wiley

ALERT

Right to Independent Counsel Triggered By Possibility of Excess Judgment, Even Where Insurer Did Not Reserve Rights

May 13, 2014

Applying Illinois law, an Illinois federal district court has held that the "nontrivial possibility" of an excess judgment creates a conflict of interest that entitles the insured to independent counsel, even where the insurer is providing a defense *without* a reservation of rights. *Perma-Pipe, Inc., v. Liberty Surplus Ins. Corp.*, — F. Supp. 2d —, 2014 WL 1600570 (N.D. Ill. Apr. 21, 2014).

By letter dated October 26, 2010, the underlying claimant alleged that pipes manufactured by the insured had suffered "catastrophic failure" and that the claimant intended to hold the insured liable for the resulting damage. The insured's commercial liability carrier initially agreed to provide a defense, but reserved its rights with respect to coverage. Because the carrier's reservation of rights created a conflict of interest, the insured selected its long-time law firm to serve as independent counsel. In February 2012, the manufacturer was named in two lawsuits seeking a combined total of more than $40 million. At that point, the carrier notified the insured that it was withdrawing all bases upon which it had previously reserved rights and was exercising its right to defend the lawsuits through its choice of counsel. After the carrier ignored the insured's request to re-appoint its chosen attorneys as defense counsel, the insured filed suit.

The court first held that Illinois law applied because Illinois had the most significant contacts with the insurance policy, given that: the insured was domiciled in Illinois; the contract was delivered to the insured in Illinois; and the premiums were paid by the insured from Illinois.

Practice Areas

D&O and Financial Institution Liability

E&O for Lawyers, Accountants and Other Professionals

Insurance

Professional Liability Defense

The court next held that the carrier breached its contractual duty to defend by refusing to pay for independent counsel. According to the court, the underlying lawsuits presented a "nontrivial probability" that an excess judgment would be rendered against the insured, given that the claimants sought more than $40 million – well in excess of the policy's $1 million per occurrence limit of liability. The court rejected the carrier's argument that there could not be a conflict of interest given that the insured knew about the possibility of an excess judgment from the outset of the lawsuits and had ample opportunity to notify its excess insurers. The court explained that, because excess insurance applies only after the exhaustion of primary coverage, its existence did not vitiate the conflict between the insured and its primary carrier (*i.e.*, the possibility that, because the primary carrier's exposure is capped by the policy's limits, the carrier would opt to try the claims notwithstanding the risk that the insured could be held liable for a far greater amount).

The opinion is available here.