

# Cray • Huber

## **Illinois Coverage Basics**

### *Escaping Estoppel Errors: If Absence of Coverage is Clear An Insurer Might Avoid Estoppel*

The most dangerous rule in Illinois' coverage law is, without a doubt, Illinois' rule of insurer estoppel. Under Illinois' traditional rule of insurer estoppel, there are only two ways that an insurer can 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 validity of the defense. Under the general rule, if an insurer simply denies coverage without undertaking one of those two methods for preserving its coverage defense, it will be barred from asserting its coverage defenses.

Although the Illinois Supreme Court announced the estoppel rule in 1999, insurers continue to get caught in the estoppel trap. Maybe some insurers are not aware of the estoppel rule. Others may be reluctant to advance the costs that must be incurred to avoid estoppel (i.e., the costs of defending under reservation or prosecuting a declaratory action). Other insurers may be confused by the inconsistent estoppel rulings issued by the Illinois Appellate Court.

The only sure way to avoid estoppel is to defend under reservation of rights or file a declaratory judgment action. If an insurer denies coverage and does not pursue either one of those two alternatives, it will be called upon to respond to estoppel allegations. When that occurs, it becomes the insurer's practical burden to show why the estoppel rule should not be applied.

To this end, one hopeful line of rulings suggests that estoppel should not be applied against an insurer if the absence of coverage is "clear." Under this line of cases an insurer that fails to defend under reservation of rights or file a declaratory judgment action might escape estoppel if "there clearly was no coverage or potential for coverage." Employers Insurance of Wausau v. Ehlco Liquidating Trust, 186 Ill.2d 127, 151, 708 N.E.2d 1122, 1135 (1999).

Of course, this "clearly no coverage" exception to the estoppel rule raises some important questions, including: (1) who decides what is "clear"; and (2) how "clear" must the absence of coverage be to avoid estoppel? The answers, not surprisingly, are that (1) a court must decide whether a coverage defense is "clear," thus (2) it is impossible to know in advance whether a particular coverage defense will be deemed to be sufficiently "clear" to avoid estoppel.

The decisions construing the "clearly no coverage" estoppel exception are inconsistent and few; consequently they have little practical predictive value. What seems "clear" to an insurer may not be so clear to a court, and what is clear to one court may not be as clear to another.

The analytical problem with the emerging “clearly no coverage” exception to the estoppel rule is that it lacks any well-defined theoretical foundation or standards. Courts apply this exception based solely upon an isolated line of *dicta* from the Illinois Supreme Court’s opinion in Ehlco, without making any effort to support their rulings with a coherent rationale. Since the Illinois Supreme Court made only passing reference to the “clearly no coverage” exception in Ehlco (i.e., “application of the estoppel doctrine is not appropriate if . . . there clearly was no coverage or potential for coverage.” Ehlco, 186 Ill.2d at 151, 708 N.E.2d at 1135), the lower courts have struggled to make sense of the exception, producing highly inconsistent results. Further, the instructive value of these rulings is minimal, because the result in each case necessarily depends upon the particular policy defense and underlying pleadings examined in each case.

Despite the unsettled state of the decisions, the “clearly no coverage” exception to the rule of estoppel may provide insurers with an important argument in circumstances where a finding of estoppel may otherwise appear to be inevitable. For example, some courts have held that estoppel should not be applied where the underlying pleadings allege no “property damage” caused by an “occurrence.” Lyerla v. Amco Insurance Co., 2008 WL 2955573 (7<sup>th</sup> Cir. 2008); Mutlu v. State Farm Fire and Casualty Co., 337 Ill.App.3d 420, 785 N.E.2d 951 (1<sup>st</sup> Dist. 2003). At least one court has also ruled that a late notice defense is immune from estoppel. Northern Insurance Company of New York v. City of Chicago, 325 Ill.App.3d 1086, 759 N.E.2d 144 (1<sup>st</sup> Dist. 2001). Several courts have even held that there can be no estoppel where the applicability of a policy exclusion is clear. *See* Pope v. Economy Fire and Casualty Co., 335 Ill.App.3d 41, 779 N.E.2d 461 (1<sup>st</sup> Dist. 2002) (“lead paint” exclusion); Gould & Ratner v. Vigilant Insurance Co., 336 Ill.App.3d 401, 782 N.E.2d 749 (1<sup>st</sup> Dist. 2002) (“professional services” exclusion); West Bend Mutual Insurance Co. v. Rosemont Exposition Services, Inc., 378 Ill.App.3d 478, 880 N.E.2d 640 (1<sup>st</sup> Dist. 2007) (“employment related practices” exclusion).

Yet, for every case that applies the “clearly no coverage” exception to overcome estoppel, others hold to the contrary. Estoppel may be applied even when a loss falls outside the insuring agreements of a policy. *See* Chandler v. Doherty, 299 Ill.App.3d 797, 702 N.E.2d 634 (4<sup>th</sup> Dist. 1998). Under the majority view, a late notice defense will not escape estoppel. Ehlco; Coltec Industries, Inc. v. Zurich Insurance Co., 2004 WL 413304 (N.D. Ill. 2004). Further, even a strong coverage defense based on a policy exclusion ordinarily will not excuse an insurer from the estoppel rule. West American Insurance Co. v. J.R. Construction Co., 334 Ill.App.3d 75, 777 N.E.2d 610 (1<sup>st</sup> Dist. 2002); Pietras v. Sentry Insurance Co., 2007 WL 715759 (N.D. Ill. 2007).

The “clearly no coverage” exception provides insurers with an after-the-fact rationale for rebutting estoppel arguments encountered in litigation, but it does not provide a reliable basis for addressing coverage disputes in real time. The cases applying this exception are still too few and too inconsistent for insurers to safely assume that the rule of estoppel will be suspended with respect to any particular coverage defense. But when an estoppel error is alleged in litigation, this exception may provide an effective argument for avoiding the estoppel sanction.

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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](mailto:jkh@crayhuber.com).