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Illinois Allows Excess and Umbrella Insurers to Bring Equitable Subrogation Claim Against Law Firm

January 23, 2013
Lawyers for the Profession® Alert

Ace American Insurance Co. v. Sandburg Phoenix & Von Gontard, P.C.,

Brief Summary

In denying defendant law firm's motion to dismiss, the U.S. District Court for the Southern District of Illinois held that Illinois would recognize a cause of action by insurers for equitable subrogation against law firms.

Complete Summary

Plaintiff first insurer issued liability insurance policies to a first insured. A second insured, which was the predecessor in interest to a first insured, was issued a primary commercial general liability insurance policy and a commercial excess and umbrella liability insurance policy by plaintiff second insurer. The first insured was a named defendant in the underlying products liability/negligence action. In 2012, the first and second insurers filed a legal malpractice action against the law firm, which it had hired to represent the first insured. According to the insurers, the law firm botched the defense of the underlying products liability suit, which resulted in the first insurer being forced to pay inflated sums to settle the suit just prior to trial. The first insurer sought to recover from the firm and the lawyers the full amount of the settlement the insurers paid on the first insured's behalf, plus legal expenses relating to the underlying action and other damages. The recovery was sought via various theories of subrogation, as well as a direct claim for legal malpractice.

The law firm moved to dismiss, arguing that the first insurer lacked standing to pursue equitable subrogation claims against the law firm. While Illinois law generally states that one who asserts a right of equitable subrogation steps into the shoes of the one whose debt he or she paid and can only enforce those rights which the latter could enforce, the law firm maintained that Missouri law (not Illinois) governed the claims. After applying the "most significant contacts" test, the court determined that Illinois had the most significant relationship to the occurrence and the parties.

In looking to Illinois law, the court observed that there was no decision on whether an excess insurer could pursue subrogation claims against a law firm, although Illinois had a strong public policy against assignments. The court

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observed that subrogation was allowed in *National Union Ins. Co. v. Dowd & Dowd, P.C.,* 2 F. Supp. 2d 1013 (N.D. Ill. 1998). The court also found the public policy concerns distinguishable:

Unlike assignment, subrogation would not lead to the merchandising of malpractice claims. Though a claim can be assigned to anyone willing to pay for it, subrogation rights can be exercised only by those who have fulfilled a duty, imposed by contract or law, to pay for another's loss. Thus, allowing subrogation of legal malpractice claims would not make them a commodity available to the highest bidder.

The court noted that an insured would have little incentive to sue where the loss was covered by insurance. Excess insurers, on the other hand, have every incentive to pursue subrogated malpractice claims. Although not discussing whether there could be a conflict between an insured's interest and that of an excess insurer as to whether to settle, the court commented that allowing subrogation would not significantly increase legal malpractice litigation.

This result would neither result in an open season on attorneys nor be detrimental to the legal profession. Insurers in general, and excess insurers in particular, rarely bring legal malpractice claims against attorneys because: (1) often the amount in controversy is not significant enough to be worth the trouble of another lawsuit; (2) with limited exceptions, insurers control whether the case settles or not, so they are involved in the process; (3) insurers are in the business of paying claims; and (4) rather than sue the lawyers, the insurers just place the lawyers on the equivalent of a "do not call" list and refuse to retain their services in the future.

Significance of Opinion
This opinion is significant because Illinois has never addressed the issue of whether an excess insurer could pursue subrogation claims against a law firm. Although Illinois has a strong public policy against the assignment of legal malpractice claims, the court held that an excess insurer may recover under the theory of equitable subrogation. Insurance defense counsel must be mindful that even if their client does not pursue a legal malpractice action, they are not isolated from the possibility of a legal malpractice claim.

For further information, please contact Terrence P. McAvoy or Katherine G. Schnake.

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