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Illinois Coverage Basics

Fresh Strategies for Hard Times: Underwriting Solutions for Some of Illinois' Worst Insurance Rules

In recent years, the Illinois courts have enacted several rules that have made the handling of liability claims more difficult and expensive for insurers doing business in Illinois. To date, the Illinois legislature has not taken any meaningful steps to rein in the activist courts. Unexpectedly, simple underwriting solutions may be available to neutralize some of Illinois' most notorious anti-insurer rules.

Neutralizing the *John Burns* Targeted Tender Rule

In John Burns Construction Co. v. Indiana Insurance Co., 189 Ill.2d 570, 574 (2000), the Illinois Supreme Court effectively removed "other insurance" clauses from liability policies in Illinois when it announced the "targeted tender rule" (also known as the "selected tender rule"). Under the targeted tender rule, an insured who is covered by two or more primary policies has the right to select which of those policies must provide defense and indemnity. By targeting a tender to one available insurer, the insured may "deselect" all other available policies, thereby excusing the deselected insurers from contributing to defense and indemnity and immunizing the deselected insurers from any contribution obligation to the insurer targeted by the insured.

While insurers may use the John Burns targeted tender rule to their advantage in particular cases, the effect of the rule is generally unfavorable because it defeats the clear intent of "other insurance" clauses and frustrates the traditional goal of equitable sharing of the risk. Although the targeted tender rule has had a profound effect on claims handling in Illinois, and the Illinois legislature has done nothing to override the court-made rule, there is a simple underwriting solution to the John Burns problem. It is this: courts will enforce policy provisions that require an insured to tender to any other insurers. In American Country Insurance Co. v. Kraemer Bros., Inc., 298 Ill.App.3d 805, 807 (1st Dist. 1998), the Illinois Appellate Court held that an insurer can effectively opt out of the targeted tender rule by placing language in a policy that requires the insured to tender to other insurers.

Neutralizing the *General Agents* No-Reimbursement for Defense Costs Rule

In General Agents Insurance Company of America, Inc. v. Midwest Sporting Goods Co., 215 Ill.2d 146, 148 (2005), the Illinois Supreme Court held that an insurer that defends under a reservation of rights may not later seek reimbursement from its insured for defense costs it has

incurred, even if it is later determined that the insurer never had a duty to defend. The Court's rationale for this rule was that if a liability policy does not expressly create such a right of reimbursement, an insurer should not be allowed to unilaterally create such a right by means of a reservation of rights letter.

The General Agents rule is unfavorable to both insurers and insureds. Insurers are hurt by the rule because it deprives them of the benefit of a favorable coverage ruling, at least to the extent that the insurer had advanced defense costs. Insureds are also hurt by the rule because it discourages insurers from advancing defense costs while the duty to defend issue is being litigated.

Insurance Services Office (ISO) has developed an endorsement that is specifically designed to negate the General Agents rule in Illinois. A special defense cost endorsement (IL 01 62 04 06) applicable to commercial general liability and umbrella policies neutralizes the General Agents rule by expressly stipulating that the insurer shall retain the right to seek reimbursement for defense costs that it has paid under reservation of rights. Although there are no published opinions addressing the enforceability of this endorsement, the endorsement is currently in use in Illinois.

Neutralizing the *Peppers* Obligation to Pay Conflict Counsel's "Reasonable Rates"

In Maryland Casualty Co. v. Peppers, 64 Ill.2d 187, 199 (1976), the Illinois Supreme Court held that if an insurer's reservation of rights creates a conflict of interest, the insured has a right to select and retain defense counsel at the insurer's expense. The only limitation on the insurer's obligation to pay defense costs under these circumstances is that the charges of the defense attorney must be "reasonable." This "reasonable rate" rule disadvantages insurers defending under reservation of rights because the rates of defense counsel chosen by insureds may greatly exceed the rates of defense counsel chosen by an insurer in the regular course of business.

A potential underwriting solution to this problem is an endorsement that mimics California's statutory Cumis counsel rate limitation under the terms of an endorsement in use in Illinois, the rates paid to conflict counsel are expressly limited to the rates actually paid by the insurer to other attorneys for similar work. The endorsement does not abridge the insured's right to select conflict counsel; it merely limits the amount that the insurer will pay. No published opinion in Illinois has yet addressed this endorsement.

Hard times call for better solutions. Although the Illinois courts have shown a propensity for creating rules that disadvantage liability insurers, they are traditionally inclined to enforce clear contractual terms unless public policy precludes enforcement. Many of Illinois' most difficult anti-insurer rules may be avoided by adding language to policies that unambiguously requires outcomes more favorable than the outcomes otherwise mandated by Illinois law.

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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.