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INSURANCE LAW BLOG

September 29, 2020

Illinois Federal Court Applies Insurer-Friendly "Mutual Exclusive Theories" Test To Independent Counsel Analysis

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Insureds often request independent counsel when insurers agree to provide a defense subject to a reservation of rights, pursuant to which an insurer takes the position that certain damages may not be indemnifiable. Requests for independent counsel are often rooted in fear that a defense attorney who has a relationship with the insurer may be incentivized to defend the insured in a way that maximizes the potential for the insurer to succeed on its coverage defenses. As explained by the Illinois Supreme Court in *Maryland Cas. Co. v. Peppers*, 355 N.E.2d 24 (Ill. 1976), when a conflict of interest arises between an insurer and its insured, the attorney appointed by the insurer is faced with serious ethical questions and the insured is entitled to its own attorney.

Illinois courts generally follow the rule that an insured is entitled to independent counsel upon a showing of an actual conflict. In *Builders Concrete Servs., LLC v. Westfield Nat'l Ins. Co.*, No. 19 C 7792, 2020 WL 5518474 (N.D. Ill. Sept. 14, 2020), the U.S. District Court for the Northern District of Illinois recently addressed a dispute between an insurer and its insured about independent counsel.

Westfield insured Builders Concrete Services (BCS). Focus Construction hired BCS as a subcontractor to perform concrete work on a new apartment building. BCS' work included pouring concrete for structural columns, one of which buckled and failed. BCS sued Focus Construction for withholding payment, and Focus Construction counter-sued for breach of contract and negligence relating to BCS' alleged faulty work that caused the column to fall. Focus Construction's counterclaim alleged that the column failure damaged other parts of the building on which Builders did not perform work.

Westfield and BCS did not dispute that the business risk exclusions leave damage to BCS' own work less likely than damage to other parts of the building to be covered by the Westfield Policy. While Westfield agreed to defend BCS under a reservation of rights, it refused to provide BCS with independent counsel. In the declaratory judgement lawsuit filed by BCS, the court was tasked with determining whether an actual conflict of interest existed such that BCS would be entitled to independent counsel paid for by Westfield.

The court cited as precedent *Nat'l Cas. Co. v. Forge Indus. Staffing Inc.*, 567 F.3d 871 (7th Cir. 2009), which applied a "mutually exclusive theories" standard for evaluating conflicts of interest. Specifically, according to the *Forge* court, conflict counsel must be appointed when the underlying complaint contains two mutually exclusive theories of liability, one which the policy covers and one which the policy excludes. The Northern District acknowledged that the *Forge* test is a "demanding standard, requiring the insured to show how the insurer, by making strategic choices in conducting the defense, could avoid any responsibility to pay the underlying judgment by shifting all losses to uncovered categories."

The Northern District concluded that, if different results in the underlying litigation affect only the relative responsibility of the insurer and the insured for the judgment without eliminating coverage completely and irreparably, the insurer retains the right to control the defense. Westfield's chosen counsel could seek only to diminish Westfield's responsibility to indemnify BCS for a judgment on Focus's counterclaims, not to eliminate it entirely, such that Westfield was entitled to control the defense.

The "mutual exclusive theory" test is a bright-line analysis beneficial to insurers because it limits independent counsel only to those cases where an insurer can disclaim owing a duty to indemnify an insured for the entirety of a judgment. The *Builders Concrete Services* decision acknowledges, however, that an actual conflict of interest can still exist where covered damages are likely to exceed policy limits, though the Northern District cautioned that courts should not predict that a conflict will arise "based solely on the pleadings."