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BAD FAITH BLOG

Is Good Faith Only A Phone Call Away?: The Seventh Circuit Discusses an Insurer's Duty to the Insured When There Is a "Non-Trivial" Probability of an Excess Judgment

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Summary: The Seventh Circuit held an insurer, who controlled the defense of a lawsuit, had a duty of good faith to notify its insured of the "non-trivial probability" of a judgment in excess of the policy limit.

R.G. Wegman Construction v Admiral Insurance

Imagine this scenario. During his deposition plaintiff testifies extensively regarding a back injury which required a lumbar fusion as well as the substantial pain and suffering he has experienced for several years, and his inability to return to work as a construction worker. Shortly thereafter, plaintiff makes a written demand for $6,000,000. The policy limit is $1,000,000. The insurance company has hired defense counsel who has been defending the lawsuit for over two years at the time the demand is made. The insured does not have separate counsel. What should the carrier do once it is notified of the demand well in excess of the $1,000,000 policy limit?

According to the Seventh Circuit in *R.G. Wegman Construction Company the Admiral Insurance Company, et al.*, No. 09-2022 (7th Cir. January 14, 2011) the carrier, pursuant to Illinois law, had a duty of good faith to inform the insured of a potential verdict in excess of the policy limit and advise there is a potential conflict of interest. Judge Posner declared the "the insurance company can satisfy its duty of good faith at the price of a phone call."

Admiral argued that under these facts it had no duty to notify the insured of a potential conflict of interest, only of an actual one, and that no conflict arises until settlement negotiations begin or the insured demands the insurance company settle the case. However, the Court held that a conflict arose when Admiral learned that an excess judgment was a "non-trivial probability" in the underlying suit.

There will be extensive debate regarding what facts trigger a “non-trivial probability” of a verdict in excess of the policy limit. The Court seems to warn carriers (and defense counsel) that it is best to err on the side of caution and advise the insured if any facts are known which raise the possibility of an excess verdict. The more you know, the more likely the duty has been triggered--especially, if the insured is taking a passive role in the defense of the case.

If the carrier is controlling the defense of a suit against the insured and initially believes there is no danger of a judgment in excess of the policy limits, the Court pointed out that it still, “has every incentive to monitor the progress of the litigation closely, for realistically it is the sole defendant. And monitoring the litigation places the [carrier] in a good position to learn about a conflict of interest if and when one arises. At that point, given the duty of good faith, [the carrier] is strongly motivated to notify the insured of the conflict immediately lest it find itself liable not only for the excess judgment but also punitive damages, which are awarded for egregious breaches of good faith.”

One of the main reasons for the insured’s suit against Admiral was it claimed if it had known of the potential for an excess judgment it would have timely put its excess carrier on notice. Instead, the insured claimed it did not learn of the potential for an excess judgment until shortly before trial and by then it was too late. Its excess carrier denied the claim as untimely. The suit proceeded to trial and the insured was found liable for a verdict of more than $2 million. Thus, the insured sued Admiral for bad faith in failing to notify of the potential for an excess verdict.

The Court acknowledged there is an argument that the loss of an opportunity to trigger excess coverage is not the kind of loss which the duty of good faith is intended to prevent. However, the Court stated the argument failed. Once the conflict arises the insured can no longer rely on its attorney or its carrier to defend the insured’s interest and must hire its own lawyer or seek coverage from another insurance policy.

The Seventh Circuit takes great pains to explain why insurers should not gamble with the insured’s money by taking a case to trial and risking an excess verdict in hopes of obtaining a defense verdict and paying nothing if the case could have been settled within policy limits, but the opinion failed to clearly state what a “non-trivial probability” of an excess verdict is (most likely because it could not). Suffice it to say, if there is even a minimal factual basis for an excess verdict, the carrier should at least consider picking up the phone, or better yet, writing a letter to its insured explaining the “non-trivial probability” of an excess verdict and the potential conflict of interest.

The Court stated this notice often proves “costless” to the carrier because insureds are unlikely to change lawyers, which may lead to a dispute over whether the new lawyer’s fees are “reasonable” and thus chargeable to the carrier. Because the defense counsel hired by the insurance company originally is both legally and ethically bound to protect the interests of the insured and not the carrier, the Court believes the insured is less likely to switch counsel in the middle of a suit. This seems to be an overly optimistic view by the Court as insureds are often skeptical of the motives of both their carrier and their attorney it selected. Regardless, the Court emphasizes it is the carrier’s duty—not the attorney’s—to inform the insured of the possibility of an excess verdict.

It seems the best defense against a claim by an insured for bad faith in failing to provide notice of a "non-trivial probability" of an excess verdict is by being proactive and making sure the insured is "kept in the loop." As the Court explained, if the trier of fact eventually finds that the insured actually knew everything the carrier should have told it and knew it in time to trigger excess coverage and it just failed to do so then there is no harm to the insured. This just reinforces the best practices of defense counsel copying the insured on all status reports and substantive correspondence with the carrier and the carrier copying the insured on substantive correspondence.

Admiral argued it was not its duty to inform the insured; rather, it was defense counsel's duty to inform the insured of the risk of an excess judgment. The Court disagreed with this argument because defense counsel informed Admiral knowing that Admiral was duty-bound to inform the insured. This ignores defenses counsel's ethical duty to its client—the insured. However, the Court explained the carrier cannot escape liability because it also has a duty to notify the insured, a duty which cannot be contracted away without the insured's consent. If defense counsel failed to inform both the carrier and the insured of the risk then the carrier may have a contribution/indemnification claim against defense counsel.

The bottom line is, under Illinois law, if the carrier controls the defense of the lawsuit it needs to be aware of any potential for an excess verdict and be prepared to put its insured on notice and potentially hire separate counsel for its insured.