excess insurer is properly permitted to secure reimbursement from the primary insurer.

An Inconsistent Case

Despite the reasonableness of requiring an insurer whose policy completely covers a loss to pay all defense costs, a recent California decision denied full reimbursement to a nonliable insurer in just such a situation. The case, Hartford Accident & Indemnity Company v. Pacific Indemnity Company,\(^4\) was a declaratory relief action concerning defense costs sustained by Hartford in a prior medical malpractice suit. In the prior suit, the plaintiff had alleged that on June 1, 1960, the insured, a dentist, had been engaged for a course of treatment that ultimately resulted in the plaintiff's damage. Hartford alone defended the suit, since its policy covered the dentist on the date that treatment had begun. However, during the trial it was discovered that the injury was caused at a time subsequent to the termination of the Hartford policy, and that at the time of the injury the dentist was insured by Pacific. Pacific subsequently paid the judgment but refused to reimburse Hartford for its defense expenses. In the declaratory relief action, the court on appeal, relying on Continental v. Zurich, held that since “Hartford benefited by the defense it interposed,” the costs of the defense were to be shared equally by both insurers.\(^4\)

This holding, rather than being in accord with Continental v. Zurich, is at variance with it. The variance seems to be the result of an improper application of the doctrine of subrogation. Here, Hartford had borne the entire burden of defending the suit against the insured. Although it was obligated to provide such defense under the rule of Gray v. Zurich,\(^4\) it is nevertheless clear that between the two companies, Pacific, which sustained ultimate liability on the judgment, had the primary obligation of defense as opposed to Hartford, whose policy had terminated before the damage was caused and which sustained no liability whatsoever. In other words, Hartford performed a duty which Pacific should have fulfilled. A proper application of subrogation would have allowed Hartford to succeed to the dentist's rights against Pacific insofar as necessary to secure reimbursement, i.e., full repayment.\(^4\)

As a result of the decision, how-
ever, Hartford was only reimbursed for one half the defense costs.

Although subrogation has been denied when its application would work an injustice upon others, the courts have not allowed any relative benefit gained by the subrogee to interfere with his right to full repayment from a primarily obligated party. Thus Hartford should have received full reimbursement for the expenses it incurred in carrying out Pacific's defense obligation. By the above decision, however, one half of Pacific's defense obligation was provided at the expense of Hartford. This is the kind of windfall against which Continental v. Zurich was directed.

Apportionment When the Loss Exceeds the Primary Coverage

Where the loss exceeds the coverage of the primary insurer, the secondary insurer becomes liable for a share of both the loss and the costs of defense. This was the situation and the result of Continental v. Zurich. As will be recalled, the court there prorated the defense costs and reimbursed Continental for its excess expenses by means of subrogation. Unfortunately, the court did not specify whether the defense costs were to be prorated by a ratio of the amounts paid by each insurer on the judgment to the total judgment or by a ratio of the applicable policy limits of each policy to the total amount of coverage available. As a consequence of the unavailability of a definite rule to apply, the two subsequent cases that have concerned factual situations similar to that of Continental v. Zurich have interpreted its wording differently. In Government Employees Insurance Company v. St. Paul Fire & Marine Insurance Company the court held that the defense costs should be distributed in the same ratio as each insurer's coverage

49 See note 20 supra.
50 See, e.g., Diehl v. Hanrahan, 68 Cal. App. 2d 32, 155 P.2d 853 (1945), which involved the payment of a senior lien on certain property by a junior lienholder. The court subrogated the junior lienholder to the senior lienholder's right against the principal, even though the court observed that from a practical standpoint, the junior lienholder benefited by such payment. Id. at 37, 155 P.2d at 856.
51 Cf. Restatement of Restitution § 80, Comment b (1937): "A person who becomes a surety upon an obligation with the consent or because of the fault of the principal obligor is entitled to reimbursement for all expenses reasonably incurred by him in connection with the obligation. This right is not necessarily based upon the benefit conferred; it is not primarily based upon unjust enrichment but results from the commission of a tort or the breach of a relational or contractual duty. . . . [T]he right to reimbursement includes the expenses of suits in connection with the obligation to the extent that such expenses are reasonable. . . ."
bore to the total coverage available; conversely, in *Travelers Insurance Company v. Norwich Union Fire Insurance Society*, the court held that if the loss exceeded the primary coverage, the defense costs would be apportioned by the same ratio as that by which the insurers satisfied the judgment. It still remains to be determined which of these results represents the proper method of apportioning the defense costs.

The Manner of Apportioning Defense Costs Between Primary and Excess Insurers in Other States

Outside California, the law concerning defense cost apportionment and reimbursement between primary and excess insurers is subject to the same split of authority as existed in California prior to *Continental v. Zurich*. That is, some jurisdictions apply subrogation in securing reimbursement to excess insurers, whereas others—those that consider the duty to defend a personal obligation—do not apply subrogation.

However, there is another distinct line of authority regarding distribution of defense costs between primary and excess insurers. Two states hold that if the plaintiff asks for an amount which is below

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55 Id. at 153, 34 Cal. Rptr. at 407-08.
56 The conclusion of this note will be that neither point of view is correct and that where the loss exceeds the policy limits of primary coverage, the doctrine of subrogation is an inappropriate remedy for the securing of distribution of defense costs among the insurers. See text accompanying notes 99-110 infra.
the primary insurer's policy limit, the primary insurer pays all defense costs. But if the plaintiff pleads damages which amount to more than the primary insurer's policy limit, the primary and excess insurers share the defense costs equally.\textsuperscript{60}

It is submitted that the pleadings of the plaintiff are an unreliable gauge for determining defense cost distribution between primary and excess insurers. A plaintiff is often unsure as to the amount of damages to which he is entitled; frequently a plaintiff will ask for more compensation than his damages warrant in order to increase his chances of obtaining a substantial settlement.\textsuperscript{61} By using pleadings as a standard for apportioning defense costs, if the plaintiff prays for an amount in excess of the primary insurer's coverage, the excess insurer will be required to pay one-half the defense costs even though it is not liable on the loss because the actual damages do not exceed the primary insurer's liability.\textsuperscript{62} Fortunately, this would not be the result in California.

The procedure in California, as various declaratory relief actions have held,\textsuperscript{63} is to require the primary insurer to defend the insured in the first instance. If, after the suit has been decided or settled, the amount of liability is more than the primary coverage, the primary carrier may recover a proportionate share of its defense expenses from the excess insurers.\textsuperscript{64} As such, it would seem that the California approach of basing defense cost liability upon the final judgment or settlement is a more stable and desirable basis for determining defense cost distribution than is an approach based upon the uncertainties of the plaintiff's pleadings.

**Apportioning Defense Costs Among Coinsurers**

Coinsurers, or concurrent insurers, insure the same risk at the same time, but on such terms that the insurers bear proportionately


\textsuperscript{61} Cf. Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 276, 419 P.2d 168, 176, 54 Cal. Rptr. 104, 112 (1966): "[T]he complainant . . . drafts his complaint in the broadest terms; he may very well stretch the action which lies in only nonintentional conduct to the dramatic complaint that alleges intentional misconduct. In light of the likely overstatement of the complaint and of the plasticity of modern pleading, we should hardly designate the third party as the arbiter of the policy's coverage."


\textsuperscript{64} See cases cited note 63 supra.
any liability occurring within the coverage of both policies.\textsuperscript{65} This proportionate sharing of liability may be the result of the presence of pro rata “other insurance” clauses in both policies,\textsuperscript{66} but it is more often the consequence of judicial reconciliation of conflicting “other insurance clauses.” For example, where two insurance policies cover the same loss and both contain excess “other insurance” clauses, the California courts prorate the liability between the two by the ratio of their maximum coverages.\textsuperscript{67}

**Basis of Apportioning Defense Costs Among Coinsurers**

Since 1961,\textsuperscript{68} the California courts have prorated the defense costs of coinsurers in the same proportion as the liability of each is determined for the loss itself.\textsuperscript{69} Thus, where one insurer has defended an insured against a claim in which it and other insurers bear proportionate liability, the defending insurer has the right to recover a pro rata share of defense costs from its coinsurers;\textsuperscript{70} but, in this case, the basis of the defending insurer’s recovery is not subrogation.

In order for subrogation to be applied legitimately, one party must discharge an obligation for which another is primarily liable.\textsuperscript{71}


\textsuperscript{68} The year in which Continental v. Zurich was decided.


\textsuperscript{71} See cases cited note 27 supra.
In coinsurance situations, it cannot be said that either insurer is primarily obligated to conduct the defense of the insured. Since both policies effectively cover the event creating liability, both are equally obligated to provide such defense. And because the equities of each are equal, the doctrine of subrogation is inapplicable. Instead, the proper basis of recovery is the remedy of contribution.

Generally speaking, contribution is the right of one obligor, who has discharged more than his fair share of a common obligation, to recover from another, who is also liable, the portion of that discharge which the latter ought to pay or bear. Hence, an important prerequisite for contribution is that the parties share a common burden. In coinsurance situations, each insurer promises to perform the same obligation for the insured, each contracts with the insured to provide a full defense in a lawsuit within the policy coverage. Thus, where both policies provide coverage for the same loss, it can be said that the coinurers bear the common burden of defending the lawsuit for the insured. And when a coinurer has discharged more than a fair share of a common defense obligation, it has a right to contribution from the other coinurers.

Another requirement which must be met for contribution to be a proper remedy is that some positive duty must compel the obligor to discharge more than his fair share of the common obligation. The

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75 See Pacific Freight Lines v. Pioneer Express Co., 39 Cal. App. 2d 609, 103 P.2d 1056 (1940). The plaintiff had paid the entire cost of prosecuting a prior action. It sought contribution from others who, together with the plaintiff, had hired the attorneys. The court said: "The doctrine of [contribution] is not founded on, nor does it arise from, contract, but is founded on principles of equity and natural justice and comes from the application of principles of equity to the condition in which the parties are found in consequence of some of them, as between themselves, having done more than their share in performing a common obligation . . . . The declaration, often made, that contribution does not spring from contract is sometimes misapprehended; it only means that there need not be an express contract for it . . . . [T]he right of Contribution . . . is the product or outgrowth of a contract implied in law . . . . In the circumstances here considered . . . plaintiff paid a debt owed in part by defendants. As a result, and by operation of law defendants became indebted to plaintiff. It is upon this debt, which the law declares it is defendant's duty to pay, and upon the implied contract by the terms of which defendants agree to pay, that plaintiff's action is based." Id. at 613-14, 103 P.2d at 1058-59, quoting in part 18 C.J.S. Contribution § 2, at 3 (1939).

76 See Machado v. Fernandez, 74 Cal. 362, 363, 16 P.2d 19, 20 (1887); Was-
courts say\textsuperscript{77} that because of this requirement if a coinsurer pays more than its fair share of a loss, it is not entitled to contribution from the other coinsurers.\textsuperscript{78} The rationale is that coinsurers have not agreed to insure the loss completely; they have only agreed to bear a specific proportion of it. And, so the rationale goes, since they cannot be forced to pay any amount above that proportionate share, any excess payment is strictly voluntary, for which no contribution may be granted.\textsuperscript{79}

The rule against contribution among coinsurers for an insured loss has no application, however, in the area of defense cost recovery.\textsuperscript{80} The basis for refusing contribution among coinsurers for a loss is that they have agreed to insure only a proportionate share of a loss, so that any payment above that share is voluntary;\textsuperscript{81} this cannot be said of their obligations to defend the insured. Although coinsurers prorate their liability through “other insurance” clauses, these clauses are not directed to prescribing any proportionate sharing of defense costs among other insurers.\textsuperscript{82} Rather, in each insurer’s policy, the insurer promises to provide a full defense for the insured. This

\textsuperscript{77} It would seem that the true reason for denying contribution for the loss in a coinsurance situation is that the requirement of a common obligation is lacking, due to the fact that the insurers agree to cover only a proportionate share of the loss. See text accompanying notes 74 & 75 supra. However, the courts say that they deny contribution because payment of more than its proportionate share of a loss by a coinsurer is voluntary. This cannot be denied since there is no duty compelling the coinsurer to make such payment. See note 15 supra. But the absence of the duty results from the fact that there is no common obligation. Thus the basic reason for not allowing contribution for the loss in coinsurance situations is really the absence of a common burden.

\textsuperscript{78} Fidelity & Cas. Co. v. Fireman’s Fund Indem. Co., 38 Cal. App. 2d 1, 100 P.2d 364 (1940).

\textsuperscript{79} Id. at 6, 100 P.2d 364, 366-67 (1940). However this rule against contribution is subject to the exception that contribution is allowed if the excess payment is made pursuant to an agreement among the coinsurers that later rights of recovery will not be prejudiced thereby. Gillies v. Michigan Millers Mut. Fire Ins. Co., 98 Cal. App. 2d 743, 221 P.2d 272 (1950).

\textsuperscript{80} See Meritplan Ins. Co. v. Universal Underwriters Ins. Co., 247 Cal. App. 2d 451, 55 Cal. Rptr. 561 (1966), in which the plaintiff had settled a claim while it was unaware of the existence of the defendant’s policy. The court allowed contribution for the settlement and defense costs. It was held that the rule in Fidelity & Cas. Co. v. Fireman’s Fund Indem. Co., 38 Cal. App. 2d 1, 100 P.2d 364 (1940), was not applicable; the court reasoned that Continental v. Zurich was directed against windfalls for nondefending insurers, and to refuse contribution here would be to allow the defendant a windfall.


\textsuperscript{82} See notes 32–35 supra.
promise is independent of the contract to indemnify and is not controlled by any proration agreement. The result is that the duty to provide a full defense for the insured is a common burden assumed by the coinurers. When it is determined that one insurer, as a result of fulfilling its positive duty to defend the insured, has sustained more than its fair share of the costs, it should be entitled to contribution from those with the same obligation.

Coinsurer's Fair Share of Defense Costs

Since 1961, California courts have considered each coinurer's fair share of the defense costs to be identical with its proportionate share of the basic liability. In other words, the fair share of defense costs to be borne by each coinurer is determined by multiplying the total defense costs by the ratio of that coinurer's liability coverage to the total amount of coverage available.

83 Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966); see Continental Cas. Co. v. Zurich Ins. Co., 57 Cal. 2d 27, 366 P.2d 455, 17 Cal. Rptr. 12 (1961): "The facts that the agreement to defend the insured may be severable from the general indemnity provisions, and that each insurer independently owes that duty to its insured, constitute no excuse for any insurer's failure to perform. . . ." Id. at 37, 366 P.2d at 461, 17 Cal. Rptr. at 18. In St. Paul Mercury Ins. Co. v. Huitt, 336 F.2d 37 (6th Cir. 1964), the court stated: "The obligation to defend is separate and distinct from the duty to provide coverage and to pay. . . . This is a contractual right of the insured irrespective of primary and excess coverage . . . . The controversy between two insurance carriers who have no contractual relationship to each other cannot operate to alter the obligation that each owes unto the insured, with whom they each have a contract." Id. at 44.


86 Here it makes no difference whether the defense costs are apportioned on the basis of the ratio by which the insurers satisfy the judgment, or the proportion each policy coverage bears to the total amount of coverage available; the resulting apportionment of defense costs is the same in either case. This is contrasted with the cases discussed in the text accompanying notes 54 & 55 supra regarding primary and excess insurers. In Government Employees Ins. Co. v. St. Paul Fire & Marine Ins. Co., 243 Cal. App. 2d 186, 52 Cal. Rptr. 317 (1966), the court allowed the plaintiff to recover one-sixth of its defense costs, using the ratio of the coverages as the correct standard. Had the court prorated the defense costs in the same proportion as that in which the judgment was satisfied, the plaintiff would have recovered five-twentyfirsts (5/21) of the total defense costs it incurred.
This method of determining each coinsurer's fair share of the defense costs is not unique. Many states that have decided this question are in accord with California in allowing contribution for defense costs among coinsurers in the same proportion as the amount of the judgment paid by each.88

However, there is another approach that has recently been adopted by the Alabama Supreme Court in *State Farm Mutual Automobile Insurance Company v. General Mutual Insurance Company*,89 and constitutes an example of a minority position on this question. The case involved a reconciliation of two conflicting excess “other insurance” clauses; although the liability of the loss was prorated in the California manner, the costs of defense were not so prorated. Instead, they were divided equally between the two insurers. The court said that since each insurer assumed the same obligation to defend, each should bear the same share of the cost of defense.90

This result is justified by simply considering the defense obligation as a common burden of the coinsurers, independent of their indemnity obligations.91 Once this rationale is accepted, the usual rules of contribution distribute the expenses of defense equally among the coinsurers.92


89 282 Ala. 212, 210 So. 2d 688 (1968). With regard to defense costs, this case follows the view set forth in Cosmopolitan Mut. Ins. Co. v. Continental Cas. Co., 28 N.J. 554, 147 A.2d 529 (1959). In this latter case the New Jersey Supreme Court held that where two excess “other insurance” clauses conflict, the insurers stand on an equal footing so that both the liability and the defense costs are to be divided equally between the insurers. The Alabama court expressly rejected the view that the insurers stood on an equal footing with regard to the liability for the loss but did adopt the view that the defense costs should be equally apportioned. The New Jersey approach has been followed in other cases. Ruan Transp. Corp. v. Truck Rentals Inc. 278 F. Supp. 692 (D. Colo. 1968); Continental Cas. Co. v. Travelers Ins. Co. 84 Ill. App. 2d 200 228 N.E.2d 141 (1967).

90 282 Ala. 212, 220, 210 So. 2d 688, 695 (1968).

91 See cases cited note 82 supra.

Should California Adopt the Minority Standard?

The primary appeal of the minority position is that it is in accord with the laws of contribution. Because the function of "other insurance" clauses is to determine the distribution of the amount of liability for the loss among co-insurers, these clauses should have no bearing on ascertaining the fair share of defense costs to be borne by each. These insurers have contracted to provide a full defense for the insured against claims within the policy coverage, and where the loss of the insured falls within the coverage of each policy, the duty to defend becomes an obligation common to each co-insurer. Since one rule of contribution is that where parties assume a common burden they should bear equally the expenses incurred in its discharge, the minority practice of dividing defense costs equally among the co-insurers is more in accord with the laws of contribution than is the California method of prorating these costs.

This minority viewpoint is further strengthened when possible justifications for the California approach are scrutinized. First, although the California method of distributing the defense costs in the same proportion as the amount of basic liability was distributed is convenient, it is no more so than the minority approach of distributing the costs equally among the co-insurers. Secondly, it may be argued that since the co-insurer with the greatest limits of coverage receives the most in premiums, it should bear the greatest percentage of defense expenses. This is also illusory. A slight increase in insurance premiums produces a highly disproportionate increase in the liability coverage; the relative amounts of premiums received by the insurers cannot provide any meaningful support for California's practice of dividing defense costs among co-insurers by the same proportion as the liability for the loss.

In short, when the duty to defend is regarded as being independent of the contract to indemnify, as is done both in California and in the states adopting the minority view, there is little reason for distributing the defense costs in the same way in which the liability is apportioned. On the contrary, an application of the usual rules of contribution would seem to demand that the co-insurers share the defense costs equally.

Should Continental v. Zurich be Modified?

Although the method of dividing defense costs equally among insurers has never been applied to a primary excess insurance situ-

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93 See notes 32-35 supra.
94 See cases cited note 92 supra.
96 See cases cited note 83 supra.
97 See note 89 & text accompanying notes 91-92 supra.
98 See cases cited note 92 supra.
ation, it easily could be so applied. It has already been noted that the California courts use subrogation to secure defense cost reimbursement for an excess insurer when the amount of loss does not exceed the amount of primary coverage. The utilization of subrogation here is legitimate, since the excess insurer has sustained defense costs in the performance of a duty that is the principal obligation of the primary insurer. Conversely, contribution would be an inappropriate remedy, since there is no common burden present between the insurers. That is, the defense obligation does not become a common burden until both policies effectively cover the loss; when only the primary policy provides such coverage, the excess policy is not in effect.

This reasoning does not apply in cases like Continental v. Zurich, where the amount of loss exceeds the policy limits of primary coverage. On the contrary, an application of subrogation in this instance would seem to ignore two of its prerequisites. First, the doctrine of subrogation is applied only in order to secure reimbursement and not to obtain a proration of costs. But more importantly, once the loss exceeds the primary coverage and the excess insurance policy takes effect, it is impossible to say that the primary insurer has the principal defense obligation. Instead, since both policies provide coverage for the loss, it must be said that both carriers share the common obligation of defending the insured. As such, contribution rather than subrogation should be the proper remedy for the excess insurer.

But contribution calls for a different defense cost distribution than either construction given to Continental v. Zurich. As noted previously, California courts interpreted Continental v. Zurich to mean that defense costs are to be prorated either in the same manner

99 But see American Sur. Co. v. State Farm Mut. Auto. Ins. Co., 274 Minn. 81, 142 N.W.2d 304 (1966). In this case the primary insurer alone had defended the insured in a lawsuit in which the loss was below the policy limits of the primary coverage. The court denied recovery to the primary insurer for any amount of its defense costs, saying: "Had the recovery exceeded the limitations of plaintiff's policy, defendant then would become equally liable with plaintiff for the expenses incurred in defending it." Id. at 84, 142 N.W. 2d at 306.

100 See cases cited note 41 supra.


102 See note 44 supra.

103 See note 18 supra.

104 The amount of the liability for the insured's loss that each insurer pays is controlled by the insurer's status as primary or excess insurer, which in turn is determined by the respective "other insurance" clauses in its policy. See note 39 supra. But the function of these clauses is solely to govern the distribution of liability for the loss. See notes 32-35 supra. The result is that when each policy is in effect, it carries with it the obligation to provide the insured with a complete defense.
as the liability is paid\textsuperscript{105} or on the ratio of the respective coverages to the total insurance coverage available.\textsuperscript{108} Neither interpretation is in accord with the rules of contribution. Contribution requires that the costs of performing a common obligation be divided equally.\textsuperscript{107} Consequently, it is submitted that where the loss exceeds the primary insurer's coverage, defense costs should be distributed equally among the insurers, rather than on any other basis.

It might be argued that this would lead to inequitable results, \textit{e.g.}, an excess insurer might sustain only a $1000 liability on a $101,000 judgment and yet be forced to pay $10,000 in defense costs. Indeed, such a result would seem unjust if the duty to defend were considered inseparable from the duty to indemnify. However, the duty to defend is a separate obligation\textsuperscript{108} which becomes the common burden of each insurer whose policy covers the loss.\textsuperscript{109} Consequently, considerations of policy limits or judgment payments are not germane to any distribution of defense costs. And since the duty to defend is a common burden of the primary and excess insurers and is not controlled by any proration agreement,\textsuperscript{110} under the usual rules of contribution the costs of carrying out the defense should be shared equally.

**Conclusion**

Since the California courts regard the duty to defend as being independent of the duty to indemnify,\textsuperscript{111} no reason is apparent for allowing the apportionment of liability for the loss to control the apportionment of defense costs. On the contrary, when two insurers have a common defense obligation, there is reason to require that the defense costs be divided equally among the insurers regardless of the manner in which the basic loss is apportioned. Such reasoning has its foundation in the doctrine of contribution, which provides that the costs of common obligation are to be borne equally by the parties sharing the common burden.\textsuperscript{112} Thus when a common defense burden arises among insurers—as when there is coinsurance,\textsuperscript{113} or when there is primary and excess insurance and the loss exceeds the primary coverage\textsuperscript{114}—the loss should be equally distributed among the insurers. Therefore it is submitted that the minority

\textsuperscript{107}See cases cited note 92 supra.
\textsuperscript{108}See cases cited note 83 supra.
\textsuperscript{109}See text accompanying note 104 supra.
\textsuperscript{110}See note 104 supra.
\textsuperscript{111}See cases cited note 83 supra.
\textsuperscript{112}See cases cited note 92 supra.
\textsuperscript{113}See text accompanying notes 83-84 supra.
\textsuperscript{114}See text accompanying notes 103-04 supra.
position be adopted in California, since it is more in harmony with the laws of contribution than is the present approach to defense cost distribution.

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