

Cray • Huber

Illinois Coverage Basics

Insurers' Exposure for Their Insureds' Attorney Fees in Illinois Coverage Litigation

An important exposure to be evaluated when you consider whether to file a declaratory judgment action is whether you will be ordered to pay your insured's attorney fees if you lose the coverage dispute. If an insured wins a coverage action in a court in Illinois, the insurer might be required to pay the insured's coverage attorney's fees, but not necessarily. Whether you will be ordered to pay your opponent's attorney fees depends upon a combination of factors, which, to some extent, remains within the control of the insurer. Understanding the potential for an adverse award of attorney fees will help you decide whether, and where, to litigate your coverage issues.

It is clear that if an insurer *wins* a coverage action in Illinois, it has no exposure for the insured's attorney fees. However, if the insurer *loses* a coverage case, there are two ways that the insured may be able to obtain an order requiring the insurer to pay its attorney fees and costs in the coverage case.

Attorney Fees Will Not Be Awarded against an Insurer Merely Because a Court Finds That the Insurer's Coverage Position Is Incorrect

The general rule in Illinois state courts has always been that parties in litigation must bear their own attorney fees, unless a statute or contract specifically authorizes a court to make an award of attorney fees. W.E. O'Neil Construction Co. v. General Casualty Co., 321 Ill.App.3d 550, 558 (1st Dist. 2001). Win or lose, each party normally must pay its own lawyer bills in a declaratory judgment action. Westchester Fire Insurance Company v. G. Heileman Brewing Co., 321 Ill.App.3d 622, 637 (1st Dist. 2001).

For many years, the rule was different in the federal courts in Illinois. In the federal courts, unsuccessful insurers in declaratory judgment actions were routinely required to pay their insureds' attorney fees when the courts ruled against an insurer's coverage positions. See Green v. J.C. Penney Auto Insurance Company, 806 F.2d 759, 765 (7th Cir. 1986). However, that conflict has been resolved, and the federal courts now apply the same rule as the Illinois state courts. Taco Bell Corp. v. Continental Casualty Co., 388 F.3d 1069, 1077-1078 (7th Cir. 2004). Today, the general rule in state and federal courts in Illinois is that attorney fees cannot be imposed against an insurer simply for being wrong about its coverage position.

Attorney Fees Can Be Imposed against an Insurer Because the Insurer's Coverage Position Is Vexatious and Unreasonable

Although losing a coverage action does not automatically mean that an insurer must pay the insured's attorney fees in a coverage action, attorney fees may be awarded if a court finds that the insurer's position is not only wrong, but wrong to the extent of being beyond the realm of good faith. In Illinois, attorney fees can be awarded against an insurer in a declaratory judgment action under Section 155 of the Insurance Code if the insurer's refusal to pay is found to be

“vexatious and unreasonable.” (215 ILCS 5/155.) But the law is clear that attorney fees cannot be imposed under Section 155 of the Insurance Code if the insurer was simply wrong in asserting its coverage position. International Insurance Company v. City of Chicago Heights, 268 Ill.App.3d 289 (1st Dist. 1994).

Section 155 is sometimes referred to as the Insurance Code’s “bad faith statute,” but the statute’s “vexatious and unreasonable” standard is not identical to the common law bad faith standard. Because the statute is penal in nature its provisions are strictly construed. Morris v. Auto-Owners Insurance Company, 239 Ill.App.3d 500 (4th Dist. 1993). No single factor is controlling in determining whether an insurer is guilty of vexatious misconduct in refusing to pay; the totality of circumstances broadly determines whether the standard has been met. Millers Mutual Insurance Association v. House, 286 Ill.App.3d 378 (5th Dist. 1997).

Attorney fees may not be awarded under Section 155 simply because an insurer takes an unsuccessful position in litigation; rather, the insured has the burden of proving that the insurer’s behavior was willful and without reasonable cause. Morris, supra. This is a somewhat vague standard, but courts have ruled that an insurer’s conduct is not vexatious and unreasonable if: (1) there is a bona fide dispute concerning the scope and application of insurance coverage; or (2) the insurer asserts a legitimate policy defense; or (3) the claim presents a genuine legal or factual issue regarding coverage; or (4) the insurer takes a reasonable legal position on an unsettled issue of law. Citizens First National Bank of Princeton v. Cincinnati Insurance Co., 200 F.3d 1102, 1110 (7th Cir. 2000).

Attorney Fees Can Be Imposed If the Insurer’s Position in Litigation Is Frivolous

Rule 11 of the Federal Rules of Civil Procedure and Illinois Supreme Court Rule 137 authorize courts to award attorney fees if a party’s pleadings are deemed to be frivolous. These rules apply to insurance declaratory judgment actions in the same way that they apply to other civil actions. They also apply with equal force to insurers and to insureds in coverage litigation. Significantly, these procedural rules provide the only way that an insurer can collect its attorney fees from an insured in a coverage dispute.

Under Rule 11, which is the basis for the state court rule, a court has discretion to make an award of attorney fees to the prevailing party (either an insurer or an insured) if the court finds that (1) the opposing party’s position was presented for an improper purpose, such as to harass, cause unnecessary delay, or needlessly increase the cost of litigation; or (2) the opposing party’s claims or legal contentions were not warranted by existing law or by a nonfrivolous argument for establishing new law; or (3) the opposing party’s factual contentions lacked evidentiary support; or (4) the opposing party’s denials of the insurer’s factual contentions are warranted on the evidence.

In summary, there should be no potential that a court will order an insurer to pay its insured’s attorney fees in coverage litigation in Illinois, unless the insurer’s coverage position is “vexatious and unreasonable” (the Section 155 standard) or the insurer violates federal Rule 11 or its state court correlate. On the flip side, under federal Rule 11 or state Rule 137 an insurer may seek its attorney fees from an insured that has taken improper or unwarranted positions in coverage litigation.

* * *

This newsletter provides information on recent legal developments. It is not intended to provide legal advice for a specific situation or to create an attorney-client relationship. If you have questions, please feel free to contact Jim Horstman (312.332.8494; jkh@crayhuber.com).