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KD Alert: Illinois Legislature Considers Codification of the Independent Counsel Doctrine in Illinois

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A policyholder's right to independent counsel on a duty to defend policy in Illinois is presently governed by the so-called "Peppers counsel" rule, named after the Illinois Supreme Court's decision in Maryland Casualty Company v. Peppers, 64 Ill.2d 187 (1976). Peppers holds that an insurer must allow a policyholder independent choice of counsel on a duty to defend policy when there is an "actual" conflict. This common law standard and its implications, including what counsel rates should be deemed covered and the extent of an insurer's right to remain involved in the defense, is frequently a source of dispute between policyholders and their insurers.

Illinois Senate Bill No. 1296, sponsored by Senator John G. Mulroe, is titled the "Insured's Independent Counsel Act" (the "proposed Act"). The proposed Act would codify the circumstances under which independent counsel is required, how such counsel is selected, and how the defense is conducted and paid for thereafter.

The proposed Act first provides that independent counsel is required only when a "significant and actual conflict of interest" arises. The proposed Act adds the requirement of a "significant" and actual conflict whereas Peppers requires only an "actual" conflict, and the Act further provides that a "significant and actual conflict of interest" does not include:

1. *claims or facts in a civil action for which the insurer denies coverage;*
2. *the mere issuance of a reservation of rights letter by the insurer;*
3. *a claim of damages in excess of the policy limits;*
4. *a claim of punitive damages; or*
5. *any other conflict that is not significant and actual.*

The proposed Act would thereby specifically eliminate some of the familiar arguments raised by policyholders to force their selection of counsel upon an insurer, by confirming a reservation of rights or partial denial does not, in itself, create a conflict, and nor does a claim for punitive damages. By way of example, Nandorf, Inc. v. CNA Ins. Co., 134 Ill. App. 3d 134, 479 N.E.2d 988 (1st Dist. 1985), holds under the present "actual conflict" standard, that where a claim for punitive damages is disproportionately greater than a claim for compensatory damages, it may create a conflict of interest requiring independent counsel.

The proposed Act would also codify the process by which independent counsel is selected, requiring the policyholder to choose from one of three firms proposed by the insurer that are not otherwise on the insurer's panel, thereby ensuring independence, but imposes requirements concerning the experience level of and reporting from counsel to the insurer, and allows the insurer to pay its normal rates for similar matters.

Although arguably tangential to the issue of independent counsel, the proposed Act would allow an insurer on a duty to defend policy to properly deny coverage for defense costs incurred on those allegations in a suit that are not covered, and only pay for those fees incurred on allegations for which it accepts coverage or reserves rights. Presently, an insurer on a duty to defend policy in Illinois must defend an entire lawsuit if any allegations trigger coverage, without any right to allocation or recovery unless specifically contracted between the parties.

As it stands, the Bill was most recently recommended by the Senate Committee on Judiciary to be passed, and will now by rule be ordered to a second reading in the Senate. Although the Bill has progressed, it is far from passage in either the Senate or the House, and we expect it will receive significant opposition from the policyholder contingent.