

# Insurance/Tort Newsletter

May 2006

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## Illinois Supreme Court Rejects \$10 Billion Lawsuit Against Phillip Morris

A case originating in Madison County, Illinois sought damages from the cigarette giant, Philip Morris, for labeling products, "light" and "low-tar". Plaintiffs, who were comprised of consumers buying cigarettes in Illinois prior to February 1, 2001, alleged that this designation on the cigarettes defrauded consumers because it did not explain that the "light" or "low-tar" cigarettes did not actually deliver less tar or nicotine. At the circuit court level, Judge Nicholas Byron awarded \$7.1 billion in compensatory damages and \$3 billion in punitive damages against Philip Morris. The class action was appealed to the Supreme Court, and the \$12 billion bond was waived, saving the company from having to file for bankruptcy protection.

The vote, with one justice abstaining, was 4-2 in favor of Philip Morris. The majority opinion concluded that the action was barred by the Illinois Consumer Fraud Act. The law exempts tobacco companies from fraud suits related to the description "low" on cigarette packages because this language has been allowed by the Federal Trade Commission. Consent orders issued by the agency have authorized, "all United States tobacco companies to utilize words like 'low' in conjunction with specified disclosures". The dissenting justices felt that the majority had misinterpreted the Statute and worried that the interpretation limited the State's ability to provide consumer protection to its residents.

The opinion was released to the public on December 15, 2005 and reactions were quick to come from national organizations. The American Cancer Society expressed its unhappiness with the decision and stated that the ruling was, "an early Christmas present for Philip Morris". The Tobacco Liability Project also stated that the decision could be appealed to the United States Supreme Court. *Price et. al. V. Philip Morris, Inc.*, No. 96326, 2005 WL 3434368 (Ill. Dec, 15, 2005).

## Seventh Circuit To Look At More Than Expert Credentials (Cont'd to Page 2)

In this case, the Seventh Circuit reversed a Plaintiff's judgment in a products liability case on the grounds that the testimony of the Plaintiff's expert on the issues of the product's defective condition and causation were unreliable. The central issue in the case was whether the prosthetic knee that the Plaintiff received in a total knee replacement procedure was defectively designed because of the manner of sterilization utilized at the time of manufacture.

The Court held that an expert's simply holding credentials within his field of expertise, alone, would not be enough to render the testimony proffered admissible; the methodology that the expert applies to arrive at his opinions must also

### Seventh Circuit To Look At More Than Expert Credentials (Cont'd)

be scrutinized and deemed reliable. In this case, the Court held that the expert had testified that the knee implant failed, but did not identify what the reason for the failure was or how this opinion would measure up to *Daubert's* reliability standard. The Court also noted that the expert did not take into account the weight and activity level of the patient on the failure rate of the device and that without some testimony as to how this was evaluated or ruled out, the testimony was considerably unreliable.

Because the Appellate Court found that the testimony should not have been admitted, it reversed the holding of the Court and remanded the case with instructions to direct a verdict in Defendant's favor.

*Fuesting v. Zimmer, Inc.*, 421 F.3d 528 (7<sup>th</sup> Cir. 2005).

### Forum Non Conveniens Reexamined By Illinois Supreme Court

A resident of Louisiana filed a class action suit in Madison County, Illinois against State Farm Insurance. The proposed class included nationwide customers of State Farm. His complaint alleged unjust enrichment as well as violations of the Illinois Consumer Fraud and Deceptive Business Practices Act in connection with State Farm's sale of salvaged vehicles.

State Farm argued that Louisiana was the proper forum, or that in the alternative, McLean County, Illinois, State Farm's principal place of business, was the proper forum. Both were rejected by the Circuit Court. The Appellate Court remanded the case for entry of an order requiring detailed discovery on the forum issues. At that point, State Farm appealed to the Illinois Supreme Court, which granted the petition for leave to appeal and reversed both the Circuit and Appellate Court decisions. The Illinois Supreme Court held that the Plaintiff did not have standing under the Illinois Consumer Fraud Act, and also held that the claims (dealing with claims of unjust enrichment) should have been dismissed by the Circuit Court under *forum non conveniens*. In an analysis of public and private interest factors, there was a strong link to Louisiana over Illinois. The Court reaffirmed the principle that the fact that the defendant is doing business in the chosen forum is not dispositive of the *forum non conveniens* issue.

*Gridley v. State Farm Mutual Auto Insurance Co.*, No. 94144, 2005 WL 3071729 (Ill. Nov. 17, 2005).

### Moorman Doctrine Prevents Negligent Design Claim Against Architect

The Plaintiffs, a married couple in Illinois, filed a lawsuit against various defendants alleging negligent design and building of their luxury home. Defendant architect was charged with not having sufficient details in the plans for the home, leaving the builder in the situation of "filling in the blanks". The builder was also named as a defendant for the alleged defects created by its work on the home. Plaintiffs sought damages in an amount equal to what it would cost to repair the various problems.

The architect moved to dismiss the count against him, charging that the *Moorman* doctrine prevented economic loss in tort cases and arguing that the claim against him had to be brought in contract. The trial court agreed and dismissed the Count. Plaintiffs appealed and the Appellate Court affirmed the decision. In their opinion, the Appellate Justices cited to a prior case, *2314 Lincoln Park West Condominium Association v. Mann, Gil, Ebel & Frazier, Ltd.*, 136 Ill.2d 302 (1990), where the Illinois Supreme Court had decided that there was no exception to the *Moorman* doctrine which could allow a plaintiff to recover economic losses against an architect under a theory of negligent design. The Appellate court found that the Plaintiffs' claims revolved around quality, rather than safety, of the building and was more appropriately dealt with under contract law.

*Martusciello v. JDS Homes, Inc., et. al.*, 2005 WL 2347683 (Ill. App.1<sup>st</sup> Dist. Sept. 26, 2005)

### **Time-Barred Counterclaim Not Always Time-Barred**

Section 13-207 of the Illinois Code of Civil Procedure is known as a “savings clause”, allowing otherwise time barred counterclaims to proceed. The Illinois Supreme Court recently addressed whether this section of the code would “trump” section 13-204 of the Code, which imposes a two-year statute of limitations for counterclaims for contribution.

The Barragan brothers were working on a construction site in 1987 when one was injured and the other killed. The surviving brother and the decedent’s spouse filed suit against the architect and the general contractor for the project. Both defendants filed counterclaims against each other. However, the general contractor’s counterclaim against the architect was filed after the expiration of the two-year period for filing contribution claims. The suit was settled as between Plaintiffs and the general in 2001 for \$4.65 million. The settlement agreement provided that the Plaintiffs’ claims against both defendants were extinguished, but the contribution counterclaims were not affected.

The architect subsequently moved to dismiss the general contractor's counterclaim, arguing that it was barred by the two-year statute of limitations found in section 13-204 of the code. This motion was granted at the trial level and affirmed at the Appellate Court. The Supreme Court of Illinois reversed the decision, holding that once the architect filed a counterclaim for contribution, he was “transformed” in to a “plaintiff” for purposes of applying the “saving” provision. Since this provision is not a statute of limitations, and in fact operates to negate an applicable statute of limitations, it would allow the otherwise time-barred responsive counterclaim to proceed.

*Barragan v. Casco Design Corp.*, 216 Ill.2d 435, 837 N.E.2d 16, 297 Ill.Dec. 236 (IL. 2005).

### **Insurer Created Conflict Of Interest By Reserving Rights On Basis That Occurrence Had Not Taken Place In Policy Period**

American Family Insurance issued a Commercial General Liability policy to McNaughton Builders beginning in 1994 and renewed for each subsequent coverage period. This policy beginning in 2002 specifically excluded coverage for mold damage, including any diminution in value of a property as caused by mold damage. McNaughton had been hired by the Begys family to construct a home for them in 1991. In July of 2004, the Begys sued McNaughton, alleging, among other things, that their home suffered mold damage as a result of the construction performed by McNaughton. American Family agreed to defend the suit but reserved its rights on the basis that the claim was based on acts occurring prior to the policy period.

McNaughton attempted to secure its own counsel at American Family’s expense, due to a perceived conflict of interest between it and American Family. McNaughton argued that American Family’s interests would be equally served if McNaughton were not found liable or if it was found liable for acts occurring prior to the policy period.

The trial court found no conflict in American Family’s controlling the litigation despite the reservation of rights. On appeal, the Court found that there was an “inherent conflict” because American Family’s interests would be equally served by a finding of no liability or by a finding of liability based on acts occurring before the policy period.

*American Family Mutual Insurance Company v. W.H. McNaughton Builders, Inc.*, 2006 WL 300441 (2d.Dist. February 6, 2006).

## Taxability of Settlements Based Upon Confidentiality Clauses

Confidentiality clauses have now become a commonplace addition to settlement agreements. Most often used when a client wishes to protect a business name or to shield current employees from discovering what a former employee may have received for his or her grievance against the company, now they have become routine for any type of defense attorney to add on to a standard release. This practice was recently called into question when Dennis Rodman attempted to settle a claim made by a cameraman for an alleged battery at an NBA game. Rodman was to pay a total of \$200,000 to the camera man and part of the release stated that in exchange for the settlement, Plaintiff would keep all terms confidential.

Everything seemed fine until the IRS got involved. The cameraman did not report the \$200,000 from the settlement as part of his gross income for the year. He stated that section 104(a)(2) of the Internal Revenue Code allowed for this exclusion as the monies received were for physical injuries he sustained in the alleged battery. The IRS disagreed and took him to Federal Tax Court, arguing that the inclusion of the confidentiality clause meant that at least a portion of the money paid in settlement was attributable to keeping quiet rather than actual injuries. Also of importance in evaluating the settlement document was the inclusion of a clause which provided that if the cameraman breached the terms of the confidentiality clause, he would be held to the full amount of the settlement in liquidated damages to Rodman.

In this case, the Tax Court held that the dominant reason for the figure of \$200,000 was the cameraman's injuries, but the inclusion of the confidentiality clause also played a role in arriving at this figure. Because of this, the court held that \$120,000 was for the physical injuries sustained and the remaining \$80,000 was attributable to the confidentiality clause and should have been included on the cameraman's gross income.

What does this mean for defendants looking forward? Many plaintiff's attorneys will now argue that settlements should be higher if they will include a confidentiality agreement, simply to offset this new "charge". Others will insist that no confidentiality clause be included in a release. Defendants should argue that a specific dollar amount be set aside within the agreement as to what is attributable to the confidentiality clause. As in the Rodman case, liquidated damages for breach of the clause should not be the total amount of the settlement, otherwise this will indicate to anyone reviewing the agreement that the main focus of the settlement was the confidentiality agreement. Most of all, any client must be told of this case and its potential ramifications, so that all parties enter into any settlement agreements with full knowledge of what they are agreeing to.

## Insurer Obligated To Defend Parents Of Child Who Intentionally Paralyzed Another Child In Fight.

Farmers Insurance insured Matthew Kure and his parents under a homeowner's policy. During an altercation with Kyle Signorelli, Matthew executed a "pile-driver" maneuver, by lifting Kyle off the ground and driving his head into the ground. As a result, Kyle was paralyzed from the waist down. Kyle sued Matthew and his parents. Kyle claimed the parents were negligent in supervising their son and in providing him with the car he used to get to Kyle's house. Kyle alleged both negligence and intentional acts against Matthew.

The trial court held that Farmer's had no duty to defend Matthew because his acts were intentional, but held that Farmer's did have a duty to defend the parents, who were charged only with negligence. Farmers appealed, claiming that there was no duty to defend because Kyle's injuries did not arise from

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## Insurer Obligated To Defend Parents Of Child Who Intentionally Paralyzed Another Child In Fight. (Cont'd)

an "occurrence", but rather from the intentional actions of Matthew, and because the intentional act exclusion applied. The appellate court affirmed the trial court's finding that the parents were owed a defense. The appellate court stated that in determining whether injuries arose from an "occurrence", the situation must be viewed from the insured's point of view. Since Matthew's parents were charged only with negligence, there was no basis to find that they intended the injuries to Kyle. For the same reason, the intentional acts exclusion did not apply to the parents, even if their son's acts were intentional.

*Illinois Farmers Insurance Company v. Kure*, NO. 3-05-0262 (3d Dist. April 3, 2006).

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