

[Duty to Defend Held to Include the Duty to Notify Insureds of Potential for Excess Liability](#)

Insurance Law Update

February 2011

By: [Kimberly Cobo](#)

U.S. Court of Appeals for the Seventh Circuit

In *R.C. Wegman Const. Co. v. Admiral Ins. Co.*, 629 F.3d 724 (7th Cir. (Ill.) January 14, 2011), the Seventh Circuit Court of Appeals held that when a potential conflict of interest between the insured and insurer arises, the duty of good faith requires the insurer to notify the insured in order to give the insured an opportunity to best protect its own interests. This duty includes situations where a potential conflict of interest arises from the possibility that the insured may be exposed to liability in excess of the policy limits.

Admiral issued a liability insurance policy to Wegman that provided a per occurrence limit of \$1 million. During the policy period, a worker at a construction site managed by Wegman was injured. The worker sued Wegman and other entities for negligence, and was ultimately awarded approximately \$2 million at trial. Wegman filed suit against Admiral for bad faith, alleging that it would not have been liable for damages in excess of the \$1 million policy limit if Admiral had acted in good faith in handling its defense and settling the case before trial. Wegman asserted that Admiral failed to warn it of the possibility that a judgment could exceed the policy limits, and that this failure prevented Wegman from providing timely notice to its excess insurer (which denied coverage as a result).

The district court dismissed Wegman's action for failure to state a claim, but the Seventh Circuit reversed. The court held that when an insurance company assumes an insured's defense, the insurer's duty includes not only hiring competent counsel, but also keeping the insured aware of the status of the litigation so that it may make informed and good faith decisions on settlement offers. Here, Admiral had a duty to notify Wegman of a potential conflict of interest when Admiral learned of the potential exposure Wegman could face based on the damages alleged by the worker during

discovery. Admiral asserted that it did not have a duty to notify Wegman until an actual conflict of interest arose or until settlement discussions were initiated but the Seventh Circuit disagreed, finding that an insurer is required to notify its insured as soon as a potential conflict arises, so that the insured may make an informed decision to protect its own interests.

Related Practices:

[Insurance Practices](#)