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Insurance Law

Tender-Hearted Insurers

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What are a liability insurer's duties to an insured before a suit or tender of claim?

TAKEAWAYS »

- In Illinois, insurance coverage generally doesn't kick in until after the insured tenders defense to the insurer.
- An insurer with "actual knowledge" of a suit may be required to pay pre-tender defense costs.
- Although Illinois caselaw appears to suggest there is no duty to defend an insured (including an additional insured) before a suit, an insurer has a good-faith duty to its insured in Illinois to respond to a demand made before suit.

When an insured tenders defense of a third-party liability claim to a liability insurer, the early stages of that claim can become a point of contention between them. The insured may have already incurred attorney fees and other costs before asking the insurer to become involved. And the insured may want the insurer to settle the claim even before a suit is filed.

In response to these requests, liability insurers often rely on two "black letter" rules. One rule is that they have no obligation to pay defense costs incurred before the insured tenders the claim to the insurer. The other rule is that the insurer owes no duties to the insured until the insured is sued.

While both rules are a rough approximation of the limits Illinois courts have placed on a liability insurer's early-stage duties in a claim, caselaw contains exceptions and qualifications to those rules. Knowing the contours of these guides to an insurer's early-stage duties will allow counsel for insureds and insurers to make informed recommendations to their respective clients about how to resolve conflicts over early-stage costs and settlements.

Relevant insurance provisions

A liability insurer's duties to its insured, either pre-tender or pre-suit, are governed principally by three provisions in the standard liability insurance policy. The insuring agreement for bodily injury and property-damage coverage of the current, commonly used commercial general liability policy states as follows:

> We will have the right and duty to defend the insured against any 'suit' seeking those damages [seeking bodily injury or property damage]. … We may, at our discretion, investigate any 'occurrence' and settle any claim or 'suit' that may result.[1]

The Supplementary Payments section for this coverage states, in part:

> 1. We will pay, with respect to any claim we investigate or settle, or any 'suit' against any insured we defend:
>
> a. All expenses we incur; …
>
> d. All reasonable expenses incurred by the insured at our request to assist us in the investigation of defense of the claim or
> 'suit' ….[2]

The final provision commonly involved in these issues is the so-called "voluntary payments" clause, which states: "No insured will, except at that insured's own cost, voluntarily make a payment, assume any obligation, or incur any expense, other than for first aid, without our consent."[3]

General rule: No coverage for pre-tender defense costs

The principal Illinois authority on coverage for pre-tender litigation costs is *Westchester Fire Insurance Co. v. G. Heileman Brewing Co.*,[4] which followed the leading Ninth Circuit case, *Faust v. The Travelers*,[5] in applying the "voluntary payments" clause to preclude coverage for an insured's pre-tender litigation costs. *G. Heileman* explained that "[a]n insurer seeking to avoid responsibility because of a breach of this clause must show prejudice."[6] It found such prejudice in the insured's incurring of attorney fees in the two-and-a-half-year delay between the filing of the suit and its notice to the insurer. *G. Heileman*'s general rule against the recovery of pre-tender defense costs has been applied in Illinois.[7]

Must an insurer defend a claim it actually knows about? The reasoning of one pre-*G. Heileman* federal case questions whether the ban on recovering pre-tender defense costs is based on older Illinois law that triggered the duty to defend with the insured's tender of a claim, not on the insurer's actual notice of claim. In *Aetna Casualty & Surety Co. v. Chicago Insurance Co.*,[8] a pharmacy and three of its pharmacists were sued for malpractice. All of the defendants were insured under a primary policy issued by West American and an excess policy issued by Aetna. One of the pharmacists, Joseph Celer, was also insured by a separate policy issued by Chicago Insurance Company. The West American policy, and, after its exhaustion, the Aetna

policy, defended all of the defendants. Aetna settled on behalf of all defendants and then sought contribution from Chicago Insurance Company for a portion of the settlement amount and defense costs attributable to Celer.

The district court held that Aetna's delay in involving Chicago Insurance Company estopped it from seeking apportionment of the unallocated settlement. It explained that in Illinois, coverage for the cost of an insured's defense can "only be triggered by knowledge that the insured has been sued *and* by knowledge that [the insurer's] assistance was desired."[9] The Seventh Circuit affirmed the district court and explained in even more uncertain terms that an insurer's mere knowledge of an action does not trigger its duty to defend, particularly where the insured has multiple policies.[10] It stated that "cases construing Illinois law have specifically considered whether the insured *must tender its defense to the insurance company before the policy coverage is triggered and have concluded that it must*."[11]

However, the Illinois Supreme Court changed that rule in *Cincinnati Cos. v. West American Insurance Co.,* holding that an insurer's duty to defend begins with "actual knowledge" of the claim, and that upon receiving such knowledge, the insurer must inquire of the insured whether its participation is desired.[12] Often, the insurer's "actual knowledge" comes from an insured's tender. But in many circumstances, the insurer already knows about the claim. A common example is where the insurer insures one named insured (for example, a construction subcontractor), against whom the claim has been pending for some time, but an additional insured on the policy (the owner or general contractor) does not tender the case until later.

Aetna's rationale against coverage for pre-tender defense costs may not survive *Cincinnati Cos. v. West American's* "actual knowledge" rule, since now a formal tender of defense is not required to trigger coverage. Perhaps *Aetna* (which was cited in *Cincinnati Cos. v. West American*) can be read as an exception to the "actual knowledge" rule—such that a "tender" is required to recover defense costs only if an insured is covered by multiple insurance policies. This question remains open.[13]

An exception where the insurer improperly denies coverage. If an insurer is later found to have improperly denied coverage, it may be required to pay the insured's pre-tender defense costs. In *Pekin Insurance Co. v. XData Solutions, Inc.,* the "voluntary payments" clause was not applied to a settlement an insured reached after the insurer had denied coverage.[14] *XData* commented that the insurer's wrongful denial of coverage relieved the insured of any need to obtain the insurer's consent. It also observed that the insurer showed that it was not prejudiced by the insured's settlement. These cases distinguished *G. Heileman*'s broader rule against reimbursing pre-tender costs and expenses on those grounds.

The same rationale was used in *Sullivan House, Inc. v. Federal Insurance Co.* to permit coverage for pre-tender defense costs.[15] The district court stated that: 1) the insurer had made no showing of prejudice; and 2) the insurer's wrongful denial of coverage waived its policy defenses, including the voluntary payments clause. Reading *XData* and *Sullivan House* together gives an insured a basis to recover its pre-tender defense costs, but these cases are only useful in the limited circumstances where the insured prevails in later coverage litigation against the denying insurer.

However, these cases' reliance on the insurer's lack of prejudice suggests that an insured that retains pre-tender counsel on an urgent basis (such as to conduct an investigation or preserve evidence) can argue that these costs should be covered because incurring them does not prejudice the insurer—and may in fact help protect the defense. Furthermore, the leading case using prejudice to find no coverage for pre-tender costs (*G. Heileman*) involved a two-and-a-half-year delay between the suit and the tender to the insurer. Shorter periods may not be deemed prejudicial.

General rule: An insurer owes investigation and settlement duties, but not a defense, before "suit" is filed

The standard insurance policy language imposes a duty on insurers to defend "suits." It also gives insurers the discretion to investigate "occurrences" and settle "claims." The question is, under this language, what duties Illinois law imposes on an insurer before the filing of a suit, either to pay defense costs or negotiate a settlement.

No pre-suit duty to defend. The general rule in Illinois is that "[a] duty to defend does not arise until after the underlying lawsuit is filed."[16] In *Outboard Marine Corp. v. Liberty Mutual Insurance Co.,* the Illinois Supreme Court found no duty to defend an environmental regulatory suit seeking only equitable relief, where the policy's "duty to defend" obligations extended to "suits seeking damages."[17] This holding indicates that, absent a "suit seeking damages," there is no duty to defend under commonly worded policies, and likewise, no duty by an insurer to respond to a tender of defense.

In Illinois, an insurer generally has a duty to defend the insured under a reservation of rights, seek a declaratory judgment, or risk waiving coverage defenses. But it has been held that the insurer's obligation to file a declaratory action does not arise until the formal filing of a suit. In *Grinnell Mutual Reinsurance Co. v. LaForge,* the court explained that, although, consistent with cases such as *Haddick v. Valor Insurance,* the insurer is obligated to "take some action" upon a claim being made, those duties do not "extend to the obligation to file a declaratory-judgment action," which "does not arise until a complaint has been filed against the insured."[18] This rule, again, confirms that the insurer has no obligation to defend the insured until a suit is filed, even where the making of a "claim" triggers other obligations of the insurer.

Is there an "imminent litigation" exception? Some cases in other jurisdictions have used the "imminent threat of litigation" as a reason to require an insurer to reimburse its insured's pre-suit defense expenses. In *Liberty Mutual Insurance Co. v. Continental Casualty Co.*,[19] an insured defectively installed glass panels in a high-rise curtainwall. When the panels failed, the insured and the owner agreed to try resolving the problem without filing suit, although those efforts failed and a suit eventually was filed. The court rejected the insurer's refusal to reimburse the insured's pre-suit attorney fees, stating that the "pre-suit services were correctly considered as part and parcel of the defense against the liability suits."[20] Other cases have allowed coverage for pre-suit legal expenses incurred on an emergency basis.[21]

Illinois courts have not expressly adopted an "imminent threat of litigation" exception to the rule that an insurer has no pre-suit duty to defend an insured. But the Illinois Appellate Court has cited *Liberty Mutual Insurance Co. v. Continental Casualty Co.* with approval in *U.S. Fidelity & Guaranty Co. v. Specialty Coatings Co.*[22] This authority could form the basis for an insured to demand reimbursement of pre-suit fees and expenses incurred either under imminent threat of litigation or out of a need to respond to a claims-related emergency.

Duty to investigate occurrences and settle claims. In *Haddick,* the court explained that in some jurisdictions, an insurer generally owes no duties to its insured prior to the filing of a suit, "generally based upon the lack of language indicating the existence of a duty in the insurance policy."[23] *Haddick* declined to follow the rule from those jurisdictions. The Third District in *Haddick* explained that, whether a settlement demand is made after a suit is filed against the insured, or a claimant is simply using the threat of litigation to further settlement, the "policyholder is without authority to negotiate on his own behalf," having "relinquished that right when he entered into an insurance contract with the insurer, paying the insurer periodic premiums in exchange for the insurer's promise to defend and indemnify him in the event of a car accident from which claim is made or suit is brought."[24] It noted that the same threat exists to the

policyholder from an above-limits judgment resulting from an insurer's wrongful refusal to settle, whether that refusal comes before or after the filing of suit. The Illinois Supreme Court affirmed the Third District in *Haddick,* endorsing the rule that insurers in Illinois owe their insureds pre-suit duties of good faith in investigating and settling claims.[25]

Haddick is consistent with *Central Illinois Light Co. v. Home Insurance Co.,* where the Illinois Supreme Court held that an excess insurer did have a duty to respond to a demand for indemnity contained within an environmental regulator's pre-suit demand for damages.[26] The Illinois Supreme Court reached this result even though that insurer's policies imposed no duty to defend. As such, the general rule imposing pre-suit investigation and settlement duties on an insurer does not depend on the insurer having a duty to defend its insured under the language of its policies.

Conclusion

Illinois cases generally provide no liability insurance coverage for defense costs incurred prior to tendering defense to the insurer, although an insurer with "actual knowledge" of a suit arguably may be obligated to pay those costs. An insured may argue that the expenses it incurred were needed to respond to the claim and did not prejudice the defense.

Illinois cases also appear to be consistent that, where the insurance policy in question imposes a duty to defend the insured upon the filing of a "suit seeking damages," no duty to defend an insured (including an additional insured) arises before a suit. However, an insured can argue for coverage of pre-suit costs related to an "imminent threat" of litigation or if those costs relate to a claims emergency.

Finally, if a claimant seeks damages from the insured before a suit is filed, an insurer has a good-faith duty to its insured in Illinois to respond to that demand, which likely imposes the need on the insurer to investigate the demand in order to respond to it.

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ISBA RESOURCES >>

- Mark Rouleau, ***Insured's Duty of Notice***, The Policy (May 2019).
- Geoffrey A. Bryce & Jennifer Cromheecke, ***Federal Courts Carve Out Their Own Rule for Construction Defect Coverage in Illinois Based on Their Own Assessment of What Triggers a Duty to Defend Under Commercial General Liability Policies***, The Policy (Dec. 2018).

- Randall W. Slade & Scott O. Reed, ***Are Courts Expanding an Insured's Duty to Pay for an Insured's Independent Counsel?***, 105 Ill. B.J. 48 (Mar. 2017).

1. Insurance Services Office (ISO), Form No. CG 00 01 12 07.
2. *Id.*
3. *Id.*
4. *Westchester Fire Insurance Co. v. G. Heileman Brewing Co.,* ***321 Ill. App. 3d 622***, 637 (1st Dist. 2001).
5. *Faust v. The Travelers,* ***55 F.3d 471***, 473 (9th Cir. 1995) ("if hiring and paying an attorney is not 'incurring an expense,' it is hard to imagine what is.").
6. *G. Heileman Brewing Co.,* 321 Ill. App. 3d at 637, (citing *Pittway Corp. v. American Motorists Insurance Co.,* ***56 Ill. App. 3d 338*** (2d Dist. 1977)).
7. *Caterpillar, Inc. v. Century Indemnification Co.,* 2011 WL 488935 (Ill. App., 3d Dist., No. 3-09-0456, Feb. 1, 2011) (Rule 23 order).
8. *Aetna Casualty & Surety Co. v. Chicago Insurance Co.,* ***782 F. Supp. 71*** (N.D. Ill. 1991).
9. *Id.* at 73 (emphasis in original) (citing *Hartford Accident & Indemnity Co. v. Gulf Insurance Co.,* ***776 F.2d 1380*** (7th Cir. 1985)).
10. *Aetna Casualty & Surety Co. v. Chicago Insurance Co.,* ***994 F.2d 1254***, 1259 (7th Cir. 1993).
11. *Id.* at 1259 (emphasis added).
12. *Cincinnati Cos. v. West American Insurance Co.,* ***183 Ill. 2d 317*** (1998).
13. The court in *Kmart Corp. v. Footstar, Inc.,* ***777 F.3d 923***, 932 (7th Cir. 2015) found no coverage for pre-tender defense costs, even when the insurer had actual knowledge of the suit, but decided this issue under New Jersey law.
14. *Pekin Insurance Co. v. XData Solutions, Inc.,* 2011 IL App (1st) 102769.
15. *Sullivan House, Inc. v. Federal Insurance Co.*, 2008 WL 410208 (N.D. Ill., No. 07 C 1774, Feb. 7, 2008).
16. *United Farm Family Mutual Insurance Co. v. Frye*, ***381 Ill. App. 3d 960***, 967 (4th Dist. 2008).
17. *Outboard Marine Corp. v. Liberty Mutual Insurance Co.,* ***154 Ill. 2d 90*** (1992).
18. *Grinnell Mutual Reinsurance Co. v. LaForge,* ***369 Ill. App. 3d 688***, 698 (4th Dist. 2006).
19. *Liberty Mutual Insurance Co. v. Continental Casualty Co.*, ***771 F.2d 579*** (1st Cir. 1985).
20. *Id.* at 586.
21. See, *e.g.*, *New York Marine & General Insurance Co. v. Lafarge North America, Inc.,* ***599 F.3d 102*** (2d Cir. 2010) (insured could recover costs of maritime attorneys retained to investigate and address issues caused by insured's smashing through a levee during Hurricane Katrina).
22. *U.S. Fidelity & Guaranty Co. v. Specialty Coatings Co.*, ***180 Ill. App. 3d 378***, 389 (1st Dist. 1989).
23. *Haddick v. Valor Insurance,* ***315 Ill. App. 3d 752***, 757 (3d Dist. 2000).

24. *Id.*
25. *Haddick v. Valor Insurance,* ***198 Ill. 2d 409*** (2001).
26. *Central Illinois Light Co. v. Home Insurance Co.,* ***213 Ill. 2d 141*** (2004).