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Illinois Coverage Basics

Estoppel Is Still An Active Threat To Insurers In Illinois (And Now In Indiana Too)

Under Illinois' law of insurer estoppel there are only two ways for an insurer to preserve a coverage defense. The insurer must either: (a) defend its insured under a reservation of rights, or (b) file a declaratory judgment action to obtain a judicial ruling to confirm the applicability of the defense. If an insurer does nothing more than deny coverage, without undertaking one of those two methods for preserving its coverage defense, it will be barred from relying on its coverage defense.

Is Estoppel Still A Concern?

Although insurer estoppel has been a part of the legal landscape in Illinois for nearly a decade, it continues to exact a heavy toll on unwary insurers. Insurers get caught in the Illinois estoppel trap for several reasons. Some insurers do not adequately protect their coverage defenses from estoppel because they are not aware of the Illinois law. Some insurers understand the Illinois estoppel rule but choose not to comply with its requirements, because it seems difficult to justify the cost of compliance when there is no coverage for a claim. Other insurers simply hope that they can pass under the Illinois estoppel radar.

Failing to comply with the estoppel rule can be disastrous, because when the estoppel rule is enforced, an insurer is required to provide full defense and indemnity for a claim that is not covered under the terms of its policy. There is no doubt that ignoring the estoppel rule is more expensive than complying with the rule.

In the years following the Illinois Supreme Court's landmark estoppel ruling in Employers of Wausau v. Ehlco Liquidating Trust, 186 Ill.2d 127, 708 N.E.2d 1122 (1999), some common misconceptions have developed about the Illinois estoppel rule. One is the belief that the Illinois estoppel rule is not being enforced by the courts in Illinois. Another misconception is that estoppel will be applied only if an insurer is found to have owed a duty to defend.

The truth is that courts in Illinois regularly enforce the estoppel rule. Research confirms that enforcement of the "death sentence" sanction of estoppel has not stopped or even slowed down. In the past five years the courts have compelled insurers to provide coverage based on the estoppel rule in many reported cases, including the following:

Pietras v. Sentry Insurance Co., 2007 WL 715759 (N.D.Ill. 2007).

BASF AG v. Great American Assurance Co., 2006 WL 1235943 (N.D.Ill. 2006).

Restoration Specialists, LLC v. First Specialty Insurance Corp., 403 F.Supp.2d 650, 665 (N.D.Ill. 2005).

Design Professionals Insurance Co. v. St. Paul Fire & Marine Insurance Co., 2005 WL 3159245 (N.D.Ill. 2005).

Electric Insurance Co. v. National Union Fire Insurance Co. of Pittsburgh, 346 F.Supp.2d 958, 969 (N.D.Ill. 2004).

Coltec Industries Inc. v. Zurich Ins. Co., 2004 WL 413304 (N.D.Ill. 2004).

Lyons v. State Farm Fire and Casualty Co., 349 Ill.App.3d 404, 811 N.E.2d 718 (5th Dist. 2004).

Illinois Emcasco Insurance Co. v. Northwestern National Casualty Co., 337 Ill.App.3d 356, 785 N.E.2d 905 (1st Dist. 2003).

West American Insurance Co. v. J.R. Construction Co., 334 Ill.App.3d 75, 777 N.E.2d 610 (1st Dist. 2002).

Indiana (Illinois' neighbor to the east) has now also expressly adopted the Illinois rule of insurer estoppel. See Bainbridge Management LP v. Travelers Casualty and Surety Co. of America, 2006 WL 978880 (N.D.Ind. 2006); Federated Rural Electric Insurance Exchange v. National Farmers Union Property and Casualty Co., 805 N.E.2d 456 (Ind.App. 2004).

Some courts have said that estoppel is proper only if an insurer has breached its duty to defend. However, the Illinois decisions are divided on this question, and that makes application of the estoppel rule very predictable. When courts enforce the estoppel rule they first consider whether the insurer has properly preserved its coverage defenses, and if the insurer has not adequately preserved its coverage defenses, those courts will not reach the coverage issues. In contrast, when courts decline to enforce the estoppel rule they often first consider whether the insurer had a duty to defend, and if the insurer had no duty to defend, those courts will not reach the estoppel issue. The Illinois Supreme Court has not yet resolved this conflict.

A risk of estoppel exists in Illinois and Indiana any time an insurer denies coverage without defending under reservation of rights or filing a declaratory action. Some courts are less likely to enforce the estoppel rule than others, but at the time an insurer denies coverage there is no way to know which court will ultimately rule on the estoppel issue or what analysis that court will use. As such, if it is important to prevail with a coverage defense, it is essential to comply with the requirements of the estoppel rule.

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If you have questions or would like to discuss the implications of this report further, please feel free to contact James K. Horstman at Cray Huber Horstman Heil & VanAusdal LLC, 303 West Madison, Suite 2200, Chicago IL 60606; 312-332-8494; jkh@crayhuber.com.