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Illinois Second District Court of Appeals Addresses Settlement and the Duty to Defend in Illinois

Swedish American Hospital and Sari Ins. Co. v. Illinois State Medical Inter-Insurance Exchange, 916 N.E.2d 80 (Ill. App. Ct. 2009)

This case of first impression in Illinois considered the inter-play between a professional liability insurance policy's "no-action" and settlement consent provisions and the insurer's good-faith duty to settle. In rendering its decision, the Second District Court of Appeals ruled in *Swedish American Hospital and Sari Ins. Co. v. Illinois State Medical Inter-Insurance Exchange,* 916 N.E.2d 80 (Ill. App. Ct. 2009) that breach of the good-faith duty to settle will be considered a breach of an insurer's duty to defend.

In 1993, Dr. Hecht performed a cardiac biopsy on an infant at Swedish American Hospital ("Swedish") which allegedly resulted in spastic quadriparesis. In 1995, the infant's parents filed a negligence suit against Dr. Hecht and Swedish for these injuries. The suit was tendered to Illinois State Medical Inter-Insurance Exchange ("ISMIE"), which accepted and defended Dr. Hecht without a reservation of rights. The ISMIE policy provided $1 million in coverage. Swedish was self-insured for $1.5 million and Sari Insurance Co. ("Sari") provided $25 million in excess coverage to Swedish and its employees.

After extensive discovery, the case settled for $5 million. However, ISMIE refused to participate in or contribute any amount to the settlement. The settlement was approved by the trial court, and Swedish and Dr. Hecht were dismissed. Dr. Hecht assigned his right to recover the $1 million from ISMIE to Swedish and Sari, leading to the instant lawsuit.

In their action against ISMIE, Swedish and Sari ("Plaintiffs") asserted cause of action for equitable contribution, reimbursement, unjust enrichment and quantum meruit, all premised upon the allegation that ISMIE breached its duty of good faith by failing to contribute to settlement and that the $1 million ISMIE policy (purchased by Swedish for Dr. Hecht) was intended to cover the first $1 million of the hospital's $1.5 self-insured retention.

Following discovery, Plaintiffs filed for summary judgment as to ISMIE's obligation to contribute to the settlement, and ISMIE filed a cross-motion for summary judgment as to why it had no such obligation. In relevant part, ISMIE argued that: (1) Plaintiffs' claim violated a "no-action" provision of the ISMIE policy which stated that no action could be brought against ISMIE until the insured's obligation was determined by either a judgment against the insured after trial or a written agreement between ISMIE, the insured and the claimant; (2) the settlement violated a provision of the ISMIE policy whereby any dispute between the insured and ISMIE regarding whether to settle a claim would be sent to a committee of physician members of ISMIE for a binding decision and, in this case, the committee recommended against settlement; (3) the insured violated the policy by entering into a settlement without the consent of ISMIE; and, (4) because Swedish provided a self-

insured primary limit of $1.5 million, which it would have paid whether ISMIE contributed or not, Swedish was not injured by ISMIE's refusal to settle.

In a one paragraph memorandum, the trial court found that the "no-action" provision was enforceable and, therefore, ISMIE was entitled to summary judgment. The trial court did not explain its decision further and did not discuss the individual causes of action brought by Plaintiffs or the specific defenses asserted by ISMIE (aside from the no-action clause). From this ruling, Plaintiffs appealed.

On appeal, Plaintiffs argued that they were entitled to ISMIE's policy limits based on the principles of equitable contribution, unjust enrichment and quantum meruit. Plaintiffs further argued that the "no-action" clause and settlement consent provisions were unenforceable due to ISMIE's breach of its good faith duty to settle.

Addressing Plaintiffs' equitable claims, the Appellate Court ruled that there was no language in either of the ISMIE or Swedish policies which supported the position that the first $1 million of the hospital's self-insured retention was to be paid by the ISMIE policy and, therefore, summary judgment in favor of ISMIE on the equitable contribution claim was appropriate. Additionally, the Court found that summary judgment was appropriate because in a situation where a specific contract governs the relationship between the parties, neither unjust enrichment or quantum meruit are viable causes of action.

Turning to the central issue in the case - ISMIE's "no-action" provision - the Appellate Court determined that the purpose of such a provision is to protect the insurer from collusive or overly generous or unnecessary settlement by the insured at the expense of the insurer. However, it is unfair to enforce such a clause when the insurer has erroneously refused to perform its obligations under the insurance contract. Regarding ISMIE's fulfillment of its obligations under the contract, the Court, relying on out-of-state decisions,[1] found that while ISMIE initially fulfilled its duty to defend by defending Dr. Hecht without reservation, a breach of the good-faith duty to settle shall be considered a breach of the duty to defend. Accordingly, in order to determine whether the no-action provision was enforceable, it must first be determined whether ISMIE breached its good-faith duty to settle the underlying action against Dr. Hecht.

In assessing an insurer's good-faith duty to settle, the Appellate Court determined that when a settlement offer is being considered, but the potential award is within the policy limits, the insurer still has the right to control the litigation and the insured must wait until after trial in order to sue the insurer for any amount awarded to claimant in excess of the policy limits. However, if the circumstances at the time of settlement establish that the potential loss and proposed settlement greatly exceed the policy limits, the insured need not await the outcome of trial, may proceed to make a prudent settlement without the insurer's consent and then sue the insurer to recover the policy limits. Furthermore, in determining whether there was bad faith on the part of the insurer with regard to settlement, the court will consider factors such as the existence of an offer by the plaintiff to settle within the policy

[1] Rupp v. Transcontinental, No. 2:07-CV-333-7C-PMW (D. Utah, Aug. 6, 2008); Crawford v. Infinity, 139 F.Supp.2d 1226 (D. Wyo. 2001); and Fireman's Fund v. Security Ins., 72 N.J. 63 (1976).

limits, a refusal to negotiate, the advice of defense counsel, the prospect of an adverse verdict, and the potential for damages in excess of the policy limits.

Applying this rationale to the instant matter, the Appellate Court found that the record revealed that ISMIE's claims manager believed that while Dr. Hecht enjoyed a 95% chance of winning at a trial before a jury of doctors, he only had a 50% chance of winning before a jury of laymen. Furthermore, the claims manager stated in her file notes that regardless of whether the case settled or was tried, ISMIE's $1 million was gone either way. Additionally, while the ISMIE physician review committee believed the case should be tried, focus groups conducted by defense counsel all resulted in verdicts against Dr. Hecht at an average award of $20 million. Lastly, the underlying plaintiffs' lowest demand before settlement was $9 million. With these seemingly contradictory facts in the record, the Appellate Court could not determine whether ISMIE should have realized that the probability of an adverse finding on liability was great and the amount of probable damages would greatly exceed the policy limits. Accordingly, the Court found that fact questions existed regarding whether ISMIE breached its good faith duty to settle which had to be resolved by the trier of fact and, as such, the trial court erred in rendering summary judgment in favor of ISMIE regarding the enforceability of the "no-action" provision.

Lastly, the Court found that summary judgment in favor of ISMIE regarding the application of its policy provision whereby any dispute over settlement between the insured and ISMIE had to be resolved by the physician's committee was improper due to the fact that: (1) the record contained so many conflicting opinions within ISMIE as to whether the case should be settled or tried; and, (2) based upon the claims manager's documented opinions regarding Dr. Hecht's exposure to liability, it was not clear that there was a conflict between ISMIE and Dr. Hecht regarding settlement in the first place.

Ultimately, all of Swedish and Sari's equitable claims were terminated. However, the Appellate Court remanded for further proceedings the issues of whether ISMIE breached its duty of good-faith settlement and therefore, voided the "no-action" provision of the policy. The Court further remanded the issue of whether the physician committee review provision to the policy was triggered and breached by Dr. Hecht's settlement without ISMIE's consent.

While it has long been the law in Illinois that an insurer's wrongful refusal to settle can expose the insurer to amounts in excess of the policy limits, the Appellate Court in this action appears to have created new law in Illinois whereby a breach of the good-faith duty to settle may be considered a breach of the insurer's duty to defend and, consequently, waiver of the insurer's coverage defenses.

BENJAMIN F. KLIMEK is an Associate with Hanson Peters Nye. He concentrates his practice in handling complex insurance coverage matters including directors and officers liability, employment practices liability, and errors and omissions. Ben can be reached at 847-277-8128 or via email at benjaminklimek@hpnlaw.com