Cray • Huber

Illinois Coverage Basics

An Important Exception to the Illinois "Four Corners" Duty to Defend Rule

A basic rule of Illinois insurance coverage law is that a liability insurer's duty to defend must be determined by the "four corners" of the underlying complaint. Yet, there is an exception to the "four corners" rule that can significantly expand an insurer's duty to defend. This exception permits a court to consider "true but unpleaded facts" outside the allegations of the underlying complaint when analyzing whether an insurer owes a duty to defend. It is important to understand this exception to the "four corners" rule and how information in a claim file can trigger a duty to defend.

The traditional "four corners" rule strictly limits the duty to defend analysis to the allegations of the underlying complaint. Under the "four corners" rule, there is a duty to defend if the underlying complaint alleges facts that bring the case within, or potentially within coverage; however, there is *no* duty to defend if the allegations of the complaint do *not* bring the claim potentially within the coverage. The "four corners" governs most declaratory judgment actions under Illinois law.

However, while Illinois courts often recite that the standard for determining a duty to defend is the "four corners" rule, the truth is more complex. A well-established exception to the Illinois "four corners rule" applies where "true but unpleaded facts" outside of allegations of the complaint raise a potential for coverage. Thus, the Illinois duty to defend rule might be more accurately called a "four corners *plus*" rule, because a duty to defend may be found based on "true but unpleaded facts" within an insurer's knowledge, even if no potential for coverage is established by the four corners of the complaint. This exception never benefits an insurer.

The "True But Unpleaded Facts" Doctrine

The "true but unpleaded facts" doctrine was first introduced into Illinois law by the Appellate Court in Associated Indemnity Co. v. Insurance Company of North America, 68 Ill.App.3d 807, 386 N.E.2d 529 (1st Dist. 1979). Even today, the Appellate Court's opinion in Associated Indemnity provides the classic statement of the "true but unpleaded facts" doctrine:

> "[A]n insurance carrier may not ignore unpleaded facts within its knowledge, which it knows to be correct, and which, when taken together with the complaint's allegations, indicate that the claim asserted against the putative insured is potentially within the coverage of the insurance policy."

Case law since Associated Indemnity has clarified what will qualify as "true but unpleaded facts" for purposes of this exception to the "four corners" rule. The doctrine is not meant to apply to situations in which the only extraneous facts in the possession of the insurer were supplied by the insured. Shriver Insurance Agency v. Utica Mutual Insurance Company, 323 Ill.App.3d 243, 251, 750 N.E.2d 1253, 1259 (2nd Dist. 2001). Accordingly, the duty to defend analysis should not consider allegations plead by the insured in a third party complaint in the underlying case. L.J. Dodd Construction Company v. Federated Mutual Insurance Company, 365 Ill.App.3d 260, 848 N.E.2d 656 (2nd Dist. 2006); National Union Fire Insurance Company v. R. Olsen Construction Contractors, Inc., 329 Ill.App.3d 228, 769 N.E.2d 977 (1st Dist. 2002).

Typically, the "true but unpleaded facts" doctrine refers to facts that are known to be true by the insurer based upon the insurer's own investigation of the underlying claim. Shriver, supra, 323 Ill.App.3d at 251, 750 N.E.2d at 1259. For example, in La Rotunda v. Royal Globe Insurance Co., 87 Ill. App. 3d 446, 408 N.E.2d 928 (1st Dist. 1980), the insurer denied coverage citing a business use of the insured's property. Although the claimant's complaint was silent as to whether the property was devoted entirely to business use, the insurer's own investigation affirmatively established that part of the property was not being used for any business purpose. Accordingly, the court in La Rotunda held that the facts known to be true through the insurer's investigation created a potential for coverage and triggered duty to defend.

The courts have declined to impute knowledge to insurers that they might have obtained (but did not actually obtain) through a more thorough investigation. See Associated Indemnity, supra, 68 Ill. App. 3d 807, 817 n.5, 386 N.E.2d at 536 n.5. However, questionable allegations or "facts" contained in a claim file that an insurer does not dispute may be considered to be "true but unpleaded facts" in the insurer's possession, unless the insurer makes some effort to contest their veracity. See Shriver, supra, 323 Ill.App.3d at 251, 750 N.E.2d at 1259.

When the "true but unpleaded facts" doctrine is combined with Illinois' estoppel rule, the results can be disastrous. An insurer relying on the "four corners" rule might accurately and in good faith determine that it has no duty to defend based on the allegations of the underlying complaint. However, "true but unpleaded facts" contained in the insurer's claim file could yet establish a duty to defend. Under current law, Illinois' estoppel rule contains no exception for cases where a duty to defend is triggered by "true but unpleaded facts" rather than by the allegations of the underlying complaint. This means that there is a threat of estoppel when a duty to defend is established by "true but unpleaded facts," even when the allegations of the complaint do not establish a potential for coverage, unless the insurer either defends under a reservation of rights or files a declaratory judgment action.

Two lessons to remember from this issue of Coverage Basics are: (1) under Illinois law, a duty to defend can be established based upon "true but unpleaded facts" contained in a claim file, and (2) questionable information or alleged "facts" contained in a claim file can trigger a duty to defend, unless they are questioned or rebutted by the insurer.

* * *

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.