MEETING THE CHALLENGES OF ILLINOIS BAD FAITH LAW

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Bad faith, or breach of the implied covenant of good faith and fair dealing, continues to be a hotly litigated issue in Illinois courts. The closer we can come to understanding the forces behind the continuing expansion in Illinois bad faith law, the more effective are the steps we can take to prevent bad faith exposures.

Background: The Origins of an Insurer's Duty of Good Faith Within a Third-Party Context

Generally, an aggrieved policyholder that wishes to bring an action against its insurer for the insurer's failure to provide insurance benefits or performance under an insurance contract has the following options:

(1) bring an action for breach of the insurance contract;

(2) bring an action under the Illinois Consumer Fraud Act, 815 ILCS 505/1, *et seq.;* or

(3) bring an action in tort for extra-contractual damages under certain tort theories, i.e., fraud.

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The Illinois Supreme Court has ruled that there is no common law “bad faith” tort action under Illinois law, which is different than many states. However, we are beginning to see an expansion of the tort avenues of recovery against an insurer in Illinois, which is worth watching, and will be discussed below.

Illinois courts have held that implied in every insurance contract is a duty of good faith and fair dealing. *Scroggins v. Allstate Ins. Co.*, 74 Ill. App. 3d 1027, 393 N.E.2d 718 (1st Dist. 1979). Thus, breach of an implied duty of good faith and fair dealing, or bad faith, is the basis of liability in a contract action against a liability insurer for wrongful practices in handling a third-party claim. *Mid-America Bank & Trust Co. v. Commercial Union Ins. Co.*, 224 Ill. App. 3d 1083, 587 N.E.2d 81, 84 (1st Dist. 1992).

Illinois courts have willingly recognized an insurer’s duty to act in good faith towards its insureds in third-party liability contexts because of the unique relationship of the parties to an insurance contract. The contractual relationship between an insurer and an insured is at times a traditional arms-length dealing between two parties, as in the initial purchase of a policy, but is also at times one of a fiduciary nature. *O’Neill v. Gallant Ins. Co.*, 329 Ill. App. 3d 1166, 769 N.E.2d 100 (5th Dist. 2002). An insurer’s duty of good faith arises because an insured purchases a policy to obtain protection from claims made by third parties, and in doing so, the insured typically surrenders to the insurer the right to control the defense and settlement of the litigation. Since the insured places control of its lawsuit in the hands of the insurer, the insurer consequently is charged with making a good faith effort to settle and protect its insured. The part of a liability insurance contract that requires an insurer to defend its insured imposes on the insurer a fiduciary responsibility to act in good faith toward its insured. *Douglas v. Allied American Ins. Co.*, 312 Ill. App. 3d 535, 543, 727 N.E.2d 376, 382 (2000).

Having said that, however, Illinois courts are not in accord as to the implications of the implied covenant of good faith and fair dealing. For example, some Illinois courts recognize the covenant as a legal ground for contractual relief. *See, American Fidelity Fire Ins. Co. v. General Ry. Signal Co.,* 540 N.E.2d 557, 561 (1st Dist. 1989). Other courts have nevertheless held that the implied covenant cannot serve as an independent and enforceable source of duties for contract parties. *See, LaSalle Nat'l Bank v. Metropolitan Life Ins. Co.,* 18 F. 3d 1371, 1375 (7th Cir. 1994); *but see, Oil Express Nat'l, Inc. v. Burgstone,* 958 F. Supp. 366, 369 (N.D. Ill. 1997)(explaining that breach of the implied covenant contained in Illinois contracts may give rise to a cause of action if one party is given broad discretion in performing the contract and abuses such discretion in bad faith). As we will discuss ahead, the question is far from resolved in Illinois.

Illinois Has Traditionally Limited the Remedies for Bad Faith Claims

Under Illinois law, a policyholder that prevails on a breach of contract action against its insurer for the insurer's failure to fulfill its obligations under the insurance contract is typically limited to recovering only those damages that are available in contract, which usually constitute only the benefit of contract performance, whereas damages for delay in performance, punitive damages and attorney fees are usually excluded. In 1937, the Illinois legislature enacted a statute to provide policyholders with monetary recovery beyond normal contract damages and to punish insurers that vexatiously and unreasonably fail to fulfill their obligations to policyholders – Section 155 of the Illinois Insurance Code.

Section 155 provides:

> (1) In any action by or against a company wherein there is in issue the liability of a company on a policy or policies of insurance for the amount of the loss payable thereunder, or for an unreasonable delay in settling a claim, and it appears to the court that such action or delay is vexatious and unreasonable, the court may allow as part of the taxable costs in the action reasonable attorney fees, other costs, plus an amount not to exceed any of the following amounts:
>
> > (a) 60% of the amount which the court or jury finds such party is entitled to recover against the company, exclusive of all costs;
> >
> > (b) $60,000;
> >
> > (c) the excess of the amount which the court or jury finds such party is entitled to recover, exclusive of costs, over the amount, if any, which the company offered to pay in settlement of the claim prior to the action.

215 ILCS 5/155 (West's 2005).

Section 155 applies to both first-party and third-party liability insurance, and the rights and remedies under Section 155 can be extended to assignees of a policyholder. *See, Garcia v. Lovellette,* 265 Ill. App. 3d 728, 639 N.E.2d 935 (2d Dist. 1994). Also, note that the remedies are exclusive, so that the maximum recovery is attorney fees and costs plus a maximum penalty of $60,000. *See, Nelles v. State Farm Fire & Cas. Co.,* 318 Ill. App. 3d 399 (2000).

As noted above, an insured or assignee must prove two elements in order to recover damages from an insurer under Section 155 of the Illinois Insurance Code. First, the insured or the assignee must prove that either the insurer disputed the amount of the loss payable on a claim, delayed settling the claim, or refused to provide coverage when coverage was not fairly debatable. Second, the insured or the assignee must prove that the insurer's action or delay was unreasonable and vexatious. Because establishing one of the first elements is readily achievable, courts focus on whether the insurer's action or delay was unreasonable and vexatious. *Buckner v. Causey*, 311 Ill. App. 3d 139 (1999).

In determining whether an insurer's action or delay is vexatious and unreasonable, the totality of the circumstances will be considered. *Motors Mutual Ins. Ass'n of Illinois v. House*, 286 Ill. App. 3d 378 (1997). In particular, the insurer's attitude and treatment of its insured will be examined. *Green v. International Ins. Co.*, 238 Ill. App. 3d 929, 935 (1992). Courts will also consider whether the insured was forced to file suit and was deprived of the use of his or her property. *Mohr v. Dix Mut. Co. Fire Ins. Co.*, 143 Ill. App. 3d 989, 999 (1986). Moreover, payment of the full amount of a claim does not preclude an insured's cause of action against the insurer if the payment was vexatiously and unreasonably delayed. *Calcagno v. Personal Care Health Management, Inc.*, 207 Ill. App. 3d 493, 504 (1991).

In comparison with the relief available under common law, the capped remedies provided under Section 155 are limited. Further, the policyholder bears the burden of proof that the insurer's action in denying liability, refusing to pay a covered loss, or delaying the settlement of a claim was vexatious and unreasonable. *Buckner v. Causey, supra.* Because of these limitations and obstacles, policyholders in Illinois frequently attempt to tie a Section 155 action with other tort theories of recovery, such as consumer fraud.

Illinois Consumer Fraud and Deceptive Business Practices Act

The Illinois Consumer Fraud Act provides, in relevant part:

> Unfair methods of competition and unfair or deceptive acts or practices, including but not limited to the use or employment of any deception, fraud, false pretense, false promise, misrepresentation or the concealment, suppression or omission of any material fact, with intent that others rely upon the concealment, suppression or omission of such material fact, or the use or employment of any practice described in Section 2 of the "Uniform Deceptive Trade Practices Act," approved August 5, 1965, in the conduct of any trade or commerce are hereby declared unlawful whether any person has in fact been misled, deceived or damaged thereby.
>
> 815 ILCS 505/2.

Illinois courts have recognized that the Consumer Fraud Act may apply to insurance companies. *Fox v. Industrial Cas. Ins. Co.,* 98 Ill. App. 3d 543, 424 N.E.2d 839, 842 (1st Dist. 1981)("sale of insurance is clearly a service and insureds are consumers and within the protection of the Consumer Fraud Act"). Remedies available under the Act include actual economic damages, injunctive relief, attorney fees and costs. 815 ILCS 505/10a(a), 505/10a(c). Punitive damages are also available if the alleged insurer misconduct is "outrageous," which has generally been interpreted to require evidence of malice, evil motive or reckless indifference toward the rights of others.

How Does Illinois Define "Bad Faith"?

Illinois maintains both common law and statutory formulations of what constitutes or is evidence of "bad faith." A common formulation is that "bad faith" lies in an insurer's failure to give at least equal consideration to the insured's interests as to the insurer's own interests. *Cramer v. Ins. Exchange Agency*, 174 Ill. 2d 513, 675 N.E.2d 897 (1996). The Illinois Forms of Jury Instruction, Section 81.03, defines good and bad faith as follows:

> ‘Good faith’ means that (*insurer*) was required to give as much consideration to (*insured*)’s interests as it gave to its own interests. A failure to exercise good faith is known as ‘bad faith.’[1]

Further, Section 154.6 of the Illinois Insurance Code contains a laundry list of acts constituting improper claims practice in Illinois:

> (a) Knowingly misrepresenting to claimants and insureds relevant facts or policy provisions relating to coverages at issue;
>
> (b) Failing to acknowledge with reasonable promptness pertinent communications with respect to claims arising under its policies;
>
> (c) Failing to adopt and implement reasonable standards for the prompt investigations and settlement of claims arising under its policies;
>
> (d) Not attempting in good faith to effectuate prompt, fair and equitable settlement of claims submitted in which liability has become reasonably clear;
>
> (e) Compelling policyholders to institute suits to recover amounts due under its policies by offering substantially less than the amounts ultimately recovered in suits brought by them;
>
> (f) Engaging in activity which results in a disproportionate number of meritorious complaints against the insurer received by the Insurance Department;
>
> (g) Engaging in activity which results in a disproportionate number of lawsuits to be filed against the insurer or its insureds by claimants;
>
> (h) Refusing to pay claims without conducting a reasonable investigation based on all available information;
>
> (i) Failing to affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed;

[1] Authorities: *Mid-America Bank & Trust v. Commercial Union, supra*; *Sanders v. Standard Mutual Ins. Co.*, 142 Ill. App. 3d 1082, 492 N.E.2d 917 (4th Dist. 1986); *Scroggins v. Allstate Ins. Co.*, 74 Ill. App. 3d 1027, 393 N.E.2d 718 (1st Dist. 1979); *Cernocky v. Indemnity Ins. Co.*, 69 Ill. App. 2d 196, 216 N.E.2d 198 (2nd Dist. 1966).

(j) Attempting to settle a claim for less than the amount to which a reasonable person would believe the claimant was entitled, by reference to written or printed advertising material accompanying or made part of an application or establishing unreasonable caps or limits on paint or materials when estimating vehicle repairs;

(k) Attempting to settle claims on the basis of an application which was altered without notice to, or knowledge or consent of, the insured;

(l) Making a claims payment to a policyholder or beneficiary omitting the coverage under which each payment is being made;

(m) Delaying the investigation or payment of claims by requiring an insured, a claimant, or the physicians of either to submit a preliminary claim report and then requiring subsequent submission of formal proof of loss forms, resulting in the duplication of verification;

(n) Failing in the case of the denial of a claim or the offer of a compromise settlement to promptly provide a reasonable and accurate explanation of the basis in the insurance policy or applicable law for such denial or compromise settlement;

(o) Failing to provide forms necessary to present claims within 15 working days of a request with such explanations as are necessary to use them effectively;

(p) Failing to adopt and implement reasonable standards to verify that a repairer designated by the insurance company to provide an estimate, perform repairs, or engage in any other service in connection with an insured loss on a vehicle is duly licensed under Section 5-301 of the Illinois Vehicle Code;

(q) Failing to provide as a persistent tendency a notification on any written estimate prepared by an insurance company in connection with an insured loss that Illinois law requires that vehicle repairers must be licensed in accordance with Section 5-301 of the Illinois Vehicle Code;

(r) Engaging in any other acts which are in substance equivalent to any of the foregoing.

215 ILCS 5/154.6 (West’s 2005).

While the Illinois Insurance Code does not provide for a private cause of action by a policyholder against an insurer based on the improper claims practice statute, nor does the Code say that any of the above acts is equivalent to bad faith or otherwise entitles the insured to Section 155 relief, evidence of the above practices has been looked at by courts in evaluating an insurer's conduct in a bad faith setting.

Typical Bad Faith Scenarios

In general, the two largest sources of bad faith liability claims arise from an insurer's erroneous denial of coverage, or the insurer's failure to settle a claim within policy limits.

Whether an insurer's conduct amounts to bad faith depends on the circumstances surrounding the insurer's conduct and its reason for denying coverage or for not paying the third-party claim. Clearly, an insurer acts in bad faith by refusing to pay a claim despite knowledge that it is liable and that its refusal would result in serious harm to the insured. Other examples of bad faith conduct drawn from Illinois case law include:

- inadequate investigation of a claim;
- denial of a claim without obtaining satisfactory supporting evidence;
- failure to evaluate a claim "objectively";
- unreasonable interpretations of policy provisions;
- unreasonably low settlement offers;

- denial of coverage based on extremely minor misrepresentations in the insurance application or false representations knowingly made by the insurer's agent when filling out the application;

- abusive or coercive practices designed to force an unreasonable compromise of the claim.

See, e.g., Emerson v. American Bankers Ins. Co., 223 Ill. App. 3d 99, 585 N.E.2d 1315, 1320-1321 (5th Dist. 1992).

The Fertile Ground of "Failure to Settle" Claims

With respect to "failure to settle" claims, Illinois law is surprisingly unsettled and tentatively expanding. Clearly, if an insurer acts fraudulently or in bad faith when negotiating a settlement on behalf of its insured, the insurer may be held liable for damages in excess of the policy limits. *Country Mutual Ins. Co. v. Anderson*, 257 Ill. App. 3d 783, 628 N.E.2d 499 (1st Dist. 1993). However, what constitutes bad faith in this context appears to be creeping from an "outrageous conduct" standard to something more akin to negligence. *See Cernocky, supra,* (fraud need not be shown). The outcome of these "failure to settle" cases generally turns on the court's treatment of three issues: (1) what standard should be applied to assessing the insurer's decision not to settle; (2) whether the insurer can fairly take into account its coverage defenses in declining to settle; and (3) whether the insurer has an affirmative obligation to seek out a settlement within policy limits or only faces liability if an actual offer was made and declined.

In general, the following elements must be present to give rise to a claim against an insurer for negligent or bad faith failure to settle a claim without policy limits:

1. The underlying claim is one for which coverage is provided under the policy;

2. An actual settlement offer within the policy limits was available to accept, and;

3. The offer is one that an ordinarily prudent insurer would accept considering the degree of the insured's liability. *See Haddick v. Valor Ins. Co.*, 198 Ill. 2d 409, 763 N.E.2d 299 (2001).

As the Illinois Supreme Court has noted, the duty to settle does not arise until a claim has been made against the insured and there is a reasonable probability of recovery in excess of policy limits and a reasonable probability of a finding of liability against the insured, as where a third party demands settlement within policy limits. *Id.* at 305.

Haddick provides a good illustration of the Illinois Supreme Court's analysis of "failure to settle" cases. In *Haddick*, the alleged driver of a vehicle that caused the death of the plaintiff's decedent had a $20,000 liability limit with his auto insurer, Valor. Three months after the accident, the plaintiff informed Valor that the decedent had incurred more than $80,000 in medical bills and demanded settlement. Valor responded by saying that it was still investigating the identity of the driver and that settlement was premature. Ten months after the accident, plaintiff made a policy limits demand and gave Valor 14 days to respond, which was subsequently extended for another 14 days. Valor did not respond. Consequently, plaintiff withdrew the demand and filed suit. Approximately one year later, Valor offered its policy limits to settle the case, but the plaintiff rejected the offer. After taking an assignment of the driver's rights under the policy, the plaintiff filed a common law bad faith action against Valor.

The trial court dismissed the case based on rulings that (1) an insurer has no duty to settle a claim until suit has been filed against its insured, and (2) a plaintiff cannot maintain a bad faith action after having withdrawn its policy limits demand. The Illinois Appellate Court reversed the trial court judgment, holding that the duty to settle arises at the inception of the insurance contract. The Illinois Supreme Court affirmed the Appellate Court, but disagreed as to when the duty to settle arises.

The Illinois Supreme Court explained that a liability insurer's duty to act in good faith in responding to settlement offers is based upon the insurer's exclusive control over settlement negotiations and defense of litigation. The court stated that when the amount of damages sought against the insured comes within the indemnity limits of the policy, the manner in which the claim is handled is a matter of no concern to the insured. However, when there is a "reasonable probability that the insured will be held liable for an excess verdict," the insurer must take the insured's settlement interests into consideration.

The Court clarified that the duty to settle does not arise at the time the parties enter into the insurance contract and does not depend upon whether a lawsuit has been filed against the insured. Rather, the duty to settle arises when a claim has been made against the insured and there is a reasonable probability of a finding of liability against the insured. Because an insurer generally is not required to initiate settlement negotiations[2], Valor's duty arose when the plaintiff made a demand for settlement of a claim within policy limits and, at the time of the demand, there was reasonable probability of recovery in excess of policy limits and a reasonable probability of a finding of liability against its insured. *Id.* at 305-06. The court then went on to

[2] While an insurer generally is not required to initiate settlement negotiations, an exception exists where the probability of an adverse finding on liability is great and the amount of probable damages would greatly exceed the policy limits. *Id.*

hold that Valor breached the duty when the plaintiff demanded that the insurer settle the claim within policy limits, but the insurer refused. *Id.*

Thus, under the *Haddick* Court's analysis, it appears that an insurer's duty to settle in good faith may arise even before the insurer has a duty to defend, i.e., where a demand has been made but suit has not been filed against the insured. Further, no good faith duty arises unless and until the plaintiff makes a demand. However, where there is a great probability of an adverse finding and the amount of probable damages would exceed policy limits, that duty may arise even before a demand has been made. Because of this important exception, *Haddick* fails to provide a bright-line rule, and it imposes a significant burden on insurers to carefully evaluate their obligations early on in each case.

Additionally, *Haddick* may be seen to tacitly endorse the use of time limit demands to set up liability insurers for bad faith claims. After finding that Valor had a good faith duty to settle, the Illinois Supreme Court held that Valor violated its duty by failing to comply with the time limitations imposed on the demand. The Court held that the conduct of the plaintiff with respect to the time limit and the withdrawal of the demand formed a proper basis for pleading a cause of action for bad faith failure to settle.

One of the more egregious "failure to settle" cases in Illinois is that of *O'Neill v. Gallant Ins. Co.*, 329 Ill. App. 3d 1166, 769 N.E.2d 100 (5th Dist. 2002). In *O'Neill*, after Marguerite O'Neill was seriously injured due to Gallant's insured's negligence (she left her 2-year old grandson unrestrained in her car with the engine running in a parking lot), her attorney sent a demand letter to Gallant for the policy limits of $20,000 to be paid within 30 days. Gallant made no response to this letter, even though the Gallant claims adjuster who reviewed the file recommended that the policy limits be paid on the claim before the demand was even made. The claims manager concurred in that recommendation. John Moss, Executive Vice President of Gallant's parent company, was the only person other than the Chief Executive Officer who could authorize a settlement above $15,000. Moss chose to ignore the recommendations of his adjusters, and also disregarded the advice of the lawyers hired by Gallant to represent its insured, who had urged Moss to tender policy limits in response to the demand and who predicted that a jury verdict for Ms. O'Neill was likely to be 15 to 30 times the amount of coverage. A jury in fact awarded $730,063 in damages to Ms. O'Neill in her trial against Gallant's insured. The insured then assigned her bad faith claim against Gallant to Ms. O'Neill. The jury in that case awarded $3,010,063, the punitive damages component of which was $2.3 million, and Gallant appealed. Gallant's argument was that the verdict was against the manifest weight of the evidence. In analyzing this issue, the appellate court first set out the standard for a finding of bad faith on the part of an insurance company. "Bad faith" exists when "an insurer fails to give at least equal consideration to the insured's interests when the insurer arrives at a decision on whether to settle the claim." In this case, when Gallant's claims manager recommended to John Moss that he meet Ms. O'Neill's demand, she wrote that it was necessary to do so "in order to make sure that the policyholder's interests were treated with equal weight as the company's interests." The court held that this admission, standing alone, was sufficient to support the jury's verdict.

The court nevertheless then went on to analyze seven factors to consider in assessing whether an insurer has acted in bad faith. *Id.* at 107-108. Those factors are:

1. The advice of the insurance company's adjusters;

2. A refusal to negotiate;

3. The advice of defense counsel;

4. Communication with the insured to keep the insured apprised of the claimant's willingness to settle;

5. An inadequate investigation in defense of the claim;

6. The substantial prospect of an adverse verdict;

7. The potential for damages that exceed the policy limits.

Finding each of these factors in favor of the verdict in this case, the court found no reason to disturb the jury's award of compensatory damages. Thus, as the *O'Neill* court itself quipped, Gallant took its small stake in the outcome of a personal injury claim, $20,000 worth of insurance coverage, and turned it into a multi-million judgment for a bad faith refusal to settle within the policy limits.

It is important to note that prior to *O'Neill*, no Illinois case had ever authorized common law punitive damages against an insurance carrier based upon a bad faith refusal to settle a third-party liability claim. The *O'Neill* court found that where the insurer's conduct exceeds mere negligence and was found by a jury to constitute utter indifference and reckless disregard for its policyholder's financial welfare, punitive damages above and beyond the Section 155 penalty can be awarded. *Id.* at 109. In doing so, the court relied on the fiduciary nature of the relationship between the insurer and the policyholder. *Id.*

Interplay Between Common Law Bad Faith Liability and Section 155

Illinois courts have struggled with determining whether Section 155 preempts a claim against an insurer for a separate and independent tort of bad faith. In 1996, the Illinois Supreme Court in *Cramer v. Insurance Exchange Agency* cleared up much of this uncertainty. 675 N.E.2d

897, 903-904 (1996). The court held that while the statute limits the recovery for a claim against an insurer for bad faith when the insurer is directly sued on an insurance contract, the statute does *not* preempt an independent tort action where the plaintiff alleges and proves the elements of a separate tort, such as common law fraud.

Moreover, Illinois courts have since found that while Section 155 preempts punitive damages in first-party denial cases, Section 155 does not preempt punitive damages in "failure to settle" third-party claims cases. *O'Neill*, 769 N.E.2d at 111-115. Thus, under Illinois law, an insurer may be liable for bad faith, which arises from the implied contractual covenant of good faith and fair dealing, through fraud, misrepresentation, or other tort, or, as in the *O'Neill* case, breach of a duty to settle; further, the insurer may be required to pay punitive damages.

Insurers' Defenses to Bad Faith Claims

While the foregoing may paint a rather bleak picture for insurers, Illinois courts have recognized that insurers may assert certain defenses to bad faith actions. Insurers generally oppose bad faith claims with factual evidence derived from their claims files and attorney recommendations to justify their actions. Expert testimony as to liability, claims valuation, and adjustment practices can also be used in some cases.

Courts have concluded that an insurer's delay or other action is not vexatious and unreasonable if a *bona fide* coverage dispute exists. *Golden Rule Ins. Co. v. Schwartz*, 203 Ill. 2d 456 (2003). Illinois courts have found that a bona fide dispute exists when an insurer relies on Illinois case law to support its coverage positions. *See, e.g., Ragan v. Columbia Mutual Ins. Co.,* 291 Ill. App. 3d 1088, 684 N.E.2d 1108, 1115 (5th Dist. 1997)(no bad faith where Illinois case law supported the insurer's coverage position, even though Illinois authority was split);

State Farm Mutual Automobile Ins. Co. v. Fisher, 315 Ill. App. 3d 1159, 735 N.E.2d 747, 754 (1^{st} Dist. 2000)(finding that bona fide coverage dispute existed where there was no Illinois case law on point, but insurer argued for extension of existing case law).

Conversely, the mere assertion of a coverage defense is insufficient to defeat a bad faith claim unless there is factual and/or evidentiary support for the defense. *See McGee v. State Farm Fire and Cas. Co.,* 315 Ill. App. 3d 673, 734 N.E.2d 144 (2d Dist. 2000).

Expansion of Bad Faith Remedies into Conflict of Interest Territory

Recently, the Illinois Court of Appeals, Fourth Division, issued a troubling opinion in *Williams v. American Country Ins. Co.*, NOS. 1-04-0250 and 1-04-2119 (July 29, 2005). The reason the *Williams* decision is of concern is that for the first time, the appellate court awarded attorneys' fees and costs pursuant to Section 155 based on an insurer's conduct in handling the defense of its insured.

In *Williams*, an Illinois state police officer was directing traffic, and he noticed a taxicab repeatedly blowing his car horn. The officer approached the cab, driven by Williams, opened the door and leaned inside the cab. While the officer was leaning inside the cab, Williams began driving, causing injury to the officer. Williams was charged with misdemeanor battery as a result, and following a jury trial was convicted of battery.

The police officer filed a complaint against Williams and Yellow Cab, both of whom were insured by American Country. At the time of the occurrence, American Country and Yellow Cab were subsidiaries of a company known as Great Dane Holdings. The complaint alleged that Williams was the agent and servant of Yellow Cab and was operating a taxicab owned by Yellow Cab. The complaint alleged negligence against both Williams and Yellow

Cab. American Country undertook the defense in the case, retaining separate counsel to represent Williams and Yellow Cab. Prior to retaining counsel, American Country sent Williams a reservation of rights letter, citing an expected or intended injury exclusion and referring to Williams' criminal battery conviction.

In answer to the officer's complaint, the attorney retained by American Country to represent Williams denied that Williams was an agent of Yellow Cab, and responded in discovery that there was no insurance available for this loss. Finding his representation to be inadequate and presenting a conflict of interest, Williams requested the appointment of alternative counsel, which was denied by American Country. Thus, Williams filed a declaratory judgment action against American Country alleging that it had failed to warn him of an actual or potential conflict of interest in defending the underlying action.

On appeal, the court found that a conflict of interest existed between Williams and American Country, and that the evidence showed that American Country failed to disclose such conflict of interest to Williams. Absent such full disclosure and consent to representation, Williams was entitled to assume control of his defense in the underlying case and American Country was obligated to pay for independent counsel. With respect to the award of Section 155 attorneys' fees, the court found that because American Country failed to notify Williams regarding the conflict of interest and controlled his defense for nearly three years despite the existence of a conflict, the trial court's discretionary ruling would stand.

What is intriguing about the *Williams* decision is that the court took existing Illinois estoppel law with respect to the duty to defend/conflict of interest and bootstrapped Section 155 attorneys' fees on it, in the absence of any other vexatious or unreasonable conduct or failure to settle. American Country almost got it right -- it retained separate counsel to represent Williams and his employer, and it issued a reservation of rights letter. However, American Country failed to initially identify the potential for a conflict of interest, and then when the issue was affirmatively brought to its attention, it failed to pay for independent counsel for over three years. Generally, Illinois courts will simply (!) rely on the estoppel doctrine and preclude all coverage defenses to punish insurers for such action. Here, American Country had a valid coverage defense on which it could have prevailed had it initially filed a declaratory judgment action. Nevertheless, it was both estopped from asserting it and then hit with a Section 155 fees and costs award. As of September 1, 2005, a decision on the insurer's petition to the Illinois Supreme Court has not yet been rendered.

Prevention of Bad Faith Claims

Does all of this mean that insurance companies are doomed and should not take coverage positions or dispute liability or damages in Illinois? Of course not. While there is no easy solution, the key is to avoid circumstances that might give rise to allegations of bad faith. As is evident from the foregoing, that brings us full circle back to good claims practices. For this reason, insurers go to great lengths to define their standard claims practices and to provide in-depth and ongoing training in claims procedures. Yet, no matter how extensive insurers train their claims personnel and how complete their policies are, an insurer will still get bad faith claims. Policyholders often consider that if they buy insurance coverage, it should cover all losses and claims regardless if the policy was intended to do so. Thus, many bad faith claims often arise out of dissatisfied or disillusioned policyholders, rather than from the implementation of claims practices or improper conduct by the insurer. For this reason alone, bad faith claims will remain as part of the claims landscape, despite the aggressive *good faith* practices of most insurers.

Further, insurance companies are often viewed as "deep pockets," and thus are likely to attract attempts to extract substantial monetary awards by alleging bad faith conduct. Unless and until courts demonstrate the willingness to throw out specious claims, the spectre of large money judgments fosters bad faith litigation against the insurance industry.

According to Willis Park Rokes in his seminal work, "Aggressive Good Faith and Successful Claims Handling," education is paramount to preventing most bad faith claims. Claims departments should know the statutes and the insurance department rules and regulations that govern how claims are to be handled; internal policies and procedures must be learned and implemented; and claims personnel at the customer contact level must be made aware of the ramifications of their actions.

Summary of Illinois Bad Faith Law

Because Illinois does not recognize an independent tort of bad faith, a policyholder has several avenues under which it can seek extracontractual damages against its insurer. In this respect, an insurance company should recognize the weapons in a policyholder's arsenal, and further, the measure of potential damages that a policyholder may obtain under each action.

Action	**Potential Damages**
Breach of Insurance Contract (i.e., erroneous denial of coverage)	Contract damages, including excess judgment amount, and Section 155 relief (attorney fees and costs plus a maximum penalty of $60,000) - *Cramer* case
Breach of Insurance Contract (failure to settle within policy	Contract damages, including excess judgment amount, Section 155 relief, and punitive damages in excess of Section

limits)	155 limitation - *O'Neill* case
Breach of Insurance Contract (defending when a conflict of interest exists)	Contract damages and Section 155 relief (attorney fees and costs plus a maximum penalty of $60,000) - *Williams* case
Illinois Consumer Fraud Act, 815 ILCS 505/1	Actual economic damages, injunctive relief, attorney fees and costs and punitive damages
Fraud, Misrepresentation	Actual economic damages, injunctive relief, attorney fees and costs and punitive damages

Critical Points to Remember:

- When an insurer is faced with a settlement demand, it must begin to adequately investigate the underlying claim. If a time limit is imposed on the settlement demand, an insurer must comply with the time limit or respond in some fashion. An insurance company may *not* sit and do nothing when it is faced with a settlement demand within policy limits, even if the demand is made before suit is filed against its insured.

- Be aware of potential conflict of interest situations. Once a potential conflict of interest arises, an insurer should inform the insured of the conflict immediately before undertaking the defense of the insured. If the insured chooses to waive the conflict, the insurer may undertake the defense of the insured. If not, the insurer must provide independent counsel for the insured.

- An insurer must immediately assess any *bona fide* coverage defenses. If there is no *bona fide* coverage defense, an insurer will have no defense to a denial of coverage or a failure to settle case.