

Insured's Failure to Exhaust Self-Insured Retention Does Not Relieve Primary Liability Insurer of Duty to Defend

Article By:

Seth Lamden

In [*American Safety Cas. Ins. Co. v. City of Waukegan, Illinois*](#), Nos. 11-2775, 11-2789 & 11-2961 (7th Cir. Mar. 16, 2012), the court affirmed a ruling that an **insurer unreasonably and vexatiously refused to defend its insured in violation of the Illinois insurance bad faith statute (215 ILCS § 5/155)** when it refused to defend because the insured had not paid defense expenses in excess of the policy's \$100,000 self-insured retention ("SIR") prior to trial in the underlying lawsuit.

American Safety Casualty Insurance Co. ("American Safety") issued a Comprehensive Law Enforcement Liability Policy to the City of Waukegan ("Waukegan") that required American Safety to pay all sums that the insured became legally obligated to pay as damages in excess of a \$100,000 SIR because of covered injury, and also provided that American Safety "shall have the right and duty to select counsel and defend any claims to which [this policy] applies."

Waukegan was sued in an underlying wrongful conviction lawsuit that triggered American Safety's duty to defend. Among American Safety's reasons for refusing to defend Waukegan in the underlying lawsuit was that Waukegan did not actually pay legal expenses in excess of the \$100,000 SIR prior to trial (even though Waukegan incurred legal expenses that exceeded \$100,000 prior to trial). The American Safety district court held that American Safety's refusal to defend Waukegan was "unreasonable and vexatious" and, therefore, violated 215 ILCS § 5/155. The appellate court affirmed, holding that the SIR policy provision applied only to American Safety's duty to indemnify, and did not apply to American Safety's duty to defend.

Rejecting American Safety's argument that a "deductible clause" in the American Safety policy "shows that it has no obligation at all until the deductible has been dispersed," the appellate court held that with regard to the applicability of the SIR, the term "obligation" refers only to American Safety's duty to indemnify, and that an interpretation of "obligation" that included the duty to defend would "effectively nullify" American Safety's defense obligation, which serves to protect the interests of both the insured (by giving the insured access to counsel without the need to pay in advance) and the insurer (by giving the insurer the opportunity to conduct an effective defense). As the appellate court observed, "[g]iving the deductible clause an interpretation that effectively nullifies the defense clause would be unsound What sense would it make for an insurer to put defense off until the insured had retained and paid a team of lawyers to undertake the tasks?"

American Safety also argued that it was not obligated to indemnify Waukegan for portions of Waukegan's liability in the underlying action because, according to American Safety, Waukegan "bungled" its defense. The court rejected this argument as "the sort of desperate argument that an insurer may advance after it failed to defend for other reasons . . . ," and stated that "[i]t comes with ill grace for an insurer that steadfastly refused to defend its customer to insist that it is relieved of liability because the insured erred in conducting a defense that was thrust upon it."

© 2025 Neal, Gerber & Eisenberg LLP.

National Law Review, Volume II, Number 86

Source URL: <https://natlawreview.com/article/insured-s-failure-to-exhaust-self-insured-retention-does-not-relieve-primary-liabili>