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Illinois Coverage Basics

The Duty to Defend Requires More than Retaining Counsel for the Insured

A Breach May Result in the Insurer's Liability for a Judgment in Excess of Policy Limits

In a ruling spelling trouble for insurers, the First District of the Illinois Appellate Court in *Delatorre v. Safeway Ins. Co.*, 2013 IL App (1st) 120852, 989 N.E.2d 268, recently ruled that an insurer was liable for the entire $250,000 judgment against its insured, despite policy limits of $20,000/$40,000. The court further ruled that an insurer's duty to defend requires more than retaining an attorney to defend the insured.

Safeway issued an auto liability policy to Ruben with liability limits of $20,000 per person and $40,000 per accident. In September, 1991, Delatorre was injured in a vehicular accident while riding in Ruben's car. Delatorre, as well as the driver and passenger in the other car, filed suit against Ruben. Safeway refused Delatorre's demand for the policy limits, but agreed to defend Ruben under a reservation of rights. By letter in November 1992, Safeway advised Ruben that it had retained an attorney to defend Delatorre's suit; the letter further advised that because a judgment in excess of limits could be rendered, Ruben should consider retaining additional counsel at his own expense. The attorney retained by Safeway filed an appearance on behalf of Ruben on December 15, 1992, but took no further action to defend Ruben. Safeway paid no attorney's fees, nor were any invoices submitted for fees. Delatorre moved for sanctions and on October 14, 1994, the court entered a default against Ruben for his failure to comply with discovery. Delatorre's counsel sent a copy of the default order to Safeway ten days later and Safeway forwarded the order to retained defense counsel. This was the only written communication between Safeway and its retained counsel since November, 1992. In November, 1995, a prove-up hearing was held on the default and Delatorre was awarded $250,000 in damages.

Meanwhile, Safeway had been litigating a declaratory action based on Ruben's misrepresentation in the policy application. The trial court ruled against Safeway and the ruling was affirmed on March 20, 1998. Thereafter, Safeway tendered its limits to Delatorre, who refused the tender. Safeway paid its limits to the other injured claimants. Delatorre, as assignee of Ruben's rights against Safeway, then filed suit against Safeway, alleging its breach of duty to defend when it ignored notice that retained counsel was not providing Ruben with a meaningful defense. The trial court awarded Delatorre damages of $250,000, the amount of the default judgment, despite Safeway's exhaustion of its limits.

The appellate court affirmed, rejecting the position that an insurer "discharges its duty to defend solely by retaining an attorney for its insured." *Delatorre, supra*, ¶ 23. The court noted that the Fourth District in *Brocato v. Prairie State Farmers Ins. Ass'n*, 166 Ill.App3d 3d 986, 520 N.E.2d 1200 (4th Dist. 1988), had reached the opposite conclusion, but the First District found that case distinguishable as the retained defense attorney there "'actually defended' the insured throughout trial." *Delatorre, supra*, ¶ 22. The First District further stated,

> "the implications of the rule announced in *Brocato* that an insurer satisfactorily discharges its duty to defend by retaining an attorney are troubling. Importantly, the law requires good faith and fair dealing by both parties in performing their contractual obligations. [citation] The *Brocato* holding, however, would allow an insurer to escape its legal obligation to provide good faith legal representation and instead freely abandon its insured to an attorney who is either unwilling or unable to undertake the defense, or who, as in this case, inexplicably deserts the client. In our view, an insurer's promise to defend entitles the insured to expect that its insurer will retain an attorney who will in fact take action to defend the insured in the face of a default order. The insurer's duty, after all, is to *defend,* not merely to provide representation, and is an ongoing duty throughout the litigation….
>
> Ultimately, defendant's nominal, passive, and one-way communication with the attorney ostensibly retained to defend its insured leads us to conclude that defendant breached its duty to defend." *Delatorre, supra*, ¶ 23, 25

The First District rejected the concern that a contrary ruling would violate the prohibition on insurers practicing law: "[w]e fail to see how requiring an insurer to ascertain whether its insured is **actually** being **defended**, particularly following notice of an order of default, necessitates the use of any legal skill or knowledge." (emphasis in original.) *Delatorre, supra*, ¶ 27.

The court went on to award the entire amount of the judgment against Safeway, citing *Conway v. Country Cas. Ins. Co.*, 92 Ill.2d 388, 397-98, 442 N.E.2d 245 (1985), for the position that an insured may recover an excess judgment where its insurer breaches the duty to defend, either (1) on a tort basis, "as a punitive measure, where the insurer has acted in bad faith, or (2) contract based, as a compensatory measure, where the insured's damages are proximately caused by the insurer's breach of duty." *Delatorre, supra*, ¶ 33. The court approvingly cited *Green v. J.C. Penney Auto Ins. Co.*, 806 F2d 759, 762 (7th Cir. 1986), for the proposition that "irrespective of bad faith, an insurer may be liable for damages beyond the policy limits if its breach of duty caused the excess judgment." *Delatorre, supra*, ¶34. The court further cited post-*Conway* Illinois cases, including *Fidelity & Cas. Co. of New York v. Mobay*, 252 Ill.App3d 992997, 625 N.E.2d 151 (1992), for the proposition that when an insurer wrongfully refuses to defend its insured, the "measure of damages is generally the amount of the judgment against its insured." *Delatorre, supra*, ¶34. The court found that the judgment in excess of policy limits "directly flows from the

breach of contract" as the original default and subsequent judgment resulted entirely from the insurer's breach and the judgment could have been averted had the insured been "**actually defended**." (emphasis in original) *Delatorre, supra*, ¶35. The court expressly limited its decision "on the suitability of a default judgment entered against the insured as the measure of damages to the precise facts of this case." *Delatorre, supra*, ¶37.

Justice Sterba dissented in the award of damages. Although concurring in the finding of the insurer's breach of duty, he found it "curious" that the majority cited the rule that "damages are intended to place the injured party in the position he would have been in if the contract had been fully performed," but the majority ignored the fact that if the insurance contract had been fully performed, the insured would have been indemnified up to the policy limits of $40,000. *Delatorre, supra*, ¶ 47. The dissent found the award of damages in excess of that amount to be a windfall, recoverable only under circumstances not present in this case. Noting that the plaintiff was proceeding under a contract theory, the dissent stated that under *Conway, supra*, plaintiff must prove that its damages were "proximately caused by the insurer's breach of duty" and thus whether the injury would have occurred in the absence of the breach. *Delatorre, supra*, ¶ 44. The dissent found that plaintiff failed to prove that damages less than $250,000 would have been awarded had the insurer properly defended. He further questioned the majority's citation to Illinois cases which did not involve an excess judgment for the proposition that the proper measure of damages is the amount of the judgment against the insured. The dissent noted the implication of "essentially allowing all plaintiffs to recover damages in excess of policy limits without proving causation," as well as the practical effect of eliminating tort claims for breach of the duty to defend as an insured "would not assume the burden of proving bad faith or negligence if all that was required to recover damages in excess of policy limits was a showing that a judgment had been entered against the insured." *Delatorre, supra*, ¶ 48.

The Illinois Supreme Court recently denied a petition for leave to appeal. The facts in this case regarding the failure to provide a defense beyond merely appointing defense counsel are egregious and the majority opinion is expressly limited to the suitability of a default judgment as the measure of damages under these facts. Nevertheless, the opinion is likely to be used by claimants' attorneys to urge that judgments in excess of policy limits are a proper measure of damages for an insurer's failure or refusal to defend its insured. In addition, the opinion invites future arguments regarding whether an insurer has "actually defended" its insured. Insurers and their claims handlers would be well-advised to keep an eye on and document their retained defense counsel's efforts to defend insureds.

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If you have questions or would like to discuss the implications of this report further, please feel free to contact Jeanne Zeiger at Cray Huber Horstman Heil & VanAusdal LLC, 303 West Madison, Suite 2200, Chicago IL 60606; 312-332-8493; jmz@crayhuber.com.