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UPDATED: The Duty Of Good Faith Of An Insurer To Advise The Insured Of A "Non Trivial Probability" Of An Excess Verdict Of The Policy Limits And An Insured's Right To Independent Counsel.

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I. Introduction.

A friend calls you. He was the at fault driver in a two car crash a year ago. He was sued by the injured party in the other car. His insurance company provided a defense attorney. The defense attorney told him to not worry since the insurance company would pay for the attorney fees, expenses and costs of litigation and would pay for any monetary settlement or jury verdict. About six months into litigation, your friend discovers that the injured party has serious injuries and is making a demand of $100,000. The injured party has no other insurance coverage. The problem is that your friend only has $25,000 in coverage. The friend asks you for advice. What do you tell him? Even though liability is in question, your friend faces the real possibility of an excess verdict in which he can be personally responsible. Does the insurance defense counsel owe a duty to advise the tortfeasor that there is a conflict of interest between the insurance company and the tortfeasor because there is a significant possibility that a jury verdict may exceed the policy limits?

A recent federal court case out of the Seventh Circuit Court of Appeals, although it addresses Illinois law, may provide some guidance. In *R.G. Wegman Construction Co. v. Admiral Insurance Co.*,[1] an employee for Wegman Construction was injured at a work site. The employee sued his employer, Wegman. Because the employee commenced suit, Wegman's insurance policy was triggered. The insurance company, Admiral Insurance, provided defense counsel to Wegman. The policy had a $1,000,000 policy limit. During the course of litigation,

the employee made a settlement demand of $6,000,000. At no time did the insurance defense counsel advise Wegman that it may have to pay any jury verdict above $1,000,000. A jury awarded the employee $2,000,000. Wegman was now on the hook for the excess $1,000,000 verdict.[2]

Wegman filed a bad faith claim against Admiral Insurance. Wegman argued that Admiral owed a duty to advise its insured that there was a possibility that the insured would be responsible for an excess jury verdict. The insured had an excess liability carrier above and beyond the $1 million dollar coverage that it had with Admiral Insurance. The insured did not learn of the real possibility of an excess judgment above and beyond $1 million until a few days before trial. The insured attempted to obtain indemnity from its excess insurer, but because of the late notice was unsuccessful. Since the potential of an excess jury verdict would create a conflict of interest between the insurer and insured, the insurer had a duty to disclose that an excess jury verdict was a real possibility. Admiral Insurance argued that it did not have a duty to advise its insured of any potential conflict of interests. The trial court granted Admiral's motion to dismiss. Wegman appealed to the Seventh Circuit.[3]

II. Insurers Cannot Take A "Heads I Win, Tails You Lose" Approach To The Risk Of An Excess Verdict.

Quoting past Illinois state law precedent, the Seventh Circuit stated an insurance company has a "duty not to gamble with the insured's money by forgoing reasonable opportunities to settle a claim on terms that will protect the insured against an excess judgment." Otherwise, the insurance company would have nothing to lose. If the jury verdict is below the policy limits, no harm no foul. If the jury verdict is above the policy limits, the insurer's exposure is limited to the policy limits.

The Seventh Circuit succinctly stated the issue:

> The situation in question is the emergence of a potential conflict of interest between insurer and insured in the midst of a suit in which the insured is represented by a lawyer procured and paid for by the insurer.[4]

In *Wegman*, the insurance defense counsel admitted in oral argument that he had relied upon a chance that, regardless of the total amount of plaintiffs' damages, the insured might be liable only for a limited portion of those damages under Illinois' comparative negligence statutes, which provide for proportionate liability when a defendant is found to have been 25 percent or less at fault. If the insured was found 27 percent or more at fault, however, the insured would be jointly liable for the entire jury verdict. The insurer was willing to gamble that it could limit its liability and instead of paying $1 million, it would only pay $500,000 (assuming a two million dollar jury verdict). The insurer's risk was $500,000. The insured's risk was an excess judgment of $1 million. The Seventh Circuit found this created a clear conflict. "This likelihood created a conflict of interest by throwing the interests of Admiral and Wegman out of alignment."[5] "Such gambling with an insured's money is a breach of fiduciary duty."[6]

III. The Duty to Notify

Under these circumstances, the Seventh Circuit held the insurance company has a good faith duty under Illinois law to notify the insured of a potential conflict of interest when the insurance company learns that an excess judgment iss a "non-trivial probability."[7] If the insurance company hires the attorney and controls the conduct of the litigation, then the insurance company owes a duty to the insured to notify the insured of the potential conflict of interest.

In most cases, the tortfeasor-insured will not have much of an interest in the underlying case. Excess judgments are not the norm. The Seventh Circuit recognized that the insured does not pay for legal counsel or for the costs and expenses of the case and as long as the settlement or verdict is at or less the policy limits, the effect on the insured is minimal. The insurance company, on the other hand, does have a substantial stake in the outcome. The insurance company not only pays the attorney fees and expenses, but it will be paying out money for a settlement or verdict. The insurance defense attorney will report to the insurance company – not to the insured. An adjuster from the insurance company will be assigned to monitor the litigation. This is the right of the insurance company since it is the one with the financial risk.[8]

In those cases where an excess verdict is possible, the Seventh Circuit correctly points out that once the financial risk transfers to the insured – through the risk of an excess jury verdict – the insured then has the same rights that the insurance company has in monitoring the litigation. The insured, for instance, may wish to hire his or her own attorney. Though paid by the insurance company, this attorney would owe no allegiance to the insurance company, but only to the insured, and would presumably be more likely to settle the underlying claim for under the policy limits as long as the resolution was reasonable in light of the risk of an excess judgment.[9]

The good faith duty requires the insured to notify the insured of the conflict of interest, the potential of an excess verdict above the policy limits, and that the insured has the right to hire an independent attorney paid for by the insurance company.

IV. Notice Places No Burden On The Insurer.

The Seventh Circuit points out that the cost to the insurance company for notice to the insured of the potential conflict of interest may be as simple as the price of a telephone call.

> Often notice proves costless to the insurance company. Rather than change lawyers in midstream and perhaps have a dispute with the insurer over whether the new lawyer's fee is "reasonable" and hence chargeable to the insurer, the insured is quite likely to take his chances on staying with his insurer-appointed lawyer, Pryor & Silver, supra, 78 Tex. L.Rev. at 662-63, and so decide to waive the conflict of interest, relying on the fact that the lawyer "remains bound, both ethically and legally, to protect the interests of the insured in the defense of the tort claim. The latter obligation is separate and distinct from the insurer's duty to inform the insured of its position, and is not waived, as defendant's argument suggests, by mere acquiescence to the conduct of the insurer." Cowan v. Ins. Co. of North America, 318 N.E.2d 315, 326 (Ill.App.1974). The insurance company can satisfy its duty of good faith at the price of a phone call.[10]

V. What is a "non-trivial probability?"

The Seventh Circuit held a conflict of interest occurs when an excess judgment is a "non trivial probability." This poses a factual issue. For guidance, we can examine the facts considered by the Seventh Circuit in reaching the conclusion that an excess jury verdict in the Wegman case was a "non-trivial probability."

The Court determined that when the defense counsel deposed the injured Plaintiff in the underlying case, defense counsel learned the extent of the injuries and had the knowledge that "the judgment or the settlement might well exceed $1 million." And at that moment, the conflict of interest arose and the insurance company had a duty to notify the insured of this conflict.[11]

The Court did not lend much guidance in this area. That is probably why after a petition for rehearing the Court took the opportunity in their supplemental opinion to address the issue of what is a non-trivial probability.[12] The Court found that the following facts were relevant to its determination that an excess judgment had been a "non-trivial probability."

(1) The nature and severity of the plaintiff's injury;

> (2) The settlement demand in excess of policy limits;
>
> (3) The fact that the case had been slated for trial (and in fact tried);
> (4) The plaintiff's securing at trial an award *double* the policy limit;
>
> (5) Admiral's admission that its primary litigating strategy was to downplay Wegman's responsibility rather than to deny liability; and
> (6) Admiral's failure to warn Wegman that it had adopted a strategy that placed Wegman in jeopardy of an excess judgment.[13]

VI. Who has the duty to notify of possible excess verdict?

Admiral Insurance attempted to hold its defense counsel responsible for not disclosing the potential conflict of interest to the insured. The Court found the insurer – not just the defense counsel – has the duty to notify the insured of the conflict of interest. If the defense counsel fails to notify the insurer of the potential conflict of interest, then the insurer would have an action against its insurance defense counsel. The failure of the defense counsel to notify the insurer of the potential conflict of interest does not relieve the insurer's duty to its insured.[14]

VII. The right to hire an independent attorney.

What happens if an excess judgment is a non-trivial probability? What happens if a conflict of interest exists between the insured-tortfeasor and the insurance defense counsel retained by the insurer? Based upon Wegman, the insured has a right to independent counsel to represent him in the underlying case and have the insurance company pay the attorney and all related costs and expenses. The insured should also make the argument that not only can he hire his own attorney, but that the insured has the right to settle the underlying case without the consent of the insurance company where the insured is exposed to a non-trivial probability to a verdict in excess of the policy limits.

The Seventh Circuit hypothesized that an insured receiving such notice might well keep the insurance defense counsel as his or her attorney and waive the conflict of interest, and that the insurance defense counsel would then be ethically duty bound to the insured.[15] This observation by the Court may prove to be simple. In the real world of choices, it is hard to imagine an insured not taking advantage of the opportunity to control the direction of the lawsuit and hire his own attorney at the expense of the insurance company.

When faced with the non-trivial probability of an excess verdict, the defense counsel should advise the tortfeasor of the conflict of interest. The tortfeasor should not waive that conflict of interest. The tortfeasor should exercise his right to hire independent counsel to be paid for by the insurer. If the insurer refuses to relinquish control of the underlying case, the tortfeasor can file an action with the Court requesting an order permitting the tortfeasor-insured to hire independent counsel at the insurer's expense. The tortfeasor-insured can also request an order from the Court forcing the insurer to settle the underlying claim and to pay for the attorney fees and expenses and the settlement amount.

When an excess verdict is a "non trivial probability," plaintiff's counsel can request the insurance defense counsel to notify the tortfeasor of the "non-trivial probability" of an excess jury verdict and that the tortfeasor has the right to hire his own independent counsel to be paid by the insurer. Plaintiff's counsel should also provide a copy of the *Wegman* case to defense counsel.

VIII. Conclusion.

As the Seventh Circuit stated:

> For when a conflict of interest arises, so that the insured can no longer count on the insurance company and its lawyer defend his interests but must (unless he wants to waive his rights) fend for

> himself, the hiring of his own lawyer is only one option that is opened to him.[16]

When the insured is exposed to liability in excess of the policy limits, the insured has the right to hire an independent attorney, at the insurer's expense, and the insured also has the right to settle the underlying case without the insurer's consent. The insured should not waive any potential conflict of interest. The insured that faces the "non trivial probability" of an excess verdict has the right to hire an independent attorney.

IX. Update on *Wegman* Case Law

The following Court decisions have cited and addressed the case *R.C. Wegman Const. Co. v. Admiral Ins. Co.,*[17] in which the Court of Appeals, applying Illinois law, held that an insurance company had a duty to timely notify an insured of the possibility of an excess verdict. The Court found that such a possibility may create a conflict of interest which would give the insured the option to hire independent counsel.

In *Auto-Owners Ins. Co. v. Lake Erie Land Co.,*[18] the District Court found that an insured was entitled to hire independent counsel because of the conflict of interest created by the expected harm as a result of the defense as to coverage issues in the underlying claim. The Court analyzed the duty through an ethical lens. Can the lawyer meet his duty to two clients with divergent interests? The Court reviewed the Indiana Rules of Professional Responsibility which stated a conflict of interest arises when "there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client." The combination of a potential for an excess verdict and a conflict based on coverage defenses caused the Court to find "that these two 'clients' are so at odds with each other that no attorney can reasonably be expected to properly serve the interests of both."

In *Nautilus Ins. Co. v. Dubin & Associates, Inc.*,[19] the District Court found that though the insurer did not explain the conflict of interest between the insured and the insurer in a reservation of rights letter, the Court found that the insured failed to identify any prejudice sustained as a result of the joint defense. Though the Court found that there was a "serious conflict of interest," the insured has the burden to also prove prejudice as a result of the insurer's actions. The mere fact of an excess verdict is not dispositive when the insured fails to produce evidence of prejudice.

In *Carolina Cas. Ins. Co. v. Gallagher Sharp*,[20] the District Court found *Wegman* did not apply because a conflict of interest did not exist. Unlike *Wegman*, where the insurer admitted it was "gambling on minimizing its liability at the expense, if necessary, of [the insured]", in Gallagher Sharp, there was no proof that the insurer was minimizing its exposure at the expense of the insured. In fact, the parties agreed to a high-low settlement agreement during trial.

In *Fox v. Will County*,[21] the insured alleged a conflict of interest arose when one law firm represented both a governmental entity and police detectives and a finding of lower compensatory damage versus a higher punitive damage finding would be to the detriment of the police detectives. The District Court held that *Wegman* did not apply to excess insurance companies (as opposed to primary insurers) since an excess insurer would not control the defense of the underlying action.

In *U.S. Specialty Ins. Co. v. Burd*,[22] the District Court limited the *Wegman* ruling to the salient point that "an insurer has a duty of good faith to keep its insured informed." Specifically, the lawyer has a duty to advise the insured that there is excess exposure above the policy limits. The Court found that *Wegman* did not apply to the case at hand because in the

Burd case everybody agreed, i.e. the insured and the insurer, that the damages clearly exceeded the policy limits.

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1. 629 F.3d 724 (7th Cir. 2011), denied petition for rehearing, 634 F.3d 371 (7th Cir. 2011).
2. *Id*. at 727.
3. *Id*.
4. *Id*.
5. *Id*. at 728.
6. *Id*. at 729 (*citing Cramer v. Ins. Exchange Agency*, 675 N.E.2d 897, 903 (Ill.1996); *LaRotunda v. Royal Globe Ins. Co*., 408 N.E.2d 928, 935-36 (Ill.App.1980); *Transport Ins. Co. v. Post Express Co*., 138 F.3d 1189, 1192-93 (7th Cir.1998) (Illinois law); *Twin City Fire Ins. Co. v. Country Mutual Ins. Co*., supra, 23 F.3d at 1179 (same); *Magnum Foods, Inc. v. Continental Casualty Co*., 36 F.3d 1491, 1504 (10th Cir.1994)).
7. *Id*. at 730.
8. *Id*. at 728.
9. *Id*. at 729.
10. *Id*. at 730.
11. *Id*. at 727.
12. The Court denied the petition for rehearing.
13. 634 F.3d 371, 372 (7th Cir. 2011)
14. 629 F.3d at 731.
15. *Id*. at 730
16. *Id*. at 731.
17. 629 F.3d 724 (7th Cir. 2011).
18. 2013 WL 4401834, (N.D. Indiana Aug 13, 2013).
19. 2012 WL 2458607, (N.D.Ill. Jun 27, 2012).
20. 2013 WL 1641151, (N.D. Ohio Apr. 16, 2013).
21. 2011 WL 3876591, (N.D.Ill. Aug 31, 2011).
22. 833 F.Supp.2d 1348, 1353 (M.D.Fla. Jun 14, 2011).