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Illinois Coverage Basics

How Quickly Must An Insurer Act To Avoid Estoppel In Illinois?

Without a doubt, the greatest threat to liability insurers in Illinois is estoppel. Under Illinois' law of estoppel the only two ways that an insurer can safely preserve a coverage defense are to either: (a) defend its insured under a reservation of rights, or (b) file a declaratory judgment action to confirm the applicability of the coverage defense. If an insurer fails to undertake one of these two methods, it will later be barred from asserting its coverage defenses.

By now, insurers generally understand *what* they must do to avoid estoppel in Illinois, but most remain in doubt as to *when* those defense-preserving actions must be undertaken. No Illinois statute or regulation provides an answer to that question. Nor have the Illinois courts provided a bright line rule to inform insurers how promptly they must act to avoid estoppel. The Illinois decisions are vague and leave insurers in doubt to act at their peril. To make matters even worse, the answer to this timing question also depends upon the particular appellate district in which the question is raised.

What the Illinois Supreme Court Has Said On the Issue

The Illinois Supreme Court has offered little guidance regarding how soon an insurer must act to defend under reservation or file a declaratory judgment action to successfully avoid estoppel. One of the few clear guideposts provided by the Supreme Court is that an insurer cannot delay action until the suit against its insured has been settled or resolved by judgment. An insurer who waits until after a settlement or judgment to offer its insured a defense or to file a coverage action will be estopped from asserting coverage defenses. Employers of Wausau v. Ehlco Liquidating Trust, 186 Ill.2d 127, 157, 708 N.E.2d 1122, 1138 (1999).

In State Farm Fire & Casualty Co. v. Martin, 186 Ill.2d 367, 710 N.E.2d 1228 (1999), the Illinois Supreme Court clarified that the operative act for avoiding estoppel is the insurer's act of filing the declaratory judgment action, not necessarily its obtaining judgment in the declaratory judgment action. An insurer will not be estopped from denying coverage merely because the underlying case proceeds to judgment before judgment is rendered in the declaratory judgment action, so long as the declaratory judgment action was timely filed. In other words, the applicability of estoppel will not be determined by the fortuity of which case is resolved first.

Aside from the general guidance provided by Ehlco and Martin, the Illinois Supreme Court has remained silent on the timing question. However, the Illinois Appellate Court has interpreted Ehlco and Martin as requiring insurers to act "promptly" (*see* Household

International, Inc. v. Liberty Mutual Insurance Co., 321 Ill.App.3d 859, 869, 749 N.E.2d 1, 9 (1st Dist. 2001)) or in a "timely" manner (*see* Aetna Casualty & Surety Co. v. O'Rourke Brothers, Inc., 333 Ill.App.3d 871, 776 N.E.2d 588, 596 (3rd Dist. 2001)) to preserve their coverage defenses. These later interpretations of Ehlco and Martin have spawned inconsistent approaches regarding how soon an insurer must act to preserve its coverage defenses.

Three Distinct Approaches To the "Timeliness" Question

In the absence of any significant guidance from the Illinois Supreme Court, panels of the Illinois Appellate Court have forged diverse and inconsistent answers to the "timeliness" question. One group of decisions from the Appellate Court holds that a declaratory judgment action is timely if it is filed at any time before the underlying suit is terminated. *See*, e.g., Pekin Insurance Company v. Allstate Insurance Co., 329 Ill.App.3d 46, 768 N.E.2d 211 (1st Dist. 2002); Farmers Automobile Insurance Association v. Country Mutual Insurance Co., 309 Ill.App.3d 694, 722 N.E.2d 1228 (4th Dist. 2002).) This approach provides a bright line standard: if a declaratory judgment action is filed after the underlying action is resolved, it is too late.

A second group of the Appellate Court decisions imposes estoppel if it appears that the insurer waited until settlement or judgment in the underlying case was imminent before taking action to preserve its coverage defenses. *See*, e.g., Aetna Casualty & Surety Co. v. O'Rourke Brothers, Inc., 333 Ill.App.3d 871, 776 N.E.2d 588, 596 (3rd Dist. 2001); Westchester Fire Insurance Company v. Heileman Brewing Co., 321 Ill.App.3d 622, 747 N.E.2d 955 (1st Dist. 2001). This approach rejects the objective standard supplied by the first approach and substitutes an imprecise subjective standard. Under this approach, the courts decide on a case by case basis whether the insurer waited too long to preserve its coverage defenses, using the date of settlement or judgment in the underlying case as a reference point but not as the exclusive test.

An emerging third group of Appellate Court decisions utilizes a "reasonable time" test, which allows the court to apply estoppel in each case based on the particular facts and circumstances. This is currently the law in two of Illinois' five appellate districts. *See* State Automobile Mutual Insurance Company v. Kingsport Development, LLC, 364 Ill.App.3d 946, 960, 846 N.E.2d 974, 987 (2nd Dist. 2006); L.A. Connection v. Penn-American Insurance Co., 363 Ill.App.3d 259, 265, 843 N.E.2d 427, 433 (3rd Dist. 2006). Under this approach, the courts decide whether an insurer has waited too long to preserve its coverage defenses, guided solely by the deciding court's discretionary judgment as to what it feels is reasonable under all the facts. These courts admittedly prefer the "reasonable time" approach because they believe that the undefined threat of estoppel works best to encourage "quick action" on the part of insurers. Id.

The trend of the Appellate Court decisions is not favorable to insurers. Even when an insurer has filed a declaratory judgment action to preserve its coverage defenses, estoppel may still be imposed based on a court's determination that the insurer did not act *soon enough* to preserve its coverage position. The recent Appellate Court decisions supply less certainty than ever to inform insurers how quickly they must act to avoid estoppel in Illinois.

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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.