

# Cray • Huber

## Illinois Coverage Basics

### ***Insurer vs. Insurer: Extracontractual Recovery in Illinois***

Claims handlers face this issue frequently: two carriers cover the same risk, but one of them takes an unreasonable position and refuses to pay. As a result, the other carrier pays more than it otherwise would have paid for defense costs, settlement, or both. The question arises – can the settling insurer pursue a claim for extracontractual damages against the insurer which unreasonably refused to pay?

Illinois courts have recognized two situations in which an insurer can pursue such claims. First, in *Statewide Ins. Co. v. Houston General Ins. Co.*, 397 Ill. App. 3d 410, 920 N.E.2d 611 (1st Dist. 2009), the Illinois appellate court awarded attorneys fees and costs of more than \$262,000 under Section 155 to Statewide Insurance Company based on Statewide’s successful prosecution of a declaratory judgment against Houston General. In *Statewide*, Houston General additionally insured JCC, the general contractor on the project, under a CGL policy issued to one of JCC’s subcontractors. When Michael McCartin, a worker on the project, was injured and sued JCC, JCC target-tendered its defense and indemnification to Houston General, which refused to defend. JCC’s own insurer, Statewide, defended JCC. JCC and Statewide filed a declaratory judgment action against Houston General.

JCC, Statewide and another carrier then entered into a settlement funding agreement, whereby Statewide and the other carrier agreed to pay \$840,000 each to settle the McCartin lawsuit, and reserved their rights to pursue recovery of their settlement payments from Houston General. Statewide later amended its complaint for declaratory judgment to seek recovery from Houston General on theories of equitable subrogation, equitable contribution and unjust enrichment. The trial court in the declaratory judgment action, after considerable discovery, entered summary judgment in favor of Statewide and against Houston General, ruling that Statewide was entitled to recover the \$840,000 it paid toward settlement of the McCartin lawsuit, the attorneys fees and costs it incurred defending the McCartin lawsuit, prejudgment interest, and \$261,856.60 in attorneys fees and costs incurred in prosecuting its declaratory judgment action against Houston General under Section 155.

The appellate court affirmed the award of Section 155 attorneys fees and costs. The court first noted that under prior Illinois cases, the remedy contained in Section 155 had been extended only to the insured and to policy assignees. However, the court found Statewide, as the paying insurer, was entitled to recover against Houston General as the non-paying insurer based on: (1) the contractual subrogation clause in the Statewide policy (sometimes referred to as the “transfer of rights of recovery” clause); as well as (b) the settlement funding agreement which according to the court established that Statewide was JCC’s assignee. The court stated: “[a]s assignee of JCC, Statewide succeeded to the same position as JCC, and therefore was entitled to recover

attorneys fees if Houston General's actions were vexatious and unreasonable." 397 Ill. App. 3d at 427. The court agreed with the trial court that Houston General's conduct was unreasonable and vexatious in twice failing and refusing to defend after JCC target-tendered to it, failing to reserve rights, and failing to file a declaratory judgment action.

The second situation in which Illinois courts have recognized an insurer v. insurer claim for extracontractual damages is where a lower-level excess insurer fails to settle within its limit, thereby exposing the layer above it to greater damages. In *Central Illinois Public Service Co. v. Agricultural Ins. Co.*, 378 Ill. App.3d 728, 880 N.E.2d 1172 (5th Dist. 2008) (CIPS), Central Illinois Service Co. was a power company which owned and operated a power plant in downstate Illinois. CIPS filed a declaratory judgment action against its insurers after an accident in which an elevator carrying 23 boilermakers plummeted 15 stories into the sub-basement, leading to a number of serious injuries and lawsuits. Settlement discussions between CIPS and its carriers resulted in a settlement of the personal injury lawsuits, and an allocation trial ensued to determine relative fault between the elevator manufacturer and CIPS. As a result of those discussions, American Specialty Lines Insurance Co. (AISLIC), a higher-tiered insurer of CIPS, and Agricultural/Great American, which insured the layer immediately below AISLIC, along with the insurers in the tower below Great American, agreed to jointly fund \$29 million of the settlement subject to the results of the allocation trial.

Thereafter, in a declaratory judgment action, AISLIC filed a counterclaim against Great American, alleging bad faith in failing to settle within Great American's limits. Great American filed a motion to dismiss the counterclaim. The trial court found AISLIC had failed to state a claim under Illinois law and dismissed the counterclaim. The Illinois appellate court reversed.

The appellate court reasoned that AISLIC could state a claim against Great American if the latter in fact had the right to control the defense of CIPS and to control the settlement negotiations. The court concluded that recognizing such a cause of action for bad faith failure to settle within limits was in the public interest: "A cause of action in favor of the excess carrier is therefore in the public interest as the settlement of good-faith disputes at or near the amount of an expected judgment will be promoted, with the consequence of less litigation over disputes that logically should not be litigated, as well as the result of lower insurance premiums for excess coverage." *Id.* at 1180.

The court found that on the pleadings before it, the issue of whether Great American had control of the settlement was a fact question: "the factual question raised by the counterclaim is whether Great American failed to participate in settlement negotiations in a meaningful way so that AISLIC was exposed to greater damages."

Thus, there are two situations in which one insurer can obtain extracontractual relief from another insurer in Illinois: (1) when the first insurer pays and succeeds to its insured's rights based on the subrogation clause in the policy; and (2) when a lower-level insurer fails to take reasonable steps to settle a claim within its layer, thereby exposing the layer above it.

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This newsletter provides information on noteworthy legal issues. 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 Jeff Siderius at 312-332-8495 or by email at [jas@crayhuber.com](mailto:jas@crayhuber.com).