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ILLINOIS APPELLATE COURT RULES ON CONFLICT OF INTEREST BETWEEN INSURED AND INSURER

On May 3, 2019 the Illinois Appellate Court issued its opinion in *Xtreme Protections Services, LLC v. Steadfast Insurance Company,* 2019 IL App (1st) 181501 (May 3, 2019), (click here for PDF) deciding that where punitive damages represent a "substantial portion" of liability as alleged in the complaint, and punitive damages are excluded under a policy, then a conflict of interest may exist between the insured and insurer, entitling the insured to select independent counsel.

The underlying plaintiff sued Steadfast's insured in the Circuit Court of Cook County, Illinois. By the third amended complaint, plaintiff alleged claims for electronic eavesdropping, surveillance, wiretapping, intrusion upon seclusion, trespass, sending threatening text messages and emotional distress. He sought not less than $120,000 in compensatory damages and $2.1 million in punitive damages. The Steadfast armed security services policy had limits of $1 million but excluded coverage for punitive damages and intentional acts. About three months after being notified of the case, and long after the insured started defending the case, Steadfast sent a reservation of rights citing the two policy exclusions. Steadfast also assigned panel counsel, but the insured rejected panel counsel and continued defending the underlying case with its chosen attorney.

The insured then filed a declaratory judgment complaint against Steadfast seeking a declaration that it was entitled to independent counsel because a conflict of interest arose from Steadfast's reservation of rights on punitive damages and intentional acts. Steadfast counterclaimed that the insured breached the cooperation clause by denying Steadfast the right to participate in and control the defense. The lower court granted the insured summary judgment. The Illinois Appellate Court affirmed.

The key issue was whether Steadfast's reservation of rights for punitive damages and intentional acts created a conflict of interest between the insured and insurer. Citing *Nandorf, Inc. v. CNA Insurance Cos.*, 134 Ill. App. 134 (1985), the Illinois Appellate Court found that the insured's and insurer's interests diverged if the insured was liable for punitive damages. The insurer would have an interest in providing a less-than-vigorous defense to allegations supporting a claim of punitive damages. This does not mean an insured is automatically entitled to independent counsel whenever punitive damages are sought but excluded under the policy. The court wrote: "where 'punitive damages formed a substantial portion of the potential liability in the underlying action and the [insurer's] disclaimer of liability left [plaintiff] with the greater interest and risk in the litigation,' a conflict of interest existed."

The Illinois court compared allegations with Steadfast's policy limits, noting that the third amended complaint sought no less than $120,000 in compensatory damages and $2.1 million in punitive damages, and the compensatory damages fell within the policy limits. Therefore, the underlying complaint sought a substantially greater amount of punitive damages than compensatory damages, and since Steadfast

disclaimed liability, the insured was left with the greater interest and risk in the litigation. Even though a fifth amended complaint filed during the appeal alleged a higher amount of compensatory damages, it also alleged twice the amount of punitive damages, allowing the court's reliance on the gap between types of damages to remain intact.