2016 IL App (1st) 150810-U

Nos. 1-15-0810, 1-15-0942 cons.

Fourth Division
June 30, 2016

IN THE

APPELLATE COURT OF ILLINOIS

FIRST DISTRICT

WEST BEND MUTUAL INSURANCE COMPANY, For Itself and as Assignee of National Union Fire Insurance Company of Pittsburgh, PA, Plaintiff-Appellant, v. ZURICH AMERICAN INSURANCE COMPANY, Defendant-Appellee	)	Appeal from the Circuit Court of Cook County. No. 14 CH 3770 Honorable Neil H. Cohen, Judge, presiding.

JUSTICE COBBS delivered the judgment of the court.
Presiding Justice McBride and Justice Ellis concurred in the judgment.

O R D E R

¶ 1 *Held*: Any duty to settle owed by a lower-tiered excess insurer to higher-tiered excess insurers was not implicated where the higher-tiered insurers did not allege that there was a reasonable probability of damages above lower-tiered insurer's policy limits. Trial court's dismissal of claims was therefore proper.

¶ 2 West Bend Mutual Insurance Company (West Bend) filed an action for declaratory judgment in the circuit court of Cook County seeking a resolution of matters regarding coverage by several insurers for an accident involving two plaintiffs. In its complaint, West

Bend, a higher-tiered excess insurer, alleged that Zurich American Insurance Company (Zurich), a lower-tiered excess insurer, was negligent and acted in bad faith during settlement negotiations. National Union Fire Insurance Company of Pittsburgh, PA (National Union), another higher-tiered excess insurer, filed a cross-claim alleging similar counts against Zurich. The circuit court dismissed West Bend's and National Union's claims. On review, West Bend, for itself and as assignee of National Union, raises issues regarding (1) whether a lower-tiered excess insurer owes a direct duty to a higher-tiered excess insurer to participate in meaningful settlement negotiations and (2) whether it or National Union sufficiently pled facts alleging that Zurich owed the other insurers a duty to settle. We affirm.

¶ 3 BACKGROUND

¶ 4 As a consequence of the trial court's disposition of the case, the facts available from the record come primarily from the pleadings.

¶ 5 Herman Calloway, Sr., and Herman Calloway, Jr., were working in a trench on a construction site on June 6, 2005, when the walls of the trench collapsed. Calloway Sr. was killed and Calloway Jr. was injured. At the time of the accident, the Calloways were employees of a construction company subcontracted to Dupage Top Soil, Inc. (Dupage). Bovis Lend Lease, Inc., (Bovis) was the construction manager of the project.

¶ 6 Insurance Policies

¶ 7 Four insurance policies were implicated by the accident and are relevant to the current appeal. Dupage held two policies with West Bend, both of which covered Bovis as an additional insured. The first policy (West Bend liability policy) was a commercial general

liability policy with a limit of $1 million. The second policy (West Bend umbrella policy) was an umbrella policy with a $4 million limit as applicable to Bovis.[1]

¶ 8 In addition to the insurance policies procured by Dupage, two additional policies listed Bovis as the named insured. Zurich issued a general liability policy (Zurich policy) to Bovis with a $2 million limit. By its terms, the Zurich policy operated as an excess policy whenever Bovis was named as an additional insured on another policy, as in this case. Where the policy operated as an excess policy, it did not create a duty to defend. The final applicable policy, issued by National Union (National Union policy), was an umbrella policy providing a $25 million limit.

¶ 9 The parties do not dispute that the four policies provided Bovis an aggregate $32 million in coverage, exhausting each policy's limits in the following order: (1) the West Bend liability policy, (2) the Zurich policy, (3) the West Bend umbrella policy, and (4) the National Union policy.

¶ 10 Underlying Litigation

¶ 11 Calloway Jr. and the Special Administrator of the Estate of Herman Calloway, Sr., (Estate) each filed lawsuits alleging that the accident was caused by the negligence of Bovis and the lawsuits were consolidated for trial. Bovis tendered the claims to West Bend and the company began to defend Bovis pursuant to the West Bend liability policy. In preparation for mediation, defense counsel procured by West Bend provided Bovis, Zurich, and West Bend with an evaluation of the lawsuits' claims. Counsel opined that a jury would likely find Bovis liable for the accident. He estimated the "gross value" of the Estate's claim was between $200,000 and $300,000, with comparative fault of 40 to 50%. He estimated the gross value

[1] The West Bend umbrella policy had a total limit of $9 million; however, the trial court determined that the policy's terms provided only a $4 million limit in covering Bovis. Neither party appeals that ruling.

of Calloway Jr.'s claim to be between $2.5 million and $3 million, with comparative fault of 15 to 30%.

¶ 12 At mediation, West Bend indicated that it was willing to offer its $1 million policy limit on the West Bend liability policy to settle the claim. Zurich did not make any settlement offers and refused to negotiate. During a subsequent pre-trial conference, the trial court recommended that the parties settle the Calloway Jr. claim for $4 million. Calloway Jr.'s counsel indicated that he would accept such an offer, but Zurich did not make any offer.

¶ 13 The consolidated lawsuits advanced to trial and a jury found Bovis liable on both claims. It awarded approximately $8.59 million in damages to Calloway Jr. and $2 million in damages to the Estate. The Estate's damages were reduced to $1.2 million based upon the jury finding Calloway Sr. to be 49% at fault in the accident. Following the verdict, Zurich tendered its $2 million limit towards payment. After unsuccessful settlement negotiations, West Bend directed that the judgments be appealed. This court affirmed the judgments. *Calloway v. Bovis Lend Lease, Inc.*, 2013 IL App (1st) 112746. Following the appeal, West Bend settled the Calloway Jr. claim for an undisclosed amount which exhausted both the West Bend liability policy limits and the Zurich policy limits and a portion of the West Bend umbrella policy limit. Subsequently, West Bend settled the Estate's claim for approximately $1.2 million utilizing funds from the West Bend umbrella policy.

¶ 14 The Declaratory Action

¶ 15 On March 5, 2014, West Bend filed a complaint for declaratory judgment against Zurich and National Union. It alleged, *inter alia*, that Zurich owed West Bend a duty to participate in settlement negotiations and its refusal to negotiate was negligent and in bad faith. Zurich filed a motion to dismiss the complaint pursuant to section 2-615 of the Code of Civil

Procedure ("Code"). 735 ILCS 5/2-615 (West 2012). The trial court ruled that Illinois law does not recognize a duty to settle between insurers and dismissed the complaint.

¶ 16 West Bend filed an amended complaint repeating the dismissed counts and adding equitable subrogation claims alleging negligence and bad faith. National Union filed a cross-claim against Zurich, asserting equitable and contractual subrogation claims based upon Zurich's failure to participate in settlement negotiations. Zurich filed separate motions to dismiss West Bend's and National Union's claims. The trial court granted Zurich's motions and West Bend and National Union both filed notices of appeal. After this court consolidated the two appeals, West Bend and National Union entered into a settlement agreement regarding the claims between them. As part of the agreement, National Union assigned its claims against Zurich to West Bend.

¶ 17 ANALYSIS

¶ 18 West Bend contends on appeal that the trial court erred in dismissing both its and National Union's claims because the parties' pleadings sufficiently alleged that Zurich had a duty to participate in settlement negotiations in good faith. It argues both that Zurich owed a duty to Bovis, which West Bend and National Union[2] may now claim under a theory of equitable subrogation, and that Zurich owed a direct duty to West Bend. It asserts that its complaint and National Union's cross-claim both adequately alleged: (1) that control over the settlement negotiations passed to Zurich upon West Bend's offer to tender its policy limit on the West Bend liability policy and (2) that Zurich unreasonably refused to negotiate despite a likely finding of liability resulting in damages in excess of its policy limit.

[2] Unlike West Bend, National Union did not raise a theory of a direct duty in its cross-claim.

¶ 19 Zurich responds that Illinois does not recognize a direct duty to settle between excess insurers. It further argues that West Bend's and National Union's claims under equitable subrogation must also fail because no duty could arise where (1) Zurich did not have control over the underlying suit's litigation and settlement; (2) there was no demand made for a settlement within the combined limits of the West Bend liability policy and Zurich policy limits; and (3) the alleged potential damages were below those limits.

¶ 20 West Bend's complaint and National Union's cross-claims were dismissed pursuant to section 2-615 of the Code. 735 ILCS 5/2-615 (West 2012). A section 2-615 motion tests "whether the allegations of the complaint, when taken as true and viewed in a light most favorable to the plaintiff, are sufficient to state a cause of action upon which relief can be granted." *Cowper v. Nyberg*, 2015 IL 117811, ¶ 12. In making its determination, the circuit court should consider the facts apparent from the face of the pleadings, as well as any attached exhibits. *Haddick v. Valor Insurance*, 198 Ill. 2d 409, 414 (2001). The court may not dismiss a cause of action under section 2-615 unless "no set of facts can be proved that would entitle the plaintiff to recovery." *Cowper*, 2015 IL 117811, ¶ 12. We review a section 2-615 dismissal *de novo*. *Id.*

¶ 21 Illinois courts have long recognized an insurer's duty, owed to the insured, to respond to settlement offers in good faith. See *Krutsinger v. Illinois Casualty Co.*, 10 Ill. 2d 518, 527 (1957); see also *Haddick*, 198 Ill. 2d at 414. Where the insurer breaches this duty, it may be liable for the entire judgment against the insured, regardless of policy limits. *Haddick*, 198 Ill. 2d at 414. Our supreme court has noted, however, that the duty does not generally require an insurer to initiate a settlement negotiation and "does not arise until a third party demands settlement within policy limits." *Id.* at 417.

¶ 22 Some appellate court rulings have extended the duty to settle beyond the insurer-insured relationship.[3] In *Schal Bovis, Inc., v. Casualty Insurance Co.*, 314 Ill. App. 3d 562 (1999), the First District of the appellate court held that an excess insurer could bring a duty to settle claim against a primary insurer based on equitable subrogation principles. *Id.* at 571. The *Schal* court also noted, "[E]ven absent subrogation principles, we find that there is a duty which runs from [the primary insurers] to [the excess insurer] to act reasonably and in good faith in attempting to settle claims within their respective policy limits." *Id.* at 571-72. By contrast, in a subsequent First District case, the court ruled that "Illinois does not impose a duty by the primary insurer to the excess carrier." *U.S. Fire Insurance Co. v. Zurich Insurance Company*, 329 Ill. App. 3d 987, 1003 (2002). While the court in *U.S. Fire Insurance Co.* did not disagree with *Schal*'s reasoning as it related to equitable subrogation, it declared, with little discussion, that *Schal* did not hold that a direct duty existed, but merely "predicted" in dicta that such a duty would eventually be recognized. *Id.* at 1002-03. Further complicating matters, the Fifth District later relied upon *Schal* in holding that a direct duty to settle could attach between two excess insurers. *Central Illinois Public Service Co. v. Agricultural Insurance Co.*, 378 Ill. App. 3d 728, 734-36 (2008). In that case, the court ruled that a lower-tiered excess insurer could owe a duty to settle to a higher-tiered excess insurer if the lower-tier insurer gained "control over the litigation." *Id.* at 735. We find it unnecessary, however, to resolve the apparent conflict regarding a direct duty to settle for the reasons that follow.

¶ 23 Regardless of whether West Bend's claims arise under a theory of a direct duty or equitable subrogation, they are derived from the underlying precedent and rationale regarding

[3] We note that both parties extensively cite to federal court cases interpreting Illinois law in their briefs. As we find that Illinois case law exists sufficient to address the claims at issue, we need not look to other jurisdictions for guidance. *Graham v. Commonwealth Edison Co.*, 318 Ill. App. 3d 736, 744 (2000).

the duty to settle between an insurer and an insured. Accordingly, any such claim would be governed by the same principles and elements as a claim between the insurer and the insured. The duty to settle is based on an "insurer's exclusive control over settlement negotiations and defense of litigation." *Haddick*, 198 Ill. 2d at 414. The insurer's complete control of the litigation can lead to misaligned incentives in cases of settlement. See *Cramer v. Insurance Exchange Agency*, 174 Ill. 2d 513, 524 (1996). For example, where it is likely that a third-party's claims will result in damages far exceeding an insurer's policy limits, there is little incentive for the insurer to offer its policy limits in settlement as it stands to lose the same amount whether through settlement or verdict. In such a situation the insured would surely prefer a settlement as he or she bears the bulk of the risk that an award will exceed the policy limits. Because of this imbalance, an insurer is required to give the insured's interests equal consideration alongside its own. *Adduci v. Vigilant Insurance Co.*, 98 Ill. App. 3d 472, 475 (1981); see also *Haddick*, 198 Ill. 2d at 416. Conversely, the consideration of the insured's interests is less relevant where the potential damages do not exceed policy limits. *Haddick*, 198 Ill. 2d at 416. For this reason, the duty of an insurer is not implicated unless there is a reasonable probability of damages in excess of policy limits which will expose the insured. *Central Illinois Public Service*, 378 Ill. App. 3d at 737 (citing *Haddick*, 198 Ill. 2d at 417).

¶ 24 Taking the factual allegations in West Bend's complaint and National Union's cross-claim to be true, both pleadings failed to sufficiently allege that there was a reasonable probability of potential damages being awarded in excess of the combined limits of both the West Bend liability policy and the Zurich policy. Given the asserted policy limits, damages would have had to exceed $3 million before West Bend's excess policy would have been exposed and $7 million before Nation Union's policy was exposed. West Bend's complaint alleged that its

attorney had evaluated the Estate's claim at a gross value of between $200,000 and $300,000, with 40 to 50% comparative fault. Thus, the estimated potential damages in the Estate's claim were between $100,000 and $180,000. The attorney estimated Calloway Jr.'s claim as having a gross value of $2.5 million to $3 million, with comparative fault of 15 to 30%. The estimated likely damages in Calloway Jr.'s claim were therefore between $1.75 million and $2.55 million. The aggregate likely damages in both claims were therefore between $1.85 million and $2.73 million, well within the $3 million combined limit of the West Bend liability and Zurich policies. Accordingly, based on the pleadings, neither West Bend nor National Union adequately asserted that there was a reasonable probability of damages in excess of the relevant policy limits. Without such an assertion, the pleadings failed to sufficiently allege that any duty to settle was implicated.

¶ 25 Additionally, we need not determine whether Zurich had sufficient control of the settlement proceedings, nor whether a settlement demand within policy limits is required to establish a duty. Even if we accept West Bend's arguments on these issues, the duty to settle would not be implicated in the current case as the asserted likely damages did not threaten to expose West Bend's or National Union's excess policies. Accordingly, the trial court did not err in dismissing West Bend's and National Union's claims.

¶ 26 CONCLUSION

¶ 27 For the foregoing reasons, the judgment of the circuit court of Cook County is affirmed.

¶ 28 Affirmed.