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## Illinois Coverage Basics

### A Primary Liability Insurer Does Not Discharge Its Policy Obligations By Tendering Its Indemnity Limits, Unless A Release Of The Insured Is Obtained In Return

In cases where the exhaustion of primary limits seems inevitable, frustrated primary insurers often ask whether they can tender their limits and end their involvement in the case. Early exhaustion of the primary insurer's indemnity limits would be an attractive possibility in such a case, because by exhausting its limits the insurer at the same time might terminate its duty to defend and avoid paying additional expense. In some jurisdictions, even some sharing borders with Illinois, this may be an effective and approved practice. However, in Illinois it is not.

Under the law of Illinois, a primary insurer cannot tender its limits to a claimant and escape its duty to defend its insured. If such a tender of the limits is made, and the insured is not released in exchange for the limits payment, the insurer's duty to defend continues on. The insurer's duty to defend ends only if there is a settlement that results in the release of an insured. The outcome is no different if an insurer seeks to pay its indemnity limits into the court, instead of paying money directly to the claimant. Illinois law on this subject is firmly established by a 20 year-old opinion of the state's highest court.

The governing authority is Conway v. Country Casualty Insurance Company (1982), 92 Ill.2d 388, 442 N.E.2d 245, where the issue arose in the context of a vehicular accident. In Conway, the insurer paid its full indemnity limits to the injured plaintiff in an effort to close its involvement in the case. Although the plaintiff accepted the payment, she did not release either the insurer or the insured in return, but continued to actively prosecute her damages action against the insured. When the insured requested the insurer to defend him in the damages action, the insurer refused, citing a provision in its policy that purported to terminate its defense obligation whenever its indemnity limits became "exhausted by payments of any judgments or settlements." The insurer argued that its payment of its limits to the plaintiff had terminated both its defense and indemnity obligations to its insured.

The Illinois Supreme Court accepted the Conway case for review and ruled that an insurer cannot discharge its duty to defend its insured simply by making payments to a claimant in the amount of its indemnity limits. The Court noted that an insurer's duty to defend and duty to indemnify are separate and distinct. Although the language of the policy provided that the insurer's duty to defend terminated upon exhaustion of its indemnity limits through payment of settlements or judgments, the Court found that the insurer in Conway still owed a duty to defend

because it had made no payment pursuant to a settlement or judgment. In the absence of a bona fide settlement and release, the insurer's payment of its limits did not relieve it of its duty to defend.

The Illinois Supreme Court's analysis in Conway rested heavily upon a particular provision in the policy that expressly terminated the insurer's duty to defend upon exhaustion of its limits "through settlement or judgment." However, the same result has also been reached with respect to policies that do not contain the particular language examined in Conway. In Douglas v. Allied American Insurance, 312 Ill.App.3d 535, 727 N.E.2d 376 (5<sup>th</sup> Dist. 2000), several persons who were significantly injured in a vehicular accident brought suit against the insured driver, who was insured under a liability policy with a \$40,000 aggregate limit. It was clear that the limits of the policy were insufficient to adequately compensate all of the claimants, and the insurer tendered its \$40,000 limit to the court, leaving the task of disbursing the proceeds to the court. Following the insurer's payment of its indemnity limits, the defense attorney who had been hired by the insurance company withdrew from the insured's defense.

The insurance policy at issue in Douglas stated that the insurer's duty to defend would end when its limits were "exhausted by payment," but unlike the policy examined by the Illinois Supreme Court in Conway, it did not specify the manner in which the payment must be made to accomplish exhaustion. Nevertheless, the insurance policy at issue in Douglas did provide that the insurer's indemnity obligation was to pay "sums which the insured shall be become *legally* obligated to pay." In the absence of any other guidance in the policy language, the Douglas court concluded that the insurer's payment of the amount of its indemnity limits to the court did not constitute a payment for which the insured was *legally* obligated to pay. It was undisputed that the payment was made voluntarily by the insurer and was not made pursuant to settlement or judgment. Consequently, the Appellate Court in Douglas held that the payment which the insurer made to the court did not terminate the insurer's duty to defend.

The court in Douglas acknowledged that the insurance policy language construed in Conway was more explicit on the exhaustion question than the policy in Conway. Nevertheless, it concluded that, regardless of the particular language of the insurance policy, the public policy of the State of Illinois prohibits a liability insurer from escaping its duty to defend by simply tendering its limits. The Douglas court reasoned that to allow an insurer to terminate its duty to defend by tendering its limits, without obtaining a release for the insured, would render the policy's duty to defend "a near nullity."

The lesson of Conway and Douglas is that an insurer's payment of an amount equal to its indemnity limits does not terminate its duty to defend, whether the payment is made to the court or directly to the claimant. Payment of the amount of the limits will an insurer's duty to defend only if it results in the release of an insured.

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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).