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Failure to Identify Conflict of Interest Proves Costly for Insurer

By Jennifer L. Smith

In a recent decision, an Illinois Court of Appeals held that an insurer failed to properly identify and disclose a conflict of interest with its insured, which would have required the insurer to provide independent counsel at its own expense. *Williams v. American Country Insurance Company,* 2005 Ill. App. LEXIS 748, 833 N.E.2d 971 (2005). As a result, the insurer was forced to pay $125,000 in attorney fees and $25,000 as a penalty for its vexatious conduct.

In October 1996, Illinois State Police officer Herman Davila was on duty and working in downtown Chicago when he observed Thomas Williams repeatedly blowing the horn of the taxicab he was driving. Davila approached Williams' cab, opened the door and leaned inside of the car. Williams began to drive off while Davila was still in the car, forcing him to run alongside the cab for 15 feet, causing injuries. Williams was charged with misdemeanor battery as a result of his actions, and following a 1997 jury trial, was convicted and sentenced to community service and probation.

On May 12, 1998, Davila filed a civil complaint naming Williams and Williams' employer, Yellow Cab Company, as defendants. The complaint, which alleged that Williams was the agent and servant of Yellow Cab, contained counts for negligence and negligent entrustment. Both Yellow Cab and Williams were insured by American Country Insurance Company ("American Country"). At the time of the incident, American Country and Yellow Cab were both subsidiaries of a company known as Great Dane Holdings. American Country undertook the defense in this case, naming two different firms to represent Williams and Yellow Cab. Prior to retaining counsel, American Country sent Williams a letter reserving its rights under the terms and conditions of his policy. Specifically, it stated that Williams had been cited with criminal battery, and that battery and intentional conduct were expressly excluded by Williams' insurance policy.

After the case proceeded, Williams authored an affidavit in which he alleged the defense provided by American Country was inadequate and represented a conflict of interest. Specifically, he stated that the attorney appointed by American Country failed to conduct discovery adequate to assist in his defense. He alleged he had previously complained about the inadequacy to American Country and requested appointment of alternate counsel. He alleged his request had been denied.

On October 1, 1999, Williams filed a declaratory judgment action against American Country. Count I alleged that American Country failed to warn Williams of an actual or potential conflict of interest in defending the underlying action. Williams further alleged that there was a conflict of interest in that proof of intentional conduct on his part would shift responsibility from American Country to himself. Count II alleged that American Country

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Insurers asked to defend multiple parties in one action must carefully analyze whether or not a conflict of interest exists that would require the retention of independent counsel. Situations involving conflicts of interest could prove costly, as shown by this Illinois holding. A conflict exists if, in comparing the allegations of the complaint to the terms of the policy, the insurer's interests would be furthered by providing a less than vigorous defense.

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breached its duty to defend through numerous acts and omissions. Davila was granted leave to intervene in Williams' action.

The parties filed cross-motions for summary judgment. Williams alleged that his battery conviction created a coverage defense, therefore presenting a conflict of interest. In support, he stated that neither American Country nor the appointed counsel informed him of a conflict of interest in such representation, and that he did not consent to such representation. American Country maintained that Illinois law has recognized that a conflict of interest arises out of the intentional acts exclusion of an insurance policy only where the underlying complaint alleged both negligence and battery and where punitive damages are sought.

The trial court granted American Country's motion for summary judgment and Davila appealed. The court of appeals affirmed the trial court's determination in part and vacated in part, remanding the case to the trial court to determine whether a conflict of interest was present and whether Williams was prejudiced by American Country's failure to pay for independent counsel to represent Williams.

On remand, the trial court found that American Country had a conflict of interest when it assumed Williams' defense in the underlying case and that Williams was prejudiced as a result of the conflict. Granting Williams' motion for summary judgment, the trial court ordered American Country to provide independent counsel to Williams at American Country's expense, and held that American Country was estopped from asserting any coverage defenses in the underlying action. After a hearing for attorney fees and costs, the trial court entered judgment against American Country in the amount of $150,000, which included $125,000 for attorneys fees incurred in both the underlying tort action and the declaratory judgment action and $25,000 as penalty for vexatious conduct. American Country appealed both judgments.

In its analysis, the court of appeals stated that an insurer is obligated to defend a suit against an insured where the complaint contains allegations that bring the claim actually or potentially within the policy. As an exception, when there is a conflict of interest between an insurer and the insured, the insurer must decline to defend and pay the costs of independent counsel for the insured. In determining whether or not a conflict exists, the insured must compare the allegations of the complaint to the terms of the policy. If the insurer's interest would be furthered by providing a less than vigorous defense to the allegations, then independent counsel is needed.

In affirming the trial court's holding, the court of appeals held that a conflict of interest did in fact exist. The defenses of Williams and Yellow Cab in the underlying action were diametrically opposed, in that it was in the best interests of Williams to argue that he was Yellow Cab's agent, which would spread the liability for his intentional conduct to Yellow Cab under the Doctrine of Respondeat Superior. However, it was in Yellow Cab's interest to place the liability on Williams by arguing he was not an agent or employee of Yellow Cab. Thus American Country was presented with an ethical conflict where it could not choose a defense strategy in the underlying action without harming either Williams or Yellow Cab. In addition, the court found that American Country failed to disclose the conflict of interest to Williams. Williams was prejudiced during the nearly three-year period American Country maintained control of his defense because American Country had the opportunity to "mold" discovery on its behalf.

The court of appeals also upheld the trial court's award of attorney fees, holding that there was no abuse of discretion in finding that American Country's conduct was vexatious and unreasonable.

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We welcome your questions and comments.

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