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Illinois Coverage Basics

Appellate Court's First Estoppel Ruling of 2010 Reflects Evolution and Hardening of the Troublesome Doctrine

The doctrine of estoppel receives frequent attention in this newsletter because estoppel is one of the worst things that can happen to a liability insurer. Simply stated, Illinois' rule of insurer estoppel strips insurers of their coverage defenses. In fact, it does more than that. An even more robust version of estoppel is now evolving. An emerging doctrine of estoppel not only precludes insurers from asserting coverage defenses; it may deprive them of even the most fundamental definitions and limitations of the contractual coverage.

Whatever hopes insurers may have had that courts would soften Illinois' harsh estoppel doctrine were laid to rest by the First District Appellate Court's February 2010 opinion in Uhlich Children's Advantage Network v. National Union Fire Company (No. 1-08-3400). The Uhlich opinion introduces a form of "estoppel on steroids." Uhlich not only applied estoppel to an insurer that (the Court acknowledged) had no duty to defend; it also employed the estoppel doctrine to expand the scope of coverage beyond the terms of the policy's insuring agreement. Illinois estoppel has always been bad, but with Uhlich it has gotten a lot worse.

The Uhlich Case

In Uhlich, a former employee of the Uhlich Children's Advantage Network (UCAN) filed suit against UCAN and one of its officers alleging that UCAN and the officer had retaliated against the claimant for exercising his rights under the Family and Medical Leave Act. National Union insured UNAC and the officer for such claims under claims-made policies. However, a coverage issue arose because the former employee's claim against UCAN and the officer was first made during a prior policy but was not reported to National Union until a later policy period.

The Appellate Court recognized that the National Union policies were "claims first made and reported" policies, meaning that the insuring agreements of policies provided coverage only to claims that were first made and reported within the same policy period. The policies also contained notice conditions requiring the insureds to give the insurer written notice claims "as soon as practicable."

National Union did not receive notice of the retaliation claim for approximately three years after the claim was initially made against UCAN and its officer. More importantly, the claim was not "first made and reported" within the policy period of either of the National Union policies. Consequently, National Union denied coverage. In response, UCAN and the officer filed a declaratory judgment action to challenge the coverage denial, but the trial court found in favor of National Union. The insureds then appealed.

Estoppel on Steroids

On appeal, National Union contended that the judgment should be affirmed because the claim against UCAN was not first made and reported during the policy period, as required for coverage under the terms of the policy's insuring agreement. However, the Appellate Court began its analysis of the coverage question with a recital of the rule of estoppel, rather than looking to the insuring agreement of the policy. Citing Employers Insurance of Wausau v. Ehlco Liquidating Trust, 186 Ill.2d 127(1999), the Appellate Court in Uhlich recited the well-known rule that in order to preserve a coverage position an insurer in Illinois must either file a declaratory judgment action or defend its insured under reservation of rights.

The Uhlich Court found "there is nothing in Ehlco limiting the estoppel doctrine to occurrence-based policies." The Appellate Court also found that Ehlco "expressly rejected" National Union's contention that a claim made and reported during the policy period is a condition precedent for coverage that cannot be defeated by the rule of estoppel. Characterizing the "claims first made and reported" prerequisites of the policy's insuring agreement policy merely as a notice provision, the Appellate Court found that "there is no exception to the estoppel doctrine for late-notice defenses," and ruled that National Union was estopped from denying coverage on the basis that the claim was not "first made and reported" during the policy period.

In its general discussion of the estoppel doctrine the Appellate Court in Uhlich stated that estoppel arises only when an insurer breaches its duty to defend. This is a point often made by insurers in efforts to avoid estoppel. However, the Uhlich Court went on to find that had National Union not been estopped under Ehlco, it would not have had a duty to defend UCAN. Using purely circular logic, the Appellate Court found that National Union was estopped because it had breached its duty to defend, and it then found that National Union had breached its duty to defend because it was estopped to assert any coverage defenses. The Uhlich opinion explained:

[O]nce the insurer breaches its duty to defend, the estoppel doctrine "has broad application and operates to bar the insurer from raising policy defenses to coverage, even those defenses that may have been successful had the insurer not breached its duty to defend" . . . Accordingly, but for Ehlco, [National Union] would not have had a duty to defend . . . Ehlco required [National Union] to either represent [UCAN] under a reservation of rights or file a declaratory action.

It is difficult for insurers to successfully argue for the limitation of the estoppel doctrine, because the Illinois Supreme Court never explained the analytical basis for the rule. As such, the doctrine tends to continuously expand in application. As an unfortunate example of this trend, Uhlich now stands as authority for the following propositions: (a) a breach of a duty to defend can be based upon a duty to defend that is created by estoppel, and (b) estoppel can create coverage where coverage would not exist under the terms of the insuring agreement itself.

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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.