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Illinois Federal Court Addresses Insured's Duties to Umbrella Carrier for Case Handled by Insured Within Self-Insured Retention

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In *North American Elite Insurance Company v. Menard, Inc.*, 2020 WL 5810411 (N.D. Ill. Sept. 30, 2020), the U.S. District Court for the Northern District of Illinois examined duties owed by an insured to its umbrella insurer to settle a lawsuit in good faith for an amount within the insured's self-insured retention ("SIR").

North American Elite Insurance Company ("NAE") issued a commercial umbrella liability policy to Menard with liability limits of $25 million. In order to implicate NAE's coverage, Menard was required to exhaust its SIR of $2 million along with a $1 million excess policy issued by Greenwich. The NAE policy provided that Menard must "cooperate with [NAE] in the investigation or settlement of the claim or defense against the 'suit.'" The NAE Policy also gave NAE the "right and duty to defend [Menard]" in suits for bodily injury, property damage, or personal and advertising injury when the underlying insurance has "been exhausted by payment of loss."

In 2016, a plaintiff sued Menard for negligence based on an incident that occurred at a Menard store. Menard controlled the entirety of its defense within its SIR. Before trial, the plaintiff made a $1.985 million demand to settle. Menard never responded to the offer. NAE wrote to Menard to demand that it accept the offer, but Menard refused. During trial, Menard agreed to settle with the plaintiff for $6 million, and Menard requested that NAE fund the settlement amount exceeding $3 million. NAE initially protested based on Menard's unreasonable and bad faith failure to settle within the SIR. However, NAE ultimately agreed to pay the amount requested based on the contingency that NAE would retain all rights to seek reimbursement from Menard.

NAE then filed suit against Menard for breach of contract and breach of the duty to settle. It also sought a declaratory judgment stating that it did not owe a duty to indemnify Menard or pay any part of the $6 million settlement. Menard moved for the court to dismiss all three claims.

NAE first argued that Menard owed NAE an express duty to "exercise utmost good faith, diligence and prudence to settle all claims and suits within the Self-Insured Retention." However, the court pointed out that this express term is never mentioned in the NAE policy, but rather only in Menard's underlying policy with Greenwich. Since the NAE policy did not incorporate the terms of the Greenwich policy, Menard had no express duty of good faith as to NAE.

NAE next argued that because the policy did not contemplate settlements, an implied duty of good faith to settle disputes should be included into the contract as a gap-filler. Under Illinois law, "a covenant of fair dealing and good faith is implied into every contract absent express disavowal." *Reger Dev., LLC v. Nat'l City Bank*, 592 F.3d 759, 764 (7th Cir. 2010). NAE argued, if there was no express term in the contract that would override this implied duty, then principles of good faith would apply. The court determined that the NAE policy lacked terms that would override this implied duty, such that NAE's claim against Menard could not be dismissed on this ground. The court emphasized that because Menard exercised discretion in settling the underlying suit, the duty would apply to Menard.

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Lastly, the court analyzed NAE's claim that a party owes its excess carrier a good-faith duty to settle. NAE argued that because an insurer has a duty to settle in good faith on behalf of its policyholder, a policyholder should owe the same duty to its insurer. The court declined to impose this duty, emphasizing that this was a novel state law claim best left to Illinois state courts. The court was also hesitant to expand the policyholder's duties and potential liability due to the reluctance of Illinois state courts and the Seventh Circuit to do so.

Although the court declined to find that policyholders owe an inherent duty to settle as to its excess carriers, the court left open the possibility that a contractual implied duty of good faith could subject a policyholder to liability to its excess carrier for failing to settle a claim within the policyholder's SIR. The court, however, explained that the implied duty of good faith to settle would not be imposed when the policy expressly denies such a duty. If the parties contracted for their respective rights in the settlement process, the court says, there may be an argument against imposing the implied duty.

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