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Defending the Insurance Producer: Duties, Proximate Cause Defenses and Avoiding Punitive Damages

Whether the circumstance involves a web of complex liability coverage issues among construction contractors or first-party claims for property losses, a trend in lawsuits continues. Following denial of coverage, policy-holders sue not only the insurer but also the agent or broker for alleged failure to procure proper or adequate coverage. While Illinois law may be clear as to the insurer's available defenses, the insurance producer's duties, defenses and vulnerability to punitive damages is not as settled. This article analyzes the duties of insurance producers to make adequate inquiries into the needs of their clients and to advise clients of available coverage options and limitations. The article also highlights potential proximate cause defenses and provides a practical and updated approach to attacking claims for punitive damages.

I. Insurance Broker Duties in Procuring Insurance

Under Illinois law, an insurance broker has a duty to exercise competence and skill when rendering the service of procuring insurance. The relationship between the insurance broker and his client is fiduciary in nature. Accordingly, an insurance broker is bound to exercise reasonable skill and diligence in procuring a policy according to the client's needs and requirements, and will be responsible to the client for any loss resulting from his failure to do so. However, a broker is not liable if he acts in good faith and with reasonable care, skill and diligence in placing insurance in compliance with his client's instructions.[1]

While these general principles offer a starting point, they provide little practical help in defining the duties an insurance broker owes to an insured in a particular case. This is especially true in cases where the insured sues the broker for failing to recommend certain coverage or to warn of gaps in insurance coverage. It is important to note that while insurance agents and brokers are both considered producers, the insurance broker owes duties to a client that agents do not owe. This article provides a brief survey of case law and offers a practical guide to the nature and scope of an insurance broker's duties to his client.

A. The Duty to Procure a Policy in Compliance with the Client's Instructions

The most basic duty of an insurance broker is to procure a policy in compliance with the instructions of his client. If the broker fails in this basic task, liability will follow. For example, in *Omni Overseas Freighting Co. v. Cardell Ins. Agency,*[2] an insured in the business of handling containerized cargo requested that its broker obtain insurance coverage for any liabilities which it might incur for cargo damage.[3] The broker obtained three policies. The first was a marine liability policy, the second a burglary policy, and the third an inland transit policy. The inland transit policy was subsequently cancelled. Following cancellation, an inland cargo loss occurred while in the insured's possession. Coverage was denied under all three policies, and the insured brought suit against the broker. The appellate court affirmed the judgment against the broker, finding that the procurement of the marine and burglary policies did not provide the coverage requested by the insured. Moreover, while the inland transit policy would have provided the requested coverage, the broker was found negligent for having failed to communicate the cancellation.[4]

B. The Duty to Inquire and Provide Adequate Coverage

Procuring coverage in compliance with an insured's instructions will not always be sufficient for a broker to avoid liability if the broker knows or should know that the coverage requested is inadequate to meet the insured's needs. Thus, we have the often-cited rule that "the broker must inform the insured of all material facts within the broker's knowledge that may affect the transaction or the subject matter of the relationship."[5] In other words, if a broker knows of information regarding the insured's risks, and the insurance requested by the insured is inadequate to protect the insured from those risks, the broker has a duty to inform the insured of the gap in coverage and to recommend additional coverage.

In *Economy Fire & Casualty Co. v. Bassett*, an insured that operated a licensed baby-sitting business out of her home was sued when a child was injured.[6] The insured was covered by a standard homeowner's policy, which excluded losses arising out of the insured's business activities. After the insurer denied coverage, the insured filed suit against her insurance broker alleging that the broker negligently failed to procure an insurance policy covering the babysitting business or, alternatively, breached an oral contract to obtain such insurance.[7]

Although the insured did not specifically request insurance coverage for her babysitting business, the broker knew that her client was operating a babysitting service out of her home when the broker recommended and procured the homeowner's policy. Despite this knowledge, the broker never warned the insured that she may need additional coverage. The broker explained that it did not believe the insured's babysitting service was a "business" under the meaning of the policy. However, the broker also admitted that it never made an inquiry with representatives of the insurance company to determine whether the insured's babysitting services were covered.[8]

The trial court entered judgment in favor of the broker, but the appellate court reversed, finding that the broker had negligently procured a policy that was inadequate for the insured's needs. The appellate court reasoned that the broker "knew or should have known" that the insured might need additional insurance coverage for her babysitting service. In the view of the court, the broker "could easily have ascertained from [the insurer] whether that babysitting service was covered under the policy they had chosen for her."[9] Moreover, the insured "placed [her] insurance needs in the hands" of the broker, but the broker "clearly did not understand or try to understand the product they were selling, and their efforts to ascertain the [insured's] actual insurance needs were virtually nonexistent."[10] Therefore, the court concluded that the broker's action in procuring the policy was "devoid of reasonable care, skill, and diligence required by law."[11]

In dissent, one justice stated that he would have affirmed judgment in favor of the broker because the insured did not specifically request coverage for her babysitting services.[12] In the dissent's view, the majority was expanding the scope of an insurance broker's liability too far by imposing a duty to inquire upon insurance brokers. The dissent explained:

> The basis of this court's decision is to fashion a rule of law that an insurance agent has a duty to explore in depth the potential insurance needs of his clients and to offer to procure insurance to cover potential risks that may be associated with each client, which presumably will be desired. Of course, questions of cost may arise. For instance, assume the standard homeowner's policy excludes coverage for money and valuables, such as furs and jewelry. Does the agent have a duty to review with each principal the kinds of valuables that might be in his home and the cost of related coverage?
>
> We are really imposing a duty to inquire on insurance agents. The potential for liability is extensive. It does not seem to me unreasonable that the principal should have the responsibility to ask if his business activities are covered and to request such coverage if desired.[13]

The duty to inquire regarding a prospective insured's coverage requirements is further articulated in *National Boulevard Bank v. Brokerage Resources, Inc.*[14] The case involved an insured renovating and converting a building into four apartments. The insured retained a broker to procure insurance for the building during reconstruction, and he procured four policies providing fire and extended coverage for the apartments. During renovation, and while the property was vacant, a fire destroyed a substantial portion of building. After an investigation, the insurance companies who had issued the four policies denied coverage on the grounds that the premises were vacant for more than 60 days, in violation of the terms of the policies.[15]

The insured asserted that the broker was negligent in failing to add the proper vacancy endorsement to the fire insurance policies, and that as a result the insurer denied coverage. At trial, the broker testified that he knew the building was undergoing extensive renovation, but denied being told by the insured that the building would be vacant during remodeling and denied any independent knowledge of the building's vacancy. However, the broker never inquired whether the building would be vacant despite acknowledging that such information would be material to the risk.[16]

The court held, as a matter of law, that the broker was negligent because it had failed to procure a vacancy endorsement to the fire insurance policies. In so holding, the court noted that it was immaterial whether the broker actually knew the building was vacant because the broker "had a clear duty learn" of vacancy because it was aware that the building was being renovated and, therefore, vacancy was material to the insurance risk.[17]

C. Limitations on the Duty to Inquire

Key to the findings of liability against the brokers in *Bassett* and *National Boulevard* was their knowledge of information which should have alerted them to a potential gap in coverage. Such information should have prompted further inquiry and, if necessary, either an offer of additional coverage or a warning regarding the gap in coverage. However, those cases did not address the question of whether, as a general matter, an insurance broker has a duty to inquire into his client's insurance needs.

The issue was addressed by the district court for the Northern District of Illinois in *National Union Fire Co. of Pittsburgh, PA v. Pontiac Flying Service*.[18] The case arose out of the crash of an airplane owned by the insured, Pontiac Flying, in which an instructor and student were killed. At the time, Pontiac Flying was insured under a commercial liability policy which provided coverage for "crop dusting," but did not cover flight training. The insurer denied coverage because the plane was being used for training purposes at the time of the crash. Pontiac Flying then sued its insurance broker for the failure to procure flight training insurance.[19]

Pontiac Flying was established through the purchase of the assets of a company named Harold Miller's Flight Service, which included the plane involved in the crash. Harold Miller's Flight Service provided crop dusting and flight training operations. The broker who procured the crop dusting policy for Pontiac Flying insurance was the same broker who had procured insurance for Harold Miller's Flight Service and, therefore, was aware that Harold Miller's Flight Service included flight training.[20] However, when Pontiac Flying contacted the broker about acquiring insurance for the plane, it asked only about crop dusting insurance and did not inquire about flight training insurance or inform the broker that it was providing flight training to the public. The broker procured the crop dusting policy, but in so doing, did not inquire whether Pontiac Flying needed insurance for flight training or warn Pontiac Flying that flight training would not be covered under the crop dusting policy.[21]

Accordingly, the court framed the specific issue in the case as follows: "whether an insurance producer can be held liable for failing to procure insurance when he was never told of the insured's specific requirements but never asked or investigated into the specific needs of the insured."[22] The court answered the question in the negative, and granted summary judgment in favor of the insurance broker.[23] In so holding, the court recognized the often recited rule that a "broker must inform the insured of all material facts *within the broker's knowledge* that may affect the transaction or the subject matter of the relationship."[24] Taking that rule one step further, however, the court concluded that "[t]he implication is that if a fact is not within the broker's knowledge, then no duty is placed on the broker to inform the insured of the consequences of that fact."[25]

The court recognized that some jurisdictions have imposed a duty upon insurance brokers to advise their clients that there are gaps in coverage if they have "a special relationship." The court explained that a special relationship "can be developed through either an agreement or discussions on the subject of the broker advising the client of the client's needs."[26] However, the court found that no such special relationship had been alleged by Pontiac Flying.

The court made two other noteworthy conclusions regarding insurance broker liability. First, the court held that expert testimony cannot be used to establish the standard of care for insurance brokers.[27] Pontiac Flying introduced expert testimony that the broker had an affirmative duty to inquire into additional uses of the plane, *i.e.*, flight training, and advise Pontiac Flying that it needed additional insurance coverage. The court stated:

> The opinion of Pontiac Flying's expert may represent good business practices. Indeed, it might be good business practice for an insurance agent to inquire not just about training but also about other potential uses of a small two-seat plane including sightseeing, transportation, search and rescue, stunt flying and law enforcement. However, the standards for ideal business practices are different than the standards for broker negligence. Indeed, the opinions of Pontiac Flying's expert cannot, on its own, expand the body of law in Illinois governing broker negligence.[28]

Second, the court recognized that the Illinois Insurance Placement Liability Act of 1996, codified at 735 ILCS 5/2-2201, established negligence as the standard of liability for insurance brokers and eliminated broker liability for breach of a fiduciary duty. In the view of the court, this was significant because much of the case law governing insurance broker liability has been decided under standards governing fiduciary relationships, which is much more expansive than the concept of negligence.[29] Although the court ultimately held that a broker did not have a duty to inquire under either standard, in future cases the Act may serve as another basis for limiting an insurance broker's duty to inquire and advise, as *Bassett* and *National Boulevard* were decided before passage of the Act.

D. Limitations on the Duty to Advise

Illinois courts have limited the duties of insurance brokers to advise clients where such advice would, essentially, require a legal opinion as to insurance coverage. In *Industrial Enclosure Corp. v. Glenview Ins. Agency, Inc.*,[30] the insured had a policy providing first party coverage for property damage caused by sewer back-up. However, the policy excluded coverage for damage caused by "flood" or "surface water." The broker and the insured discussed flood coverage on several occasions, but the insured decided to not purchase it. After a severe rain storm, the insured found several feet of standing water in its basement, which caused substantial damage to the equipment stored there. The insurer, while conceding that the storm may have overwhelmed the sewer system, denied coverage on the grounds that the damage was "flood related" and caused by substantial "storm water runoff."[31]

The insured argued that the broker was negligent in failing to recognize and advise the insured that the flood-surface water exclusion in the policy would nullify the sewer back-up coverage. The jury found in favor of the insured, but the trial court entered a judgment notwithstanding the verdict in favor of the broker, which the appellate court affirmed. The court reasoned that there was no evidence that "such a nullification [of coverage] would have been known to an insurance broker exercising the requisite 'competence and skill' the law places on the insurance broker." In the view of the court, the insured was "essentially seek[ing] to impose upon insurance brokers a duty to advise their customers of the import and meaning of the provisions of insurance policies which have previously been faithfully procured according to the customer's requirements."[32] The court held that no such duty exists under Illinois law, and added that the burden is upon the insured to know the import and meaning of insurance contracts it accepts.[33]

E. Conclusion and Practical Advice

The basic duty of an insurance broker is to procure insurance in compliance with the instructions of its client. Therefore, it is imperative for attorneys defending an insurance broker to define the scope of the broker's engagement as narrowly as possible. This is achieved by inquiring about what exactly the client requested of the broker. Often the client will assert that they wanted "full coverage" for the risk in question. However, this position can be made to appear unreasonable by asking whether the insured really believed that it could or wanted to be insured for every imaginable risk, *regardless of cost*, and that the policy would not contain any exclusions. The more sophisticated the insured is, the more unreasonable such a position becomes. Therefore, an attorney defending a broker should also ask questions that establish the sophistication of the insured. Most business owners will admit that they are knowledgeable persons, especially when it comes to their own business. This approach shifts the focus back to the client and its failure to request insurance, and away from the broker and its alleged failure to recommend.

Nevertheless, courts have recognized that insurance brokers are professionals, and not just takers of orders. Brokers will be presumed to have some expertise regarding insurance. Although the level of expertise expected is unclear, it probably is not at the level expected of other professionals such as attorneys, doctors and accountants. Therefore, if the broker procures a policy that fails to cover the very risk the client's activities expose it to, liability is likely even where there is no specific request for coverage by the client. If the question of coverage is complex, or the broker lacked knowledge of the risk causing the loss, a motion for summary judgment asserting a lack of duty by the broker to advise the insured or recommend additional coverage may be successful.

II. Proximate Cause Issues in Defending Insurance Producers When Insurer Denies Coverage

Illinois law is clear that the primary function of an insurance producer is to faithfully negotiate and procure an insurance policy according to the wishes and requirements of his client.[34] Should a producer act in good faith and with reasonable skill and diligence in compliance with his principal's instructions, he will not be liable for a loss that turns out be uninsured.[35] Consequently, where an insurance producer fails to procure an insurance policy per his client's direction, he becomes liable for any damages that would have been covered had the requested policy been obtained.[36] However, this article deals with the situations where the insurance producer has procured the policy requested, and the insurance carrier then denies the claim relying on a policy exclusion or defense. In these situations, there are a variety of defenses and strategies available to the producer, specifically addressing the issue of proximate cause and whether the producer's conduct had any relationship to the policy denial.

A. The Conditional Nature of an Insurance Producer's Liability

Several recent Illinois appellate opinions have addressed this proximate cause issue. The court in *Industrial Enclosure Corp. v. Glenview Ins. Agency, Inc.*,[37] considered the situation where a manufacturer of industrial boxes, IEC, sought coverage for its business through its insurance producer, Glenview. Glenview obtained a quote for coverage from Maryland Insurance, which IEC accepted. Shortly after the inception of the Maryland policy, IEC's facilities experienced 17 inches of rainfall. When the IEC facility flooded, IEC sought coverage for the damage under the Maryland policy. Maryland denied coverage because its adjuster examined the site and determined that the damage was not caused by backup of sewers or drains, which was covered under the policy, but by surface water flooding or general flooding, which was not covered.

IEC eventually sued Glenview for breach of contract and negligence due to the denial of coverage. IEC claimed that it had requested coverage for sewer backup and runoff, but Glenview failed to provide a policy that was sufficiently specific in that regard, thereby giving Maryland a basis for denying coverage. The court found, however, that Maryland's denial was due to the fact that Maryland's adjuster characterized the damages as due to flooding rather than sewer backup, not because the policy was lacking in specificity.[38] In fact, the court held that Glenview had provided IEC with exactly the coverage it had requested—sewer backup and runoff—but that Maryland's characterization of the damage as flooding triggered the application of the policy's flooding exclusion, which had nothing to do with the portion of the policy that IEC claimed was lacking in specificity. Thus, Maryland's denial did not hinge at all on the alleged lack of precision in the Maryland policy language.[39] Because of this, and because IEC had repeatedly rejected policy proposals from Glenview that included flooding coverage, the court held that Glenview had not committed a breach of duty to IEC (either under contract law or the law of negligence) because Glenview had done exactly what IEC had asked it to do.[40]

The *Glenview* court considered whether acts or omissions of the defendant agency proximately caused any damages to IEC. The court correctly found that the basis of the denial by Maryland had nothing to do with lack of specificity of the policy language, but rather with how the Maryland adjuster characterized the loss. Moreover, Maryland was unsuccessful in its declaratory judgment action seeking to enforce the flooding exclusion, and was required to pay the damages suffered by IEC.

The Supreme Court of Illinois also addressed the potential liabilities of an insurance producer in a coverage denial situation when the court, on its own motion, found a third-party action against an insurance producer moot in *Country Mutual Ins. Co. v. Carr*.[41] The appeal involved a third-party action filed on behalf of Steve Carr, d/b/a Carr Construction, against his insurance producer, Harold Vogelzang, who was an authorized agent for Country Mutual. Country Mutual filed a declaratory judgment action seeking a determination that it was not obligated to defend or indemnify Carr for an action for damages brought against him and his subcontractors by a homeowner. Carr then filed a third-party action against Vogelzang, contending that Vogelzang owed him a duty to exercise ordinary care and skill in procuring his insurance and that if Country Mutual was correct that there was no coverage under the policy at issue, then Vogelzang should be required to compensate him for any damages, including costs of defense, that he would incur in the action brought by the homeowner.[42]

The court found that the underlying case against Carr had been settled, with Carr getting a complete release and not being required to pay any damages to the underlying plaintiff. Moreover, it correctly found that the third-party action was clearly conditional in nature. Thus, Carr could not recover from Vogelzang unless: (1) Carr was found liable to the underlying plaintiff requiring the payment of damages; or (2) Country Mutual had no duty to defend Carr against the claims asserted against him by the underlying plaintiff.[43]

Because the underlying case was settled with the homeowner, and no damages were paid on behalf of Carr, Country Mutual's duty to indemnify was not triggered, and Vogelzang could not be held liable for failing to provide Carr an insurance policy which would have indemnified him for the claim. The court also found the second condition to be absent, as the appellate court had already rejected Country Mutual's policy defense, and because the law provides that "an insurer is obligated to defend its insured even if the allegations are groundless, false or fraudulent."[44] Country Mutual was held to have a duty to defend Carr, and thus Carr had no cause against Vogelzang for recovery of his legal expenses.[45] Consequently, the court dismissed the third-party action against Vogelzang as being moot, since neither of the two conditions had been satisfied for Carr to maintain an action against Vogelzang.

B. Motions to Stay or Dismiss Where Coverage Has Not Been Adjudicated

The *Country Mutual* case serves as a suitable segway to the discussion of whether an insurance producer should seek a stay of any legal proceedings where a court has not made a coverage determination. The power of the trial court to stay the proceedings is an attribute of its inherent power to control the disposition of the cases before it.[46]

Thus, trial courts are afforded great discretion in issuing stay orders.[47] When determining whether to stay litigation, courts consider a number of factors, including: comity; prevention of multiplicity; vexation and harassment; likelihood of obtaining complete relief in the foreign jurisdiction; and the *res judicata* effect of a foreign judgment in the local forum.[48] A court may also consider factors such as the orderly administration of justice and judicial economy when determining whether to stay the proceedings.[49]

Until a court determines whether the insurance policy at issue covers a given claim, the action against the producer is not "ripe," or, in other words, the insured has not suffered any recoverable damages. Moreover, should the court determine that there is coverage for the claim, the producer can then take the position that he did faithfully negotiate and procure an insurance policy per his client's wishes.

Furthermore, the producer can also seek to dismiss an action as being premature where the plaintiff is unable to prove any recoverable damages. If the anticipated harm is speculative and if the plaintiff's interests would be adversely affected only in the event some future possibility occurs or does not occur, a declaratory judgment action should be dismissed.[50] A plaintiff seeking a declaratory judgment must show that the relief sought is based upon an actual justiciable controversy.[51] An actual controversy requires a showing that the underlying facts and issues of the case are not moot or premature, so as to require the court to pass judgment on mere abstract propositions of law, render an advisory opinion, or give legal advice as to future events.[52] If a plaintiff's rights would be adversely affected only if some future possibility in fact occurs or does not occur, then the right in question is speculative and a court cannot enter a declaratory judgment.[53]

C. Motions to Sever from Underlying Action

There are also situations where an insurance producer may be sued as a third-party or fourth-party defendant in the same personal injury action where insurance coverage is at issue. In these cases, a motion to sever is proper because the third-party action would inject the issue of insurance before a jury, which is not allowed under Illinois law.[54] An example of this would be in a construction accident case, where the plaintiff sues the general contractor, who then files a third-party complaint against plaintiff's employer, not only on negligence grounds but also for the failure to procure an insurance policy naming the general contractor as an additional insured on the employer's policy. The employer then brings a fourth-party action against the insurance producer for failing to obtain insurance with the proper named additional insureds. This fourth-party action should be, at a minimum, the subject of a motion to sever, as the issue of insurance should never be before the jury in the construction case; and for public policy reasons, the jury should not be advised or informed of insurance issues which could prejudice the defense of the case. Moreover, a further argument could be raised that the fourth-party complaint is not ripe, since it is conditional on a judgment or settlement being first paid in the underlying action. As that has not yet occurred, there are no possible damages that could be recovered against the producer.

D. Failure of Insured to Comply with Policy Conditions

Another defense available to insurance producers that is often overlooked is the fact that the insured must comply with all policy conditions in order to recover under an insurance policy. Should the insured fail to comply with a condition, this may be the proximate cause of his loss or lack of coverage. This was precisely the issue in *Apollo Label Co. v. Schultz,*[55] where the court found that an insurance producer was not liable to the plaintiff for failing to obtain a sufficient amount of life insurance because the insurance carrier had denied coverage on completely unrelated grounds – that the employee for whom coverage was sought was not actively at work in accordance with the policy requirements. This was a requirement of the policy completely unrelated to the amount of coverage procured by the producer. The court therefore found the producer not liable to the plaintiff for having failed to obtain higher limits of life insurance coverage on the employee. Consequently, denial letters issued by insurers should be closely analyzed to determine the exact policy language upon which the insurer claims it is relieved of coverage obligations to the insured.

E. Material Misrepresentations

Similarly, an insurer may deny a claim due to a material misrepresentation on an application for insurance. An insurance company may void a contract for material misrepresentation if the misrepresentation is made with actual intent to deceive or materially affects the acceptance of the risk or the hazard assumed by the insurer.[56] Most likely, the issue of what specific misrepresentation was made, and who actually provided or filled out the application, will be important to the issue of who proximately caused the loss of coverage. However, if the insured signed off on the application, or ratified the information contained therein, the producer would have another proximate cause defense, similar to the *Apollo Label* case, in that the proximate cause of the loss of coverage was the misrepresentation of the insured, and was completely unrelated to any action or conduct of the producer.

F. Conclusion and Practical Advice

When defending insurance producers, attorneys should consider various proximate cause and other conditional requirements that must be satisfied before a producer can be held liable to a client. In addition, in the interests of limiting attorneys' fees and unnecessary litigation, motions to stay or sever actions should be considered at the outset, especially if the damages have not been determined, or if an underlying case has not gone to trial and actually triggered the indemnity portion of the disputed insurance policy. Finally, additional proximate cause arguments may be available where the cause of the denial of coverage is due to the insured failing to comply with policy conditions or making material misrepresentations on the application for insurance.

III. Defending Claims for Punitive Damages Against Insurance Producers

Claims for punitive damages against an insurer, its agent, or its broker are routinely asserted in actions involving the issuance of an insurance policy. When faced with such claims, defense counsel should be aware of arguments that can be raised against the availability, and the potential amount, of punitive damages.

As a general rule, punitive damages cannot be recovered for a breach of contract.[57] An exception to this rule is recognized, however, when the breach amounts to an independent tort and there are adequate factual allegations of malice, wantonness, or oppression.[58] For example, punitive damages may be available where an insurance agent makes fraudulent representations in the course of selling the policy. In *Sommer v. United Savings Life Insurance Co.*,[59] the plaintiff successfully asserted a fraud claim, for which punitive damages would be available, by alleging agent misrepresentations regarding the cost and the amount of a life insurance policy's death benefits.

When a lawsuit seeking punitive damages involves a claim under an insurance policy, the first question to ask is whether Section 155 of the Illinois Insurance Code applies.[60] This applies to licensed insurance agents, brokers and any producer, as some courts have suggested that Section 155 limitations would extend to them.[61]Certainly, if there is a ruling that no policy was obtained or that coverage is disputed due to fault of the producer, and if that producer is therefore held to be the "insurer" for that loss, there is no reason Section 155 should not apply. Pursuant to Section 155, a court finding vexatious and unreasonable conduct by an insurance company with respect to its handling of a claim under an insurance policy may award attorney fees, costs, and an amount not to exceed: (a) 60% of the amount which the court or jury finds such party is entitled to recover against the company, exclusive of all costs; (b) $60,000; or (c) the excess of the amount which the court or jury finds such party is entitled to recover, exclusive of costs, over the amount, if any, which the company offered to pay in settlement of the claim prior to the action.[62]

Although a Section 155 award is never desirable, it may be preferable when an insurer is faced with the alternative of an unlimited punitive damage award. Therefore, defense counsel should determine whether the punitive damage claim is preempted by Section 155. The Illinois Supreme Court has held that Section 155 preempts first-party claims made directly by a policyholder against his insurer for coverage owed under an insurance policy.[63] Section 155 preemption, however, does not apply when the plaintiff alleges and proves the elements of a separate tort, such as common law fraud,[64] or when the claim involves a third-party action for a bad-faith refusal to settle.[65]

If Section 155 preemption is inapplicable, defense counsel can attack the punitive damage award on state common law or constitutional grounds.[66] Under state common law, the issue is whether the punitive damage award was so excessive as to demonstrate passion, partiality, or corruption on the part of the decision-maker.[67] Factors considered in reviewing an award of punitive damages under the common law approach include the "nature and enormity of the wrong, the financial status of the defendant, and the potential liability of the defendant."[68]

Contrasted with the common law, is the constitutional standard under the Due Process Clause of the Fourteenth Amendment. Under that standard, a punitive damage award will be unconstitutional only if "grossly excessive."[69] Three guideposts are utilized in the due process analysis: the degree of reprehensibility of the defendant's conduct; the disparity between the harm or potential harm suffered by the plaintiff and the punitive damages award; and the difference between the remedy and the civil penalties authorized or imposed in comparable cases.[70]

As to the first guidepost, the United States Supreme Court has indicated that "perhaps the most important indicium of the reasonableness of a punitive damage award is the degree of reprehensibility of the defendant's conduct."[71] Factors considered with respect to degree of reprehensibility include whether: the harm caused was physical or economic; the conduct evinced an indifference to or reckless disregard of the health or safety of others; the target of the conduct had financial vulnerability; the conduct involved repeated actions or was an isolated incident; and the harm was the result of intentional malice, trickery, or deceit, or mere accident.[72]

With respect to the second "ratio" guidepost, the Court has declined to impose a "bright-line" ratio which a punitive damage award cannot exceed.[73] It has nonetheless stated that "in practice, few awards exceeding a single-digit ratio between punitive and compensatory damages . . . will satisfy due process" and that "an award of more than four times the amount of compensatory damages might be close to the line of constitutional impropriety."[74] Any argument that these passages establish an outer ratio of 4:1 will be met with the Court's further statements that a greater ratio may not offend due process where "a particularly egregious act has resulted in only a small amount of economic damages."[75] A lesser ratio of perhaps one-to-one, in contrast, may reach the outermost limit of due process when the compensatory damages are substantial.[76]

Relying on the Court's reprehensibility guidepost, plaintiffs may seek to introduce evidence of the defendant's conduct relative to nonparties. For example, the plaintiffs in *State Farm Mutual Automobile Ins. Co. v. Campbell* introduced evidence of out-of-state conduct on the part of the defendant which were claimed to show a "national scheme to meet corporate fiscal goals by capping payouts on claims company-wide."[77]

Although evidence of recidivism is relevant to the reprehensibility factor, the Court has recently limited the use of that evidence.

In *State Farm*, the Court found error because "much of the out-of-state conduct was lawful where it occurred." Much of the evidence that was introduced, moreover, had nothing to do with a third-party lawsuit.[78] The Court's concern over the use of recidivism evidence was reiterated in *Philip Morris USA v. Williams*.[79] In *Philip Morris*, the plaintiff's estate sued the defendant for negligence and deceit arising from production and sale of cigarettes. At trial, plaintiff's counsel asked the jury to consider how many others were injured by the defendant's conduct. Evidence of the defendant's market share was introduced. The jury gave a $79.5 million punitive damage award that reflected a 100:1 ratio to the compensatory damages awarded.

The Court reversed the judgment on procedural due process grounds, finding that a State cannot "use a punitive damage award to punish a defendant for injury that it inflicts on non-parties."[80] The court reasoned that while a jury may consider actual harm to non-parties as part of the reprehensibility determination, it cannot use "a punitive damages verdict to punish a defendant directly on account of harms it is alleged to have visited on non-parties."[81] Accordingly, where there is a significant risk the jury will use the recidivist evidence to punish the defendant for having caused injury to others, "the court, upon request, must protect against that risk."[82] Although the Court leaves to the States the nature of the protection to be afforded, it appears clear that defense counsel, at the very least, should request a jury instruction when "recidivism" arguments are made either through evidence at trial, or by plaintiff counsel's argument.

The Supreme Court's most recent 2008 punitive damage decision addresses the limits of punitive damages under maritime common law.[83] Although the Court settled on a 1:1 ratio, the value of this case in a civil law context is limited because the Court did not address the constitutionality of the punitive damage award.[84] There is, however, a discussion of studies showing that "by most accounts the median ratio of punitive to compensatory awards has remained less than 1:1" and that the figures "suggest that in many instances a high ratio of punitive to compensatory damages is substantially greater than necessary to punish or deter."[85] Whether this discussion will be referenced or helpful in cases discussing the constitutionality of punitive damages, remains to be seen.

When faced with a punitive damage claim against an insurance producer, ask the following questions: (1) whether the punitive damage claim is preempted by Section 155 of the Insurance Code; (2) whether the punitive damage award can be attacked under common law or constitutional grounds; and (3) whether the plaintiff is offering recidivism argument or evidence; and, if yes, request a limiting instruction.

(Endnotes)

[1] *Faulkner v. Gilmore*, 251 Ill. App. 3d 34, 37, 621 N.E.2d 908, 911 (3rd Dist. 1993); *Kanter v. Deitelbaum*, 271 Ill. App. 3d 750, 753, 648 N.E.2d 1137, 1139 (1st Dist. 1995).

[2] *Omni Overseas Freighting Co., Inc. v. Cardell Ins. Agency*, 78 Ill. App. 3d. 639, 397 N.E.2d 112 (1st Dist. 1979).

[3] *Id.*, 397 N.E.2d at 113.

[4] *Id.* at 113-117. *See also, e.g., Black v. Illinois Fair Plan Ass'n.*, 87 Ill. App. 3d 1106, 1112, 409 N.E.2d 549, 559 (5th Dist. 1980) (finding that an insurance broker was negligent for inserting the incorrect address on a fire insurance policy).

[5] *Lake County Grading Co. of Libertyville, Inc. v. Great Lakes Agency, Inc.*, 226 Ill. App. 3d 697, 703, 589 N.E.2d 1128, 1132 (2nd Dist. 1992).

[6] *Economy Fire & Casualty Co. v.* Bassett, 170 Ill. App. 3d 765, 565 N.E.2d 539 (5th Dist. 1985).

[7] *Id.* 525 N.E.2d at 540-41, 544.

[8] *Id*. at 544.

[9] *Id.* at 545.

[10] *Id.*

[11] *Id.*

[12] *Id.* at 545-46 (Karns, J., dissenting).

[13] *Id.* at 546.

[14] *National Boulevard Bank v. Brokerage Resources, Inc.*, 42 Ill. App. 3d 940, 356 N.E.2d 988 (1st Dist. 1976).

[15] *Id.* 356 N.E.2d at 988-89.

[16] *Id.* at 989-91.

[17] *Id.* at 991.

[18] *National Union Fire Co. of Pittsburgh, PA v. Pontiac Flying Service*, Doc. No. 03-1288, 2006 WL 3422166 (C.D. Ill. November 27, 2006).

[19] *Id.* 2006 WL 3422166 at *1.

[20] *Id.* at *5.

[21] *Id.*

[22] *Id.*

[23] *Id.* at *8.

[24] *Id.* at *7 (*citing AYH Holdings, Inc. v. Avreco, Inc.*, 357 Ill. App. 3d 17, 39, 826 N.E.2d 1111, 1130-31 (1st Dist. 2005)).

[25] *Id.*

[26] *Id.*

[27] *Id.* at * 5 (*citing Lee v. Calfa*, 174 Ill. App. 3d 101, 528 N.E.2d 336, 343 (2nd Dist. 1998); *Wheaton Nat. Bank v. Dudek*, 59 Ill. App. 3d 970, 376 N.E.2d 633 (1st Dist. 1978); *Block v. Lohan Associates, Inc.*, 269 Ill. App. 3d 745, 645 N.E.2d 207, 221 (1st Dist. 1993)).

[28] *Id.* at *6.

[29] *Id.* at *6-7.

[30] *Industrial Enclosure Corp. v. Glenview Ins. Agency, Inc.*, 379 Ill. App. 3d 434, 884 N.E.2d 202 (1st Dist. 2008).

[31] *Id.* 884 N.E.2d at 203-205.

[32] *Id*. at 207-08 (*quoting Pittway Corp. v. American Motorists Ins. Co*., 56 Ill. App. 3d 338, 347, 370 N.E.2d 1271, 1278-79 (1st Dist. 2008)).

[33] *Id.*

[34] *Pittway Corp. v. American Motorists, Inc. Co.*, 56 Ill. App. 3d 338, 370 N.E.2d 1271 (2nd Dist. 1977).

[35] *Omni Overseas Freighting, Inc.*, *supra* note 2.

[36] *Scarsdale Villas Associates, Ltd. v. Korman Associates Ins. Agency*, 178 Ill. App. 3d 261, 533 N.E.2d 81 (1st Dist. 1988).

[37] *Industrial Enclosure Corp. v. Glenview Ins. Agency, Inc.*, 379 Ill. App. 3d 434, 884 N.E.2d 202 (1st Dist. 2008).

[38] *Id*. at 438.

[39] *Id*.

[40] *Id*.

[41] *Country Mut. Ins. Co v. Carr.*, 372 Ill. App. 3d 335, 867 N.E.2d 1157 (4th Dist. 2007).

[42] *Id*.

[43] *Id*.

[44] *Id*.

[45] *Id*.

[46] *Vasa North Atlantic Ins. Co. v. Selcke*, 261 Ill. App. 3d 626, 628, 633 N.E.2d 865 (1st Dist. 1994).

[47] *Id*.

[48] *Philips Electronics v. New Hampshire Ins. Co.*, 295 Ill. App. 3d 895, 692 N.E.2d. 1268 (1st Dist. 1998).

[49] *Id*.

[50] *Township High School District 203 (New Trier) v. Village of Northfield*, 184 Ill. App. 3d 367, 540 N.E.2d 365 (1st Dist. 1989).

[51] *Id*.

[52] *Flashner Medical Partnership v. Marketing Management, Inc.*, 189 Ill. App. 3d 45, 545 N.E.2d 177 (1st Dist. 1989).

[53] *Township High School District 203 (New Trier), supra* note 50.

[54] *Joynt v. Barnes*, 71 Ill. App. 3d 187, 388 N.E.2d 1298 (2nd Dist 1979).

[55] *Apollo Label Co. v. Schultz*, 206 Ill. App. 3d 8, 563 N.E.2d 1044 (1st Dist. 1990).

[56] *215 ILCS 5/154; Conti v. Health Care Service Corporation*, 378 Ill. App. 3d 202, 822 N.E.2d 614 (1st Dist. 2007).

[57] *Morrow v. L.A. Goldschmidt Associates, Inc.*, 112 Ill. 2d 87, 492 N.E.2d 181, 184 (1986).

[58] *Id.*, 492 N.E.2d at 184.

[59] *Sommer v. United Savings Life Insurance Co.*, 128 Ill. App. 3d 808, 471 N.E.2d 606 (2nd Dist. 1984).

[60] 215 ILCS 5/155.

[61] Some courts have suggested Section 155 preemption would extend to an agent of the insurer. *See Mazur v. Hunt*, 227 Ill. App. 3d 785, 592 N.E.2d 335, 341 (1st Dist. 1992); *Combs v. Insurance Co. of Illinois*, 146 Ill. App. 3d 957, 497 N.E.2d 503, 508 (1st Dist. 1986).

[62] *Id*.

[63] *Cramer v. Insurance Exchange Agency*, 174 Ill. 2d 513, 675 N.E.2d 897, 904 (1997).

[64] *Id.*, 675 N.E.2d at 904.

[65] *O'Neill v. Gallant Ins. Co.*, 329 Ill. App. 3d 1166, 769 N.E.2d 100, 111 (5th Dist. 2002) (*citing Cramer*, 675 N.E.2d at 905-06).

[66] *Gehrett v. Chrysler Corp*., 379 Ill. App. 3d 162, 882 N.E.2d 1102, 1119 (2nd Dist. 2008).

[67] *Deal v. Byford*, 127 Ill. 2d 192, 537 N.E.2d 267, 272 (1989).

[68] *Id.*, 537 N.E.2d at 272.

[69] *BMW of North America, Inc*. *v. Gore*, 517 U.S. 559 (1996).

[70] *Id.*, 517 U.S. at 574-75.

[71] *Id.* at 575.

[72] *State Farm Mutual Automobile Ins. Co. v. Campbell*, 538 U.S. 408, 418, 123 S. Ct. 1513, 155 L.Ed.2d 585 (2003).

[73] *Id.* at 424.

[74] *Id.* at 425.

[75] *Id.* (*quoting BMW of N. Am. v. Gore,* 517 U.S. 559, 582, 116 S. Ct. 1589 (1996)).

[76] *Id*.

[77] *Id.* at 420.

[78] *Id*. at 423.

[79] *Philip Morris USA v. Williams*, 549 U.S. 346, 127 S. Ct. 1057 (2007).

[80] *Id.*, 127 S. Ct. at 1063.

[81] *Id.* at 1064.

[82] *Id.* at 1065.

[83] *Exxon Shipping Co. v. Baker*, ___ U.S. ____, 128 S. Ct. 2605 (2008).

[84] *Id.*, 128 S. Ct. at 2633. (In *Kunz v. Defelice*, ____ F.3d ____, 2008 WL 3483442 (7th Cir. Aug. 13, 2008), the Seventh Circuit cited *Exxon* and affirmed, as constitutional, a punitive damage award having a 9:1 ratio.)

[85] *Id.* at 2624.

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