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Illinois Coverage Basics

A Quiet Revolution in Illinois' Duty to Defend Rules

While the rest of the country has been preoccupied with the national economic crisis, a group of activist jurists in Illinois' First District Appellate Court have set out to rewrite this state's duty to defend standard. And, it appears that they may have accomplished their objective. In a groundbreaking series of opinions beginning in March 2008, the Sixth Division of Illinois' First District Appellate Court created a new test to determine if a liability insurer owes a duty to defend. The Sixth Division's view is that the traditional "four corners" rule is dead in Illinois. The new rule, as crafted by the Sixth Division of the First District court, is that an insurer's duty to defend should be determined by the allegations of the underlying complaint plus whatever other information might indicate a potential for coverage.

The traditional rule in Illinois, which is also the governing rule in most jurisdictions, is that a liability insurer's duty to defend should be determined by comparing the allegations of the complaint and the relevant parts of the insurance policy. Outboard Marine Corp. v. Liberty Mutual Insurance Co., 154 Ill.2d 90, 107-108 (1992). Narrow exceptions have been suggested, but the cases discussing those exceptions have been few, and the Illinois Supreme Court has never approved any exceptions. Consequently, Illinois has always been counted as a strict "four corners" jurisdiction, meaning that an insurer's duty to defend must be determined solely from the allegations contained within the "four corners" of the underlying complaint.

However, beginning a little over one year ago, a small group of Appellate Court justices assigned to the Sixth Division of the Illinois First District Appellate Court began to set Illinois' duty to defend standard on a radically new course. Based on a core group of Sixth Division opinions, other Illinois courts have now also begun to follow a new duty to defend standard. This shift in Illinois' insurance law represents a decidedly negative change for liability insurers.

It all began on March 31, 2008, when the Sixth Division of the Illinois First District Appellate Court published its opinion in American Economy Insurance Company v. Holabird and Root, 382 Ill.App.3d 1017 (1st Dist. 2008) (Justice McBride, with Justice J. Gordon and Justice Cahill concurring). In Holabird and Root, the Appellate Court held that a duty to defend analysis should not be limited to the allegations of the underlying complaint; rather, a court should be free to consider all the relevant facts contained in all the pleadings filed in the case, including third-party complaints. The Sixth Division recognized that there was clear precedent to the contrary, but it declined to follow that precedent. In *dicta*, the Holabird and Root opinion suggested that a court deciding a duty to defend issue might even properly consider evidence outside the pleadings, such as depositions and photographs.

On May 30, 2008, the Sixth Division reaffirmed its "beyond the four corners rule" in American Economy Insurance Company v. De Paul University, 383 Ill.App.3d 172 (1st Dist. 2008) (Justice

McBride, with Justice Garcia and Justice Cahill concurring). In the DePaul University opinion, the Appellate Court confirmed the new rule by citing its own Holabird and Root opinion. It held that extrinsic evidence should be considered on the duty to defend issue unless such evidence would touch upon a “critical issue” to be decided in the underlying case.

On December 19, 2008, the Sixth Division revisited and reconfirmed the “beyond the four corners rule” in Clarendon American Insurance Company v. B.G.K. Security Services, Inc., 387 Ill.App.3d 697 (1st Dist. 2008) (Justice McBride, with Justice O’Malley and Justice Cahill concurring). The court ruled that extrinsic evidence may be utilized in a duty to defend analysis unless the evidence involves an “ultimate fact” at issue in the underlying case.

On June 5, 2009, the Sixth Division once again returned to solidify the “beyond the four corners rule” in Mota Construction Company v. Westfield Insurance Company, 2009 WL 1606723 (1st Dist. 2009) (Justice J. Gordon, with Justice O’Malley and Justice McBride concurring). In Mota Construction, the Sixth Division again noted that prior precedent prohibited consideration of a third-party complaint in connection with a duty to defend issue, but it declined to follow that authority. Mota Construction is the Sixth District’s most recent articulation of the new rule.

It was not long before the Sixth Division’s new duty to defend standard began to gain momentum among other courts. After Justice Garcia (who concurred in the Sixth Division’s De Paul University opinion) was transferred to the First Division of the First District Appellate Court, he authored National Fire Insurance of Hartford v. Walsh Construction Company, 2009 WL 1393417, which unreservedly recognized Holabird and Root as the law of Illinois. Other panels of the Illinois Appellate Court have now also followed Holabird and Root. See Cincinnati Insurance Company v. American Hardware Manufacturers Association, 387 Ill.App.3d 85 (1st Dist. 2008) and Pekin Insurance Company v. Wilson, 2009 WL 1620398 (5th Dist. 2009). The federal Northern District Court has also recognized Holabird and Root as the law of Illinois. See Firemen’s Fund Insurance Company v. Amstek Metal, LLC, (N.D.Ill. 2008) and General Insurance Company of America v. Clark Mall, Corp., 2009 WL 1035041 (N.D.Ill. 2009).

The Sixth Division’s redefinition of the duty to defend standard in the Holabird and Root line of cases is significant and detrimental to insurers. Under this new line of authority, a court evaluating an insurer’s duty to defend will “not wear judicial blinders and may look beyond the complaint at other evidence.” Holabird and Root, 382 Ill.App.3d at 1032. This means that a duty to defend may arise, even if the allegations of the complaint do not raise a potential for coverage. If evidence outside the complaint is available, it must also be considered when analyzing the duty to defend. While it does not appear that insurers in Illinois have an affirmative duty to investigate in order to uncover facts that may trigger a duty to defend, policyholders may begin to argue that such a duty does exist.

The Illinois Supreme Court has accepted review of the Sixth Division’s Holabird and Root opinion. 229 Ill.2d 617. Until the Illinois Supreme Court rules, uncertainty will remain as to whether the Holabird and Root line of cases or the traditional “four corners” rule will govern duty to defend determinations under 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.