INSURANCE RECOVERY AND COUNSELING

January 2011

Seventh Circuit Holds That Primary Insurer May Be Liable for Insured's Loss of Excess Coverage

The most familiar form of insurance bad faith is when an insurance company fails to take advantage of an opportunity to settle within its policy limits and thereby exposes its policyholder to a verdict in excess of the policy limits. The rationale is that the insurance company, which has control of the defense and the decision whether to settle or try the case, should not gamble with its insured's money. The same rationale has now been applied to hold that a primary insurer (a) must allow an insured to assume control of its own defense when there is a "nontrivial probability" of an excess judgment and (b) may be liable if its failure to do so prevents the insured from collecting from its excess insurer.

In *R.G. Wegman Construction Co. v. Admiral Ins. Co.*, 09-2022 (7th Cir. Jan. 14, 2011), Wegman was an additional insured on an Admiral policy with a $1 million limit. Admiral provided and controlled Wegman's defense, and the trial resulted in a $2 million verdict against Wegman. Wegman had a $10 million excess policy but only put the excess carrier on notice days before trial, resulting in a denial of coverage due to late notice. Wegman then sued Admiral, contending that Admiral's failure to notify Wegman of the risk of an excess verdict caused Wegman to lose its own excess insurance coverage. The Illinois federal district court granted Admiral's motion to dismiss, holding that an insurer discharges its duties by providing counsel to defend the insured.

The Seventh Circuit reversed and remanded, holding under Illinois law that the "nontrivial probability" of an excess judgment or settlement created a potential conflict of interest between insurer and insured as well as a duty for the insurer to notify the insured. Slip Op. at 13. The key is that the insurer controlled the defense. By virtue of that control, however, the insurer's duty to the insured includes not only the hiring of competent counsel but also keeping abreast of progress and status of litigation in order that it may act intelligently and in good faith on settlement offers. *Id.* at 8. (Quotations omitted.) The court added that once the insured is notified of the potential conflict, the insured has the right to assume control of its own defense and hire its own lawyer whose reasonable fees must be paid by the insurer. *Id.* at 10. Moreover, the court specifically stated that the loss of opportunity to trigger excess insurance coverage is a form of harm that is protected by the insurer's duty of good faith and can be remedied by a cause of action for breach of that duty. *Id.* at 15.

When faced with high-stakes litigation, an insured may be able to use *Wegman* as leverage to persuade its insurer to let the insured choose its own defense counsel, who would be controlled by the insured but paid by the insurer. Moreover, other recent Illinois cases suggest that the insurer cannot force its own billing rates and guidelines on the attorney selected by the insured. *See, e.g., American Svc. Ins. Co. v. China Ocean Shipping Co.*, No. 1-08-1821 (Ill. App. 1st Dist. June 16, 2010), slip op. at 27, quoting *Taco Bell Corp. v. Continental Cas. Co.*, 388 F.3d 1069, 1077 (7th Cir. 2004) ("We add that the duty to defend would be significantly undermined if an insurance company could, by the facile expedient of hiring an audit firm to pick apart a law firm's billing, obtain an evidentiary hearing on how much the insured's defense costs it had to reimburse.")

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