

# Cray • Huber

## Illinois Coverage Basics

### Whether An Insurer Must Pay An Insured's Attorney Fees In Coverage Litigation Depends Upon Three Standards In Illinois.

An important exposure to be evaluated when considering whether to file a declaratory judgment action is the potential for an adverse award of attorney fees. If the insured wins a coverage action in a court in Illinois, the insurer might be ordered to pay the insured's coverage attorney's fees. Whether such an award is made against the insurer depends upon a combination of factors, which, to some extent, the insurer can control. Understanding this exposure will help you decide whether, and where, to litigate coverage issues.

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 basically three ways that the insured can seek an order requiring the insurer to pay its expenses in the coverage case. The likelihood of such an award being entered against an insurer in Illinois depends primarily upon whether the case is in state court or federal court. Insureds seeking reimbursement of their attorney fees in a coverage case may resort to three different standards or theories of recovery.

#### Attorney Fees Imposed Because The Insurer's Coverage Position Is Incorrect

The general rule in the United States is that parties in litigation bear their own attorney fees, unless a statute or contract specifically provides for an award of attorney fees. Win or lose, each party pays its own lawyer bills under the general rule. However, within Illinois an exception to the general rule is recognized for insurance coverage declaratory actions, which allows a victorious insured to obtain reimbursement for its attorney fees from the insurer. Under this exception, the standard for recovering attorney fees against an insurer is very low. All that is required for an award of attorney fees under this exception is for the court to rule that the insurer's coverage position is incorrect.

Importantly, this exception to the general rule is applied only in federal courts in Illinois. (*National Cycle, Inc. v. Savoy Reinsurance Company, Ltd.*, 938 F.2d 61 (7<sup>th</sup> Cir. 1991).) In Illinois state courts, the general "no attorney fees" rule is followed. Even if an insured wins a coverage action in the Illinois state courts, attorney fees cannot be imposed against the insurer simply for being wrong about its coverage position. (*Brotherhood Mutual Insurance Company v. Roseth*, 177 Ill.App.3d 443, 532 N.E.2d 354 (1<sup>st</sup> Dist. 1988); *Bonnie Owen Realty, Inc. v. Cincinnati Insurance Company*, 283 Ill.App.3d 812, 670 N.E.2d 1182 (5<sup>th</sup> Dist. 1996).) In contrast, in federal courts throughout Illinois, the insured's attorney fees may be awarded against the insurer whenever a court finds that the insured's coverage position is incorrect. Nothing else is required for an award of attorney fees against an insurer in federal court in Illinois.

## Attorney Fees Imposed Because The Insurer's Coverage Position Is Vexatious and Unreasonable

In state courts in Illinois, a higher standard applies when an insured seeks reimbursement for its attorney fees in a coverage action. In the Illinois state courts, attorney fees will be imposed against an insurer pursuant to the Insurance Code only if the insurer's refusal to pay is deemed to be vexatious and unreasonable. (215 ILCS 5/155.) Before attorney fees will be imposed under Section 155 of the Insurance Code, more must be shown than that the insurer was simply wrong in asserting its coverage position. (*International Insurance Company v. City of Chicago Heights*, 268 Ill.App.3d 289, 643 N.E.2d 1305 (1<sup>st</sup> 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, 606 N.E.2d 1299 (4<sup>th</sup> Dist. 1993).) No single factor is controlling in determining whether an insurer is guilty of vexatious delay in refusing to pay; rather, the totality of circumstances broadly determines the question. (*Morris, supra*; *Millers Mutual Insurance Association v. House*, 286 Ill.App.3d 378, 675 N.E.2d 1037 (5<sup>th</sup> Dist. 1997).) Fees should not be awarded under Section 155 if there is a *bona fide* dispute concerning the scope and application of insurance coverage. (*Morris, supra*; *Green v. International Insurance Company*, 238 Ill.App.3d 929, 605 N.E.2d 1125 (2<sup>nd</sup> Dist. 1992).)

Importantly, Section 155 fees are not automatically awarded against an insurer simply because the insurer fails to prove its coverage position. Under Section 155, the insured has the burden of proving that the insurer acted with improper intent in refusing payment.

## Attorney Fees Imposed Because The Insurer's Coverage Position Is Frivolous

Rule 11 of the Federal Rules of Civil Procedure and Illinois Supreme Court Rule 137 authorize the courts to award attorney fees whenever a party's pleadings are deemed to be frivolous. In any civil case, such fees may be awarded on the motion of a party, or on the court's own motion, if the legal or factual basis for a pleading is deemed to be frivolous.

In summary, the likelihood of an award of attorney fees against an insurer in a coverage case is much more likely in federal courts in Illinois than in the state court system. Although attorney fee awards are possible in the state courts, the insured has a higher burden of proof to obtain fees in state court than in federal court. In some cases, this exposure will militate strongly in favor of filing a coverage action in Illinois state court, rather than in federal court.

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If you have questions or would like to discuss the subject of this article further, please feel free to contact James K. Horstman at Cray Huber Horstman Heil & VanAusdal LLC, 303 West Madison Street, Suite 2200, Chicago IL 60606; 312-332-8494; [jkh@crayhuber.com](mailto:jkh@crayhuber.com).