

Illinois Independent Counsel Rights Not Triggered By General Request for Punitive Damages

The Illinois Appellate Court recently held that a general request for punitive damages in a lawsuit does not create a conflict of interest triggering an insured's right to retain independent counsel. *Bean Products, Inc., v. Scottsdale Ins. Co.*, 2018 WL 522627, at *1 (Ill. App. Jan. 22, 2018).

In *Bean Products*, the insured ("Bean") sought a declaration that its CGL insurer, Scottsdale, was required to reimburse it for the fees charged by independent counsel Bean retained in connection with the defense of an underlying copyright action. In the underlying action, Scottsdale provided a defense for Bean under a limited reservation of rights with respect to punitive damages. Bean retained separate defense counsel throughout the course of the litigation, although Scottsdale appointed counsel to defend Bean.

According to the Illinois Appellate Court, a conflict of interest between an insurer and insured exists under Illinois law if the insurer could further its own interest by providing a less than vigorous defense to the allegations. The court noted that this can occur when an insurer has "the opportunity to shift facts in a way that takes the case outside the scope of policy coverage." *Bean Products*, 2018 WL 522627 at *6. In such cases, the insured would not be required to use the insurer's chosen counsel in its defense and may require the insurer to pay for independent counsel. *Id.*

Relying on *Nandorf, Inc. v. CNA Ins. Co.*, 134 Ill.

App. 3d 134 (1985), Bean asserted that Scottsdale's reservation of rights with respect to punitive damages could have led Scottsdale to provide a less than vigorous defense to the punitive damages claim, causing those damages to fall outside the scope of Scottsdale's coverage. In *Nandorf*, a retail shop owner brought a declaratory judgment action against its insurer to declare the insured's right to independent counsel. In the underlying action, the insurer agreed to defend the insured under a reservation of rights for punitive damages where the punitive damages amounted to \$100,000 and compensatory damages totaled \$5,000. The court held that the insurer's reservation of rights created a conflict of interest because the insurer could satisfy its interest with a substantial punitive damage verdict and a minimal compensatory damages award. 134 Ill. App. 3d at 138.

The *Nandorf* court described the disproportionate damages as unique to the circumstances of the case and cautioned against future application of its holding, stating: "Our finding that a conflict of interest existed in the instant case is not meant to imply that an insured is entitled to independent counsel whenever punitive damages are sought in the underlying action." *Id.* at 140. And the *Scottsdale* court pointed to this language as evidence that the *Nandorf* holding does not trigger a right to independent counsel in all cases involving a punitive damages reservation of rights. "Considering the frequency of general punitive

damages demands in litigation,” the court stated, “such a trigger would eviscerate an insurer’s right to control the defense of its insured.” *Bean Products*, 2018 WL 522627 at *7.

The *Bean Products* court distinguished the remaining cases cited by the plaintiff as involving actual rather than hypothetical conflicts of interest. See *Murphy v. Urso*, 88 Ill. 2d 444, 458 (1981) (conflict existed in insurers’ representation of school van driver and van owner where agency issues dictated differing terms of coverage); *Am. Fam. Mut. Ins. Co. v. W.H.McNaughton builders, Inc.*, 363 Ill. App. 3d 505 (2006) (conflict arose where damages turned on determination of policy inception period).

In contrast, the court held in *Bean Products* that the mere presence of punitive damages in the underlying complaint did not create an actual conflict of interest. The court also found that the open-ended nature of Scottsdale’s reservation did not pose a conflict. The reservation of rights alone, the court held, did not demonstrate a divergence in the interests of the insurer and insured, but only a remote possibility that a conflict could potentially develop.

Given its determination that independent counsel was not warranted, the court found that

the insured voluntarily incurred an expense in hiring separate counsel, without Scottsdale’s consent. Therefore, the policy’s “voluntary payment” provision came into play and Scottsdale was not responsible for that counsel’s fees.

Comment

This ruling provides helpful guidance to insurers and insureds in addressing independent counsel issues under Illinois law when a request for punitive damages results in a reservation of rights to disclaim coverage. The court’s discussion of *Nandorf*, in particular, reinforces an important distinction between the scenario where a punitive damages claim is the driving force, and the more common scenario involving a general punitive damages request. The *Bean Products* court reaffirmed that the latter is insufficient to trigger a right to independent counsel.

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