

Illinois

REGULATORY LIMITS ON CLAIMS HANDLING

Timing for Responses and Determinations

The Illinois Insurance Code does not set forth time limitations on the settlement or determination of claims under a policy of health insurance. However, the Illinois Administrative Code provides that an insurer must affirm or deny liability for a claim within a reasonable amount of time. 50 IL ADC 919.50. In addition, the Administrative Code provides that payment of undisputed claims must be made within thirty days. The insurer must provide the insured with a written explanation for the delay when an insurer is unable to reach a determination on a claim within forty-five days of the claim's filing. 50 IL ADC 919.70

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Standards for Determination and Settlements

The Illinois Insurance Code provides guidelines for protecting the rights of an insured in the claim process, and specifies eighteen acts of improper claims practices. These include:

- Knowingly misrepresenting relevant facts or policy provisions relating to the coverage at issue.
- Failing to acknowledge communications from the insured.
- Not attempting in good faith to effectuate prompt, fair and equitable settlement of claims where liability is reasonably clear.
- Compelling policyholders to sue to recover amounts due under its policies by offering substantially less than the amounts ultimately recovered.
- Refusing to pay claims without a reasonable investigation.
- Delaying the investigation or payment of a claim by requiring the insured to submit a preliminary claim report and then requiring a subsequent formal proof of loss, resulting in duplication of verification.
- When denying or offering a compromise in a claim, failing to provide a reasonable and accurate explanation of the basis in the policy or law for the denial or compromise.

215 ILCS 5/154.6. The Illinois Insurance Code provides guidelines for protecting the rights of an insured after the denial of a claim. The institution or agent responsible for the adverse indemnity decision must notify the applicant of the reasons for the adverse decision. The applicant may, within 90 days after the date the notice of decision is mailed, request the following information:

1. items of personal and privileged information that support the decision;
2. medical records; and

3. the names and addresses of the institutional sources that supplied specific items of information.

215 ILCS 5/1011.

PRINCIPLES OF CONTRACT INTERPRETATION

Interpretation and construction of insurance contracts are governed by the same general provisions as those governing other contracts. *Dempsey v. Nat'l Life & Accident Ins. Co.*, 404 Ill. 423, 426, 88 N.E.2d 874, 876 (1949). Policy terms of insurance contracts must be interpreted and construed according to sense of meaning of the terms which the parties used. *Sistler v. Ill. Bankers Life Assur. Co.*, 341 Ill. App. 512, 520, 95 N.E.2d 507, 511 (4th Dist. 1950). Terms in life insurance policies are deemed ambiguous if they are susceptible to more than one reasonable interpretation. *Cincinnati Ins. Co. v. Dawes Rigging & Crane Rental, Inc.*, 321 F. Supp. 2d 975, 980 (C.D. Ill. 2004). If policy terms are uncertain and ambiguous, courts shall consider extrinsic material such as the subject matter of the contract, purpose sought to be accomplished, and circumstances surrounding issuance of the policy. *Seeburg Corp. of Del. V. U. Founders Life Ins. Co. of Ill.*, 82 Ill. App. 3d 1034, 1039, 403 N.E.2d 503, 506 (1st Dist. 1980). Any ambiguities found in this interpretation will be construed against the insurer and in favor of the insured. *Cincinnati Ins. Co.*, 321 F. Supp. 2d at 980.

CONTRACT INTERPRETATION

Common Issues

1. Faulty Workmanship as an "Occurrence"

Acuity v. M/I Homes of Chicago, LLC, 2023 IL 129087, is among the most important Illinois insurance coverage decisions of the last 25 years. Overturning 30 years of Illinois Appellate Court precedent, the court held that damage to property other than the building being constructed is not necessary to constitute an "occurrence" under a CGL policy.

The Cook County circuit court granted summary judgment in favor of Acuity, finding no duty to defend because the underlying complaint did not allege "property damage" caused by an "occurrence" under the initial grant of coverage of the insurance policy. The appellate court reversed and remanded, finding that Acuity owed M/I Homes a duty to defend. 2022 IL App (1st) 220023. The Supreme Court affirmed the appellate court and remanded the case to determine if the policy's exclusions would be applicable.

Importantly, the court held that the parties' premise—that there could be no "property damage" caused by an "occurrence" under the policy unless the underlying complaint alleged property damage to something beyond the townhome construction project—is erroneous; it is not grounded in the language of the initial grant of coverage in the insuring agreement.

2. Does Your State Have an Anti-Indemnity Statute?

Illinois courts do not recognize indemnity agreements in construction contracts. Attempts at indemnification as among parties set forth in contracts for construction work are void in violation of the Illinois Construction Contract for Negligence Act, more commonly known as the Illinois Anti-Indemnity Act. 740 ILCS 35/0/01. However, at the present time, having contract provisions that agree to provide insurance coverage for another party are acceptable and enforceable. the answer using Normal style.

CHOICE OF LAW

Illinois utilizes the “most significant contacts” test in assessing governing law. This test provides that choice of law for insurance policy disputes is determined by the location of the subject matter, the place of delivery of the contract, the domicile of the insurer or insured, the location of the last act to give rise to a valid contract, the place of performance, or any other place with a rational relationship to the general contract. *Cincinnati Ins. Co. v. Dawes Rigging & Crane Rental, Inc.*, 321 F.Supp.2d 975, 980 (C.D. Ill. 2004). Under this choice of law rule, the location of the insured risk is given special emphasis in choosing which law governs insurance policy disputes. *Id.*

DUTIES IMPOSED BY STATE LAW

Duty to Defend

1. Standard for Determining Duty to Defend

In determining whether an insurer has a duty to defend its insured, the court must look to the allegations in the underlying complaint and the relevant provisions of the insurance policy. *American States Insurance Co. v. Koloms*, 177 Ill. 2d 473, 479, 687 N.E.2d 72 (1997). A court will look to the four corners of the complaint brought against the insured to determine if a potential for coverage exists. *Illinois National Ins. Co. v. Universal Underwriters Ins. Co.*, 261 Ill. App. 3d 84, 88 (5th Dist. 1994). If the underlying complaint alleges facts within or potentially within the policy coverage, the insurer is obligated to defend its insured even if the allegations are groundless, false or fraudulent. *State Farm Fire & Cas. Co. v. Martin*, 186 Ill. 2d 367, 378, 710 N.E.2d 1228, 1234 (1999); *U.S. Fidelity & Guaranty Co. v. Wilkin Insulation Co.*, 144 Ill. 2d 64, 73 (1991).

An insurer may not justifiably refuse to defend an action against its insured unless it is clear from the face of the underlying complaint that the allegations fail to state facts which bring the case within, or potentially within, the policy’s coverage. *Id.* When the insurer has a duty to defend, it may not simply refuse to defend. Rather, the insurer has two options: (1) it can defend the suit under a reservation of rights; or (2) seek a declaratory judgment that there is no coverage. *Employers Ins. Co. v. Ehlco Liquidating Trust*, 186 Ill.2d 127, 150 (1999); *State Farm Fire & Cas. Co. v. Martin*, 186 Ill. 2d 367, 379, 710 N.E.2d 1228, 1234 (1999); *Waste Management, Inc. v. International Surplus Lines Ins. Co.*, 144 Ill. 2d 178, 207-08 (1991). If the insurer fails to take either option, and is later found to have breached the duty to defend, it will be estopped from later raising policy defenses and is liable for the award against the insured and the costs of the suit. *Employers Ins. v. Ehlco*, 186 Ill.2d at 150-51; *Murphy v. Urso*, 88 Ill.2d 444, 451 (1981); *Maryland Cas. Co. v. Peppers*, 64 Ill.2d 132, 144 (1976).

All doubts concerning the scope of coverage are resolved in favor of the insured. *U.S. Fidelity v. Wilkin Installation Co.*, 144 Ill.2d 64, 74, 578 N.E.2d 926, 930 (1991). An insurer has no duty to defend only where the allegations of the underlying case clearly fail to state facts that bring the case within or potentially within the policy’s coverage. *Employers Ins. Of Wausau v. Elhco Liquidating Trust*, 186 Ill.2d 127, 153, 708 N.E.2d 1122, 1136 (1999).

While Illinois generally follows the eight corners rule, looking to the four corners of the complaint and the four corners of the policy to determine the duty to defend, an insurer may rely on extrinsic evidence to deny a duty to defend if it brings an action for declaratory judgment. Compare, *Employers Ins. of Wausau v. Ehlco Liquidating Trust*, 186 Ill.2d 127, 150 (1999) (insurer estopped from denying coverage where it failed to defend or seek declaratory judgment, and could not rely on insured’s late notice to avoid duty to defend since late notice was not apparent

from underlying complaint); *Chandler v. Doherty*, 299 Ill.App.3d 797 (4th Dist. 1998) (insurer estopped from denying coverage based on fact that car involved in accident was not an insured vehicle, and could not rely on extrinsic evidence to establish that it had no coverage where it failed to file a declaratory judgment action); with *Fidelity & Casualty Co. of N.Y. v. Envirodyne Engineers, Inc.*, 122 Ill.App.3d 301, 305 (1st Dist. 1983)(insurer that filed declaratory action allowed to rely on extrinsic evidence to deny duty to defend); *Fremont Compensation Ins. Co. v. Ace-Chicago Great Dane Corp.*, 304 Ill.App.3d 734 (1st Dist. 1999) (insurer allowed to rely on extrinsic evidence where it filed a declaratory action).

2. Issues with Reserving Rights

A reservation of rights letter must adequately inform the insured of those rights that the insurer intends to protect and must specifically reference the policy defenses that the insurer intends to assert. *Royal Ins. Co. v. Process Design Assoc., Inc.*, 221 Ill.App.3d 966, 973, 582 N.E.2d 1234, 1239 (1st Dist. 1991). This specific reservation of rights allows the insured to make an educated decision whether to retain its own counsel or accept defense counsel from the insurer. *Id.* at 973-74, 582 N.E.2d at 1239.

An insurer's duty to defend typically includes the right to control that defense in order to both protect its financial interest in the litigation's outcome and minimize unwarranted liability claims. *Illinois Masonic Medical Center v. Turegum Ins. Co.*, 168 Ill.App.3d 158, 163, 522 N.E.2d 611, 613 (1st Dist. 1988). This presents no problems where the interests of the insurer and the insured are completely aligned. *American Family Mut. Ins. Co. v. W.H. McNaughton Builders, Inc.*, 363 Ill.App.3d 505, 511, 843 N.E.2d 492, 498 (2nd Dist. 2006). However, where these interests divert, this arrangement may potentially lead to a conflict of interest.

A conflict of interest exists where a comparison of the underlying complaint to the policy terms demonstrates an opportunity for insurer-retained counsel to shift facts in a way that takes the case outside the scope of policy coverage. *W.H. McNaughton Builders*, 363 Ill.App.3d at 511. Although the attorney retained by the insurer to represent the insured has ethical obligations to both parties, in reality the attorney may have closer ties to the insurer and thus a more compelling interest to protect the insurer. *Id.* Where such a conflict of interest exists, the insurer must decline to defend the insured and, instead of participating in the defense, the insurer must pay for independent counsel for the insured. *Murphy v. Urso*, 88 Ill.2d 444, 451-52, 430 N.E.2d 1079, 1082 (1981); *Maryland Cas. Co. v. Peppers*, 64 Ill.2d 132, 144 (1976).

The federal courts in Illinois have also held that there is a conflict of interest, requiring independent counsel, where there is a "non-trivial probability" of a verdict in excess of the policy limits. *R. C. Wegman Const. Co. v. Admiral Ins. Co.*, 629 F.3d 724, 730 (7th Cir. 2011); *Perma-Pipe, Inc. v. Liberty Surplus Lines Ins. Corp.*, 38 F.Supp.3d 890, 896 (N.D. Ill. 2014). No Illinois state courts have yet adopted this view.

A reservation of rights letter must specifically reference any potential conflict of interest." *Mobil Oil Corp. v. Maryland Cas. Co.*, 288 Ill.App.3d 743, 754, 681 N.E.2d 552, 560 (1st Dist. 1997) (citing *Royal Ins. Co.*, 221 Ill.App.3d at 973, 582 N.E.2d at 1239). This allows the insured to decide intelligently whether or not to hire independent counsel in order to avoid the conflict. *Id.* An insurer who defends its insured without disclosing the conflict of interest in its reservation of rights is estopped from subsequently raising coverage defenses. *Doe v. Illinois State Medical*

Inter-Insurance Exchange, 234 Ill.App.3d 129, 134, 599 N.E.2d 983, 986 (1st Dist. 1992).

State Privacy Laws; Insurance Regulatory Issues; Arbitration/Mediation

1. Criminal Sanctions

There are no Illinois statutes that provide for criminal sanctions in extracontractual claims against insurers.

2. The Standards for Compensatory and Punitive Damages

Insurers are potentially liable for misrepresentations made in the course of advertising their insurance products under the Consumer Fraud Act. *Elder v. Coronet Insurance Co.*, 201 Ill.App.3d 733, 558 N.E.2d 1312 (1st Dist. 1990), appeal withdrawn, 139 Ill.2d 594 (1991); *Petersen v. Allstate Insurance Co.*, 171 Ill.App.3d 909, 525 N.E.2d 1094 (1st Dist. 1988). Illinois courts awarded over \$600 million dollars in punitive damages for violation of the Consumer Fraud Act in a class action involving first-party automobile insurance. *Avery v. State Farm Mutual Automobile Insurance Co.*, 321 Ill.App.3d 269, 746 N.E.2d 1242, 254 Ill.Dec. 194 (5th Dist. 2001). *Avery* clearly shows an insurers' potential exposure under the Consumer Fraud Act. Note however, that this case was reversed by the Illinois Supreme Court which found that plaintiffs must prove the elements of a private cause of action under the Act by a preponderance of the evidence. 835 N.E. 2d 801, 296 Ill. Dec. 448 (2005).

Section 155 of the Illinois Insurance Code, discussed below, also allows the policyholder to recover reasonable attorney fees and other costs, as well as an additional sum that constitutes a penalty or punitive damages. *Cramer v. Ins. Exch. Agency*, 174 Ill. 2d 513, 531, 675 N.E.2d 897, 905-06 (1996); 215 ILCS 5/155. However, a first party claim for bad faith does not allow the recovery of punitive damages. *Id.*

3. Insurance Regulations to Watch

50 Ill. Adm. Code 926, Insurance Department Consumer Complaints implementing 215 ILCS 5/133, 149, 404(1)(a), 421, and 424 and authorized by 215 ILCS 5/401. This rule amendment addresses the Illinois Department of Insurance's ability to share information related to a complaint against an insurer, insurance producer, or other entity licensed or registered pursuant to Chapter 215 of the Illinois Compiled Statutes with criminal justice agencies for investigation or prosecution, or to State regulatory agencies for regulatory action, where Department believes the reported conduct constitutes a violation of laws or regulations. Amended at 43 Ill. Reg. 3246 and became effective February 25, 2019.

50 Ill. Adm. Code 919, Improper Claims Practices: It has been a significant period of time since the rule has been updated; the amendments to Part 919 will modernize its provisions and practices. Although not a comprehensive list, among the revisions are changes to Section 919.30 which will provide more specific details as to the type of documentation that must be contained in company files, and additions to Section 919.40 including definitions of "Claim" and "Unreasonable cap or limits on paint materials". Additions to Sections 919.50 and 919.60 will include criteria that would constitute improper practices or procedures if conducted by an insurance company. Section 919.80 will be amended to provide further guidance in regard to unreasonable delays, as well as the imposition of towing charges and betterment deductions.

4. State Arbitration and Mediation Procedures

Certain disputes in Illinois require arbitration and mediation. The Illinois Insurance Code requires all automobile insurers to include in their policies a provision that any dispute over coverage and amount of damages with respect to an uninsured and hit-and-run motor vehicle claim be submitted for arbitration to the AAA as an option. 215 ILCS 5/143a.

However, Section 155 of the Illinois Insurance Code is not covered under the scope of an arbitration because (1) section 143a(1) defines the scope of arbitration hearings on uninsured motorist claims to disputes covering covered claims; and (2) section 155 itself vests the court with discretion to determine the award, if any, in a matter brought pursuant to it. *Smith v. State Farm Ins. Cos.*, 369 Ill. App. 3d 478, 485, 308 Ill. Dec. 118, 124, 861 N.E.2d 183, 189 (2006). The court in *Smith v. State Farm Ins. Cos.* further held that an arbitration agreement did not bar a plaintiff's Section 155 action brought in court. Should all parties agree to an arbitration or mediation in Illinois state court they may proceed by contacting an organization which provides said services or ask the court the case be appointed to a court arbitrator or mediator.

Under Illinois statute 710 ILCS 5/1, parties may execute a written contract to submit any existing controversy to arbitration. The arbitration agreement should, but is not required to provide a method of appointment of arbitrators. 710 ILCS 5/3. The arbitrators will appoint a time and place for the hearing and notify the parties. 710 ILCS 5/5. During the arbitration, the parties entitled to be heard, to present evidence as to the controversy and to cross-examine witnesses appearing at the hearing. *Id.* An award shall be given in writing and delivered to each party. Upon application of any party, the court may vacate an award where:

- (1) the award was procured by corruption, fraud or other undue means;
- (2) there was evident partiality by an arbitrator appointed as a neutral or corruption in any one of the arbitrators or misconduct prejudicing the rights of any party;
- (3) the arbitrators exceeded their powers;
- (4) the arbitrators refused to postpone the hearing upon sufficient cause being shown therefor or refused to hear evidence material to the controversy or otherwise so conducted the hearing, contrary to the provisions of Section 5, as to prejudice substantially the rights of a party; or
- (5) there was no arbitration agreement and the issue was not adversely determined in proceedings under Section 2 and the party did not participate in the arbitration hearing without raising the objection; but the fact that the relief was such that it could not or would not be granted by the circuit court is not ground for vacating or refusing to confirm the award.

710 ILCS 5/12.

Parties may agree to mediate through agreement, but are not required to mediate under Illinois statute. Further, communications exchanged in mediation are privileged from discovery in a proceeding unless waived. 710 ILCS 35/4.

Further, for cases pending in Illinois State Court in the Cook County Circuit Court, a local rule instituting a mandatory arbitration program for certain commercial cases of \$75,000 or less, requires a party reject the arbitration award within 7 business days. The Illinois First District Appellate Court is valid because Illinois Supreme Court in *Terrell Jones v. State Farm Mutual Automobile Insurance Co.*, 2018 IL App (1st) 170710, authorized the local rule and thus approved any deviations between that program's rules and Supreme Court's Rules, holding Plaintiff, who failed to object within 7 days of entry of award, was bound by the arbitration judgment and may not voluntarily dismiss his suit to avoid that result.

5. State Administrative Entity Rule-Making Authority

The Illinois Department of Insurance has the authority to suggest or propose new rules or amendments to administrative rules or Illinois statutes. Any amendments or changes are posted in the Illinois Register and interested parties may comment on the proposal within 45 days after the publication of the notice, this is considered the First Notice. Public hearings on proposed rulemakings if so requested by Illinois General Assembly's Joint Committee on Administrative Rules (JCAR), the Governor, an affected local government, 25 interested individuals, or an association representing at least 100 interested individuals. Requests for public hearings on a proposed rulemaking must be submitted to the agency within 14 days after the proposed rulemaking is published in the Register. An agency may decide on its own to hold hearings on a proposed rulemaking. Notices of public hearings are published in the Register and appear in the Flinn Report.

When an agency, like the Illinois Department of Insurance is ready to submit a rule for review is files Second Notice Documents including a summary of the rulemaking and any changes the agency made to its proposed during First Notice; an estimate of the rulemaking's impact on State finances (e.g., how much will it cost, or save, the agency annually); a final regulatory flexibility analysis (i.e., the economic impact on the regulated parties); and a summary of public comment received during First Notice, along with the agency's responses to these comments. After the Second Notice is accepted the rulemaking is schedules within the next 45 days. Once the JCAR reviews and the agency receives a Certificate of No Objection, or duly responds to an Objection from the JCAR within 90 days it may adopt the rule making. An agency must adopt the rule making within one year or the rulemaking designation or the designation expires and cannot be adopted.

EXTRACONTRACTUAL CLAIMS AGAINST INSURERS: ELEMENTS AND REMEDIES

Bad Faith Claim Handling/Bad Faith Failure to Settle Within Limits

The Illinois Insurance Code provides policyholders with statutory remedies for an insurer's improper conduct. Section 155 of the Code provides, in pertinent part, as follows:

Sec. 155. Attorney fees. (1) In any action by or against a company wherein there is in issue the liability of a company on a policy or policies of insurance or the amount of the loss payable thereunder, or for an unreasonable delay in settling a claim, and it appears to the court that such action or delay is vexatious and unreasonable, the court may allow as part of the taxable costs in the action reasonable attorney fees, other costs, plus an amount not to exceed any one of the following amounts:

1. 60% of the amount which the court or jury finds such party is entitled to recover against the company, exclusive of all costs;
2. \$60,000;
3. the excess of the amount which the court or jury finds such party is entitled to recover, exclusive of costs, over the amount, if any, which the company offered to pay in settlement of the claim prior to the action.

215 ILCS 5/155.

Section 155 does not preempt a claim of insurer misconduct based on a separate and independent tort. Mere allegations of bad faith or unreasonable and vexatious conduct, however, are not sufficient to constitute a separate and independent tort. *Cramer v. Ins. Exch. Agency*, 174 Ill. 2d 513, 531, 675 N.E.2d 897, 905-06 (1996). Ordinarily, a policyholder may bring a breach of contract action against the insurer to recover the proceeds due under the policy. Section 155 of the Illinois Insurance Code also allows the policyholder to recover reasonable attorney fees and other costs, as well as an additional sum that constitutes a penalty. *Id.*; 215 ILCS 5/155. A first party claim for bad faith does not allow the recovery of punitive damages. *Id.*

A separate and independent tort action for bad faith may exist, however, where the insurer vexatiously and unreasonably refuses to recognize liability (without filing a declaratory judgment action or defending under a reservation of rights) or pay a claim under a policy against a third party for an amount equal to or less than the policy limits. *Cramer*, 174 Ill. 2d at 525, 675 N.E.2d at 903. Unlike first-party bad faith actions, third-party bad faith cases allow the recovery of punitive damages where the insurance company acts particularly egregiously. *O'Neill v. Gallant Ins. Co.*, 329 Ill. App. 3d 1166, 1176, 769 N.E.2d 100, 109 (5th Dist. 2002).

Illinois courts rely upon seven factors in assessing an insurer's bad faith.

These include:

1. the advice of the insurance company's own adjusters;
2. a refusal to negotiate;
3. the advice of defense counsel;
4. communication with the insured; i.e., keeping the insured fully aware of the claimant's willingness to settle within the policy limits;

5. an inadequate investigation and defense;
6. a substantial prospect of an adverse verdict; and
7. the potential for damages in excess of the policy limits.

O’Neill, 329 Ill. App. 3d at 1172-75, 769 N.E.2d at 106-08.

3. First Party

Illinois law does not recognize a first party claim for bad faith as a separate and independent tort action. *Cramer v. Ins. Exchange Agency*, 174 Ill.2d 513, 525-26, 675 N.E.2d 897, 904 (1996). Ordinarily, a policyholder may bring a breach of contract action against the insurer to recover the proceeds due under the policy. Section 155 of the Illinois Insurance Code also allows the policyholder to recover reasonable attorney fees and other costs, as well as an additional sum that constitutes a penalty. *Id.*; 215 ILCS 5/155. A first party claim for bad faith does not allow the recovery of punitive damages except for the statutory penalty, which is currently limited to \$60,000 or 60% of the amount the insurer owes, whichever is less. *Id.*

4. Third-Party

A separate and independent tort action for bad faith does exist, however, where the insurer unreasonably fails to settle a third-party suit against its insured that exposes the insured to a judgment in excess of its policy limit. *Cramer*, 174 Ill.2d at 525, 675 N.E.2d at 903. Unlike first-party bad faith actions, third-party bad faith cases allow the recovery of punitive damages where the insurance company acts particularly egregiously. *O’Neill v. Gallant Ins. Co.*, 329 Ill.App.3d 1166, 1176, 769 N.E.2d 100, 109 (5th Dist. 2002).

An insurer has an obligation to act in good faith toward its insured when exercising its right to settle a liability claim against the insured. *Haddick v. Valor Insurance*, 198 Ill.2d 409, 763 N.E.2d 299 (2001); *Cramer v. Insurance Exchange Agency*, 174 Ill.2d 513, 675 N.E.2d 897 (1997). The insurer is not required to place the insured’s interests ahead of its own, but is required to give at least equal weight to the insured’s interests when deciding to settle. The test often applied is whether a reasonable insurer, with no policy limits, would have declined to settle the claim. *O’Neill v. Gallant Ins. Co.*, 329 Ill.App.3d 1166, 1172, 769 N.E.2d 100, 106 (5th Dist. 2002).

To have a duty to settle a claim, there must be a probability of both an adverse verdict and a verdict in excess of the policy limits. *Powell v. Am. Serv. Ins. Co.*, 2014 IL App (1st) 123643, 7 N.E.3d 11, (2014)(must be reasonable probability of both adverse verdict and that verdict will exceed policy limit); *Olympia Fields Country Club v. Bankers Indemnity Insurance Co.*, 325 Ill. App. 649, 670-71, 60 N.E.2d 896 (1945), quoting *Hilker v. Western Automobile Insurance Co.*, 204 Wis. 1, 14, 235 N.W. 413, 414 (1931) (“When damages sought by a third party against the insured do not exceed policy limits, the question of whether the claim be compromised or settled, or the manner in which it shall be defended, is a matter of no concern to the insured.”)(internal quotations omitted).

Illinois courts rely on seven factors in assessing an insurer’s bad faith in failing to settle a claim within policy limits. These include:

- (1) the advice of the insurance company's own adjusters;
- (2) a refusal to negotiate;
- (3) the advice of defense counsel;
- (4) communication with the insured; i.e., keeping the insured fully aware of the claimant's willingness to settle within the policy limits;
- (5) an inadequate investigation and defense;
- (6) a substantial prospect of an adverse verdict; and
- (7) the potential for damages in excess of the policy limits.

O'Neill, 329 Ill.App.3d at 1172-75, 769 N.E.2d at 106-08.

The duty to settle is not limited to situations in which suit has already been filed against the insured. Rather, the duty to settle arises once a third-party claimant has made a demand for settlement within policy limits and, at the time of the demand, there is a reasonable probability of recovery in excess of the policy limits against the insured. *Haddick v. Valor Insurance*, 198 Ill.2d 409, 419, 763 N.E.2d 299 (2001).

Illinois courts have held that the duty to settle extends both to the insured and to excess carriers. *Central Illinois Public Service Co. v. Agricultural Ins. Co.*, 378 Ill. App. 3d 728, 736, 880 N.E.2d 1172 (5th Dist. 2008); *Schal Bovis, Inc. v. Casualty Insurance Co.*, 314 Ill. App. 3d 562, 572, 732 N.E.2d 1082, 1090 (1st Dist. 1999). Although, some courts evaluating Illinois law have been reluctant to agree. *N. Am. Elite Ins. Co. v. Menard Inc.*, 491 F. Supp. 3d 333, 341 (N.D. Ill. 2020), citing *Ill. Emcasco Ins. Co. v. Nationwide Mut. Ins. Co.*, 2015 IL App (1st) 140928-U, ¶ 72 (holding no duty to settle exists from primary to excess insurer), *United States Fire Ins. Co. v. Zurich Ins. Co.*, 329 Ill. App. 3d 987, 1003 (2002), and *Liberty Mut. Ins. Co. v. Am. Home Assurance Co.*, 348 F. Supp. 2d 940, 964 (N.D. Ill. 2004).

Fraud

In order to state a cause of action for common law fraud, the plaintiff must plead the following elements with specificity: (1) a false statement of material fact; (2) the party making the statement knew or believed it to be untrue; (3) the party to whom the statement was made had a right to rely on the statement; (4) the party to whom the statement was made reasonably relied upon the statement; (5) the statement was made for the purpose of inducing the other party to act; and (6) the reliance by the person to whom the statement was made led to the claimant's injury. *Cramer*, 174 Ill.2d at 528, 675 N.E.2d at 905.

The Illinois General Assembly has additionally provided a separate remedy for fraud that occurs in trade or commerce. In order to state a cause of action under the Consumer Fraud and Deceptive Business Practices Act, the plaintiff must allege: (1) a deceptive practice or act; (2) intent on the defendant's part that the plaintiff rely upon the deception; (3) that the deception occurred in the course of conduct involving trade or commerce, and (4) actual damages to the plaintiff proximately caused by the deception. 815 ILCS 505/2, *Guvnoz v. Target Corp.*, 2015 IL App (1st) 133940, ¶¶ 113-114.

Unlike causes of action sounding in common law fraud, the Consumer Fraud and Deceptive Business Practices Act

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does not require the pleader to prove actual reliance on the defendant's alleged misrepresentation. *Siegel v. Levy Organization Development Co., Inc.* 153 Ill.2d 534, 542, 607 N.E.2d 194, 198 (1992). However, the Illinois Supreme Court has suggested actual reliance may be required under the proximate cause element. *Skeen v. BMW of N. Am., Ltd. Liab. Co.*, No. 2:13-cv-1531-WHW-CLW, 2014 U.S. Dist. LEXIS 9256, at *52 (D.N.J. Jan. 24, 2014), citing *De Bouse v. Bayer AG*, 235 Ill. 2d 544 (2009).

Consumer Fraud claims are often subject to a motion to dismiss as they may be pre-empted by Section 155 of the Illinois Insurance Code. See *Young v. Allstate Ins. Co.*, 351 Ill.App.3d 151, 169, 812 N.E.2d 741, 757 (1st Dist. 2004) (Illinois Insurance Code preempts claims made under the Consumer Fraud Act if the allegations made fall within the scope of Section 155).

Intentional or Negligent Infliction of Emotional Distress

To state a cause of action for intentional infliction of emotional distress, the plaintiff must allege the following: (1) that the defendant's conduct was extreme and outrageous; (2) that the defendant either intended his conduct to inflict severe emotional distress or knew there was a high probability that the conduct complained of would cause severe emotional distress; and (3) that the defendant's conduct caused severe emotional distress. *Graham v. Commonwealth Edison Co.*, 318 Ill.App.3d 736, 745, 742 N.E.2d 858, 866 (1st Dist. 2000).

To successfully sustain an action for intentional infliction of emotional distress, the plaintiff must allege more than mere insults, indignities, threats, or annoyances. *Id.* The nature of the conduct must be so extreme as to go beyond all possible bounds of decency and be regarded as intolerable conduct within a civilized community. *Kolegas v. Heftel Broadcasting Corp.*, 154 Ill.2d 1, 21, 607 N.E.2d 201, 211 (1992). Whether conduct is extreme and outrageous is evaluated by using an objective standard, taking into account all of the surrounding facts and circumstances. *Graham*, 318 Ill.App.3d at 745, 742 N.E.2d at 866.

Illinois courts will consider the following factors in determining the outrageousness of a defendant's conduct: (1) whether the defendant abused a position of authority over the plaintiff or his interests; and (2) whether the plaintiff is more susceptible to emotional distress because of a physical or mental condition. *Kolegas*, 154 Ill.2d at 21, 607 N.E.2d at 211; *McGrath v. Fahey*, 126 Ill.2d 78, 533 N.E.2d 806 (1988) (complaint pled sufficient facts for a claim of intentional infliction of emotional distress where a bank officer threatened a client known to have a heart condition in order to induce him to turn over property to the bank, and the client suffered a heart attack as a result of the threats).

Punitive damages are not available in actions for intentional infliction of emotional distress. *Knierim v. Izzo*, 22 Ill.2d 73, 88, 174 N.E.2d 157, 165 (1961).

Negligent infliction of emotional distress causes of action differ between direct victims and bystanders. A bystander who is in the "zone of physical danger" and, because of the defendant's negligence, has a reasonable fear for his or her own safety, has a right of action for illness or physical injury resulting from such emotional distress. *Rickey v. Chi. Transit Auth.*, 98 Ill.2d 546, 555, 457 N.E.2d 1, 5 (1983). Accordingly, a bystander must prove that he or she suffered illness or physical injury. *Id.* A direct victim may only recover damages for negligent infliction of emotional distress if he or she can prove the defendant was negligent. *Corgan v. Muehling*, 143 Ill.2d 296, 306, 574 N.E.2d 602, 602 (1991). As such, a direct victim must establish that the defendant owed the victim a duty, the defendant breached that duty, and an injury was proximately caused by such breach. *Id.*, 574 N.E.2d at 602. Lastly, a direct victim must prove that he or she suffered damages in the form of an immediate severe or extreme emotional response, a severe and extreme long lasting traumatic neurosis, or both. *Id.* at 311, 574 N.E.2d at 608.

State Consumer Protection Laws, Rules and Regulations

The Illinois Insurance Code prohibits misrepresentation and defamation by insurers. The Insurance Code prohibits the following conduct:

1. any oral or written statement misrepresenting the terms of any policy issued or to be issued by an insurer or any other company, or regarding the benefits or advantages promised or any misleading estimate of the dividends or share of the surplus to be received;
2. any misleading representation or comparison of companies or policies for the purpose of inducing a policyholder to lapse, forfeit, change or surrender his insurance;
3. any verbal or written statement that contains any false or malicious statement calculated to injure any company doing business in this State in its reputation or business;
4. any verbal or written statement that:
 - a. tends to create the impression or imply that the company, its financial condition or status, or the payment of its claims, its policy forms or kinds or plans of insurance are approved, endorsed or guaranteed by the State of Illinois, United States Government or the Director or Department of Insurance or are secured by government bonds, or are secured by a deposit with the Director of Insurance;
 - b. uses or refers to any deposit with the Director or any certificate of deposit issued by the Director or reproduction of any such certificate of deposit.

215 ILCS 5/149.

The Illinois Insurance Code does not create a private cause of action for violation of Section 5/149, but does prohibit any form of misrepresentation by agents and brokers. *Glazewski v. Allstate Insurance Co.*, 126 Ill.App.3d 401, 466 N.E.2d 1151 (1st Dist. 1984).

The Illinois Insurance Code sets forth detailed claim handling standards. 215 ILCS 5/154.6. The Insurance Code enumerates the following as improper claims practices:

1. Knowingly misrepresenting to claimants and insureds relevant facts or policy provisions relating to the coverage at issue;
2. Failing to acknowledge with reasonable promptness pertinent communications with respect to claims arising under policies;
3. Failing to adopt and implement reasonable standards for the prompt investigation and settlement of claims arising under policies;
4. Not attempting in good faith to effectuate prompt, fair and equitable settlement of claims in which liability has become reasonably clear;
5. Compelling policyholders to institute suits to recover amounts due under policies by offering substantially less than the amounts ultimately recovered;

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6. Engaging in activity that results in the Department of Insurance receiving a disproportionate number of meritorious complaints against the insurer;
7. Engaging in activity that results in a disproportionate number of lawsuits against the insurer or its insureds;
8. Refusing to pay claims without conducting a reasonable investigation based on all available information;
9. Failing to affirm or deny coverage of claims within a reasonable time after completing proof of loss statements;
10. Attempting to settle a claim for an amount less than a reasonable person would believe the claimant was entitled or establishing unreasonable caps or limits on materials when estimating vehicle repairs;
11. Attempting to settle claims on the basis of an application that was altered without the insured's notice, knowledge or consent;
12. Paying a policyholder's or beneficiary's claim without identifying the coverage under which the payment is made;
13. Delaying the investigation or payment of claims by requiring the submission of a preliminary claim report followed by a subsequent submission of formal proof of loss forms, resulting in duplication of verification;
14. Failing to promptly provide a reasonable and accurate explanation for the denial or settlement of a claim based on the insurance policy or applicable law; and
15. Failing to provide necessary claim forms, including instructions, within 15 working days of a request for such forms.

A private cause of action exists for violating any of these provisions. 215 ILCS 5/154.6. An insurer that unreasonably and vexatiously violates the Insurance Code additionally risks liability for attorney fees and costs. 215 ILCS 5/155.

DISCOVERY ISSUES IN ACTIONS AGAINST INSURERS

Discoverability of Claims Files Generally

Claim files are usually discoverable as long as they are deemed relevant. Relevancy is established by reference to the issues, or more generally, a piece of evidence is relevant if it tends to prove or disprove something at trial. *Krupp v. Chi. Transit Auth.*, 8 Ill.2d 37, 132 N.E.2d 532 (1956). Only arguments based upon either attorney-client privilege or the work product doctrine can successfully contest this discovery.

Discoverability of Reserves

Courts have recently allowed limited discovery of reserves, particularly when the reserves are set without advice

of counsel.

Discoverability of Existence of Reinsurance and Communications with Reinsurers

Courts have consistently held that insurer's reinsurance policies are not discoverable. However, the unusual cases in which such discovery is admissible as discoverable involve "lost policy" issues.

Attorney/Client Communications

Attorney-client privilege precluding admissibility of claim files is established in a corporate setting if the following elements are met: a showing that the communication stemmed from a confidence that it would not be disclosed, that the communication was made to an attorney acting in his or her legal capacity for the clear purpose of securing legal advice, and that the communication remained confidential. *Archer Daniels Midland Co. v. Koppers Co., Inc.*, 138 Ill.App.3d 276, 279, 485 N.E.2d 1301, 1303 (1st Dist. 1985), *Chavez v. Watts*, 161 Ill.App.3d 664 (1st Dist. 1987); See also, *Rapps v. Keldermans*, 257 Ill. App.3d 205 (1st Dist. 1993). The burden on establishing the privilege nature of a communication is on the party claiming such privilege. *Id.*

Illinois appellate courts have split on the question of whether coverage counsel's advice to the insurer concerning the applicability of coverage is privileged. In *Western States Ins. Co. v. O'Hara*, 357 Ill.App. 3d 509, 828 N.E.2d 842 (4th Dist. 2005), the court held that the common interest doctrine prevented the application of the attorney client privilege to advice concerning the settlement of the underlying claim. However, in *Illinois Emcasco Ins. Co. v. Nationwide Mutual Ins. Co.*, 393 Ill.App. 3d 782, 913 N.E.2d 1102 (1st Dist. 2009), the court ruled that the common interest doctrine did not apply to counsel retained by the insurance company to provide coverage advice, rejecting the standard in *Western States v. O'Hara*. The court noted that its decision is limited to advice concerning coverage, and does not extend to communications from coverage counsel concerning the common interest of the insured and the insurer.

With respect to an insurer's work product, there is no work product privilege until the insurer anticipates litigation. Illinois federal courts have held that a claim investigation is ordinary course of business – not anticipation of litigation. *Allendale Mutual Ins. Co. v. Bull Data Systems, Inc.*, 145 F.R.D. 84 (N.D.Ill. 1992); *Logan v. Commercial Union Ins. Co.*, 96 F.3d 971, 977 (7th Cir. 1996).

DEFENSES IN ACTIONS AGAINST INSURERS

Misrepresentations/Omissions: During Underwriting or During Claim

Section 154 of the Illinois Insurance Code addresses the effect of misrepresentations and false warranties stated in a policy of insurance, endorsements, or riders to the policy, or in a written application for a policy of insurance. 215 ILCS 5/154. Section 154 is generally used as an affirmative defense in a breach of contract action brought by the insured for the denial of coverage under a policy of insurance.

Misrepresentation in an insurance application occurs when the applicant states something as fact when, in reality, it is untrue and materially affects the risk undertaken by the insurer. *Styzinski v. United Sec. Life Ins. Co. of Illinois*, 332 Ill. App. 3d 417, 422, 772 N.E.2d 888, 893 (1st Dist. 2002) (citing *Ratcliffe v. International Surplus Lines Ins. Co.*, 194 Ill. App. 3d 18, 25, 550 N.E.2d 1052, 1057 (1st Dist. 1990)). A material misrepresentation will void an insurance contract even when made in good faith and without the intent to deceive. *Golden Rule Ins. Co. v. Schwartz*, 323 Ill. App. 3d 86, 751 N.E.2d 123 (1st Dist. 2001) (vacated in part on other grounds by *Golden Rule Ins. Co. v. Schwartz*, 203 Ill. 2d 456, 464, 786 N.E.2d 1010, 1015 (2003)).

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An insurer has no general duty to investigate the truthfulness of answers given to questions asked on an insurance application and may rely on the truthfulness of these answers when accepting the risk. *Brandt v. Time Ins. Co.*, 302 Ill. App. 3d 159, 164, 704 N.E.2d 843, 846 (1st Dist. 1998). The insured has a duty to supply complete answers and accurate information to the insurer. *Id.*

In order for a misrepresentation or false warranty to defeat or void a claim, or to provide the basis for rescission of a policy of insurance, the insurer has the burden of proving one of the following:

1. that the misrepresentation was made with the actual intent to deceive; or
2. that the misrepresentation materially affected either the acceptance of the risk or the hazard assumed by the company.

215 ILCS 5/154

Failure to Comply with Conditions

1. Assistance and Cooperation

The basic purpose of a cooperation clause is to protect the insurer's interests and to prevent collusion between the insured and the injured party. *Waste Management, Inc. v. International Surplus Lines Ins. Co.*, 144 Ill.2d 178, 191, 579 N.E.2d 322, 327 (1991). The cooperation clause "imposes a broad duty of cooperation and is without limitation or qualification. *Id.* at 192, 579 N.E.2d at 328.

The cooperation clause obligates the insured to disclose all facts within its knowledge and otherwise to aid the insurer in its determination of coverage under the policy. *Waste Management*, 144 Ill.2d at 204, 579 N.E.2d at 333. "The insurer is entitled, irrespective of whether its duty is to defend or indemnify, to gain as much knowledge and information as may aid it in its investigation, or as may otherwise be significant to [the] insurer in determining its liability under the policy and in protecting against fraudulent claims." *Id.*

An insurer is not liable for defense or indemnification obligations if the insured willfully fails to cooperate in defending the lawsuit. *Employers Resins. Corp. v. E. Miller Ins. Agency, Inc.* 332 Ill.App.3d 326, 339, 773 N.E.2d 707, 717 (1st Dist. 2002). The insurer bears the burden of demonstrating by a preponderance of the evidence that the insured failed to cooperate. *Buckner v. Causey*, 311 Ill.App.3d 139, 144, 724 N.E.2d 95, 100 (1st Dist. 1999); *Lappo v. Thompson*, 87 Ill.App.3d 253, 409 N.E.2d 26 (1st Dist. 1980). The alleged breach of cooperation is not a defense under the policy, however, unless it substantially prejudices the insurer. *State Farm Mut. Auto. Ins. Co. v. McSpadden*, 88 Ill.App.3d 1135, 1138, 411 N.E.2d 121, 123 (5th Dist. 1980).

2. Late Notice

Insurance policy notice provisions "impose valid prerequisites to insurance coverage." *Country Mut. Ins. Co. v. Livorsi Marine, Inc.*, 222 Ill.2d 303, 311, 856 N.E.2d 338, 343 (2006). A notice provision enables the insurer to conduct a timely and thorough investigation of the insured's claim, as well as to locate and participate in the defense of the insured. *Northbrook Property & Cas. Ins. Co. v. Applied Systems, Inc.* 313 Ill.App.3d 457, 464-65, 729 N.E.2d 915, 921 (1st Dist. 2000). The insured is expected to act with due diligence when its policy requires it to give the insurer notice of a lawsuit or claim. *Northern Ins. Co. of New York v. City of Chicago*, 325 Ill.App.3d 1086, 1091, 759 N.E.2d 144, 149 (1st Dist. 2001).

A policy condition requiring notice “as soon as practicable” is interpreted to mean “within a reasonable time.” *Livorsi*, 222 Ill.2d at 311, 856 N.E.2d at 343. Whether notice has been given within a reasonable time depends on the facts and circumstances of each case; including, the specific language of the policy’s notice provision, the insured’s sophistication regarding insurance policies, the insured’s awareness that an occurrence as defined under the policy has taken place, the insured’s diligence in ascertaining whether policy coverage is available and whether any delay in notice prejudiced the insurer. *Northbrook Property*, 313 Ill.App.3d at 466, 729 N.E.2d at 922.

Where the reasonableness of notice is at issue “the presence or absence of prejudice to the insurer is one factor to consider when determining whether a policyholder has fulfilled any policy condition requiring reasonable notice.” *Livorsi*, 222 Ill.2d at 317, 856 N.E.2d at 346. However, “once it is determined that the insurer did not receive reasonable notice of an occurrence or a lawsuit, the policyholder may not recover under the policy, regardless of whether the lack of reasonable notice prejudiced the insurer.” *Id.* (emphasis added).

Challenging Stipulated Judgments: Consent and/or No-Action Clause

No action provisions protect the insurer from overly generous, unnecessary, or collusive settlement by the insured at the expense of the insurer. *Swedish American Hosp. Ass'n of Rockford v. Ill. State Med. Inter-Ins. Exch.*, 395 Ill. App. 3d 80, 97, 916 N.E.2d 80, 95 (2d Dist. 2009). However, Illinois courts have also noted that it is unfair to the insured party to enforce the clause against him or her when the insurer has “erroneously refused to perform the insurance contract.” *De Luxe Motor Stages of Ill., Inc. v. Hartford Accident & Indemnity Co.*, 88 Ill. App. 2d 188, 193, 232 N.E.2d 141 (1st Dist. 1967).

Preexisting Illness or Disease Clauses

1. Statutes

The Illinois Insurance Code limits the definition of a “preexisting condition” as follows:

No long-term insurance policy or certificate other than a policy or certificate thereunder issued to a group . . . shall use a definition of “preexisting condition” which is more restrictive than the following: Preexisting condition means the existence of symptoms which would cause an ordinarily prudent person to seek diagnosis, care or treatment, or a condition for which medical advice or treatment was recommended by, or received from a provider of health care services, within 6 months preceding the effective date of coverage for an insured person.

215 ILCS 5/351A-5. Further, on August 25, 2017 the Illinois Legislature passed HB 2959 amending the Illinois Insurance Code as follows:

Sec. 356z.25. Preexisting condition exclusion. No policy of individual or group accident and health insurance issued, amended, delivered, or renewed on or after the effective date of this amendatory Act of the 100th General Assembly may impose any preexisting condition exclusion, as defined in the Illinois Health Insurance Portability and Accountability Act, with respect to such plan or coverage.

HB 2959 became effective January 1, 2018.

2. Case Law

An insurer cannot expect or require an insured to disclose health information that is beyond the knowledge of an ordinary layperson when the insured has not been given the information by a doctor. *Holub v. Holy Family Society*, 164 Ill. App. 3d 970, 974, 518 N.E.2d 419 (1st Dist. 1987) (insurer's denial of coverage for treatment of rectal cancer under the policy's exclusion for preexisting conditions overturned where the insured did not have prior knowledge of her condition). The determination of whether an illness was pre-existing is a question of fact for the jury that requires expert testimony. *Id.*

Where the insured suffers from a preexisting condition that makes an accidental injury more likely, the accident may still lead "directly and independently of all other causes" to a compensable and covered injury. *Faulkner v. Allstate Insurance Co.*, 291 Ill. App. 3d 706, 712-713, 684 N.E.2d 155 (5th Dist. 1997).

Statutes of Limitations and Repose

In Illinois, no civil suit shall be brought to recover on health or life policies prior to the expiration of 60 days after written proof of loss is furnished in accordance with the policy. 215 ILCS 5/357.12. Moreover, no such action shall be brought after the expiration of three years after the time the written proof of loss is required to be furnished. If a health or life insurance policy or contract for insurance. *Id.*

TRIGGER AND ALLOCATION ISSUES FOR LONG-TAIL CLAIMS

Trigger of Coverage

Illinois follows the "continuous trigger" theory – also known as the "triple trigger" theory – to determine which policies are triggered by ongoing exposure to a harmful substance through multiple policy periods. The continuous trigger theory holds that "damage will have 'occurred' continuously for a fixed period 'and every insurer on the risk at any time during the trigger period is jointly and severally liable to the extent of their policy limits.'" *Maremont Corp. v. Continental Cas. Co.*, 326 Ill.App.3d 272, 277, 760 N.E.2d 550, 554 (1st Dist. 2001), quoting *United States Gypsum Co. v. Admiral Ins. Co.*, 268 Ill.App.3d 598, 644, 643 N.E.2d 1226, 1256 (1st Dist. 1994). According to the continuous trigger theory, property damage takes place at or shortly after the time the property is exposed to the injury-causing condition and continues through the property's exposure to that condition. *U.S. Gypsum*, 268 Ill.App.3d at 646, 643 N.E.2d at 1257, citing *Zurich Ins. Co. v. Raymark Industries, Inc.*, 118 Ill.2d 23, 514 N.E.2d 150 (1987). Similarly, bodily injury takes place at the initial exposure, when the disease manifests itself and at any interim time when the claimant manifests some sickness. *Zurich*, 118 Ill.2d 23.

Allocation Among Insurers

Illinois follows the "all sums" approach to allocation, in which the insurer promises to pay "all sums" relating to the policyholder's liability. *John Crane v. Admiral Ins. Co.*, 991 N.E.2d 474 (Ill. App. Ct. 1st Dist. 2013), citing *Zurich Insurance Co. v. Raymark Industries, Inc.*, 118 Ill. 2d 23, 514 N.E.2d 150 (1987). The "all sums" approach allows a policyholder to simply choose the policy or policies which must respond entirely to a loss spanning multiple policy periods. Likely, the selected carrier will pay the entire loss and then seek contribution from the other insurance carriers the policy holder is insured by. Also, if two insurers owe an insured a duty to defend, the insured may choose between the two insurers, and thereby force one insurer to pay the entire loss, up to its limit, provided the insurers are on the same layer of coverage. *John Burns Constr. Co. v. Indiana Ins. Co.*, 189 Ill.2d 570 (2000).

Illinois follows the horizontal exhaustion rule. Thus, all primary coverage, including self-insured retentions, must be exhausted before any excess coverage will be triggered. *Kajima Constr. Servs. v. St. Paul Fire & Marine Ins. Co.*, 227 Ill.2d 102, 114 (2007). The horizontal exhaustion rule applies even where the insured has targeted one carrier over another, so that the coverage provided by a non-targeted primary insurer must be exhausted before any excess coverage will be triggered. *Id.*

CONTRIBUTION ACTIONS

Claim in Equity vs. Statutory

In *Doyle v. Rhodes*, 101 Ill. 2d 1, 461 N.E.2d 382 (1984), the Illinois Supreme Court established the principle that an action for contribution is a suit for equity. More recently, the court held in a declaratory judgment action that “Contribution as it pertains to insurance law is an equitable principle arising among coinsurers which permits one insurer who has paid the entire loss, or greater than its share of the loss, to be reimbursed from other insurers who are also liable for the same loss.” *Home Insurance Co. v. Cincinnati Insurance Co.*, 213 Ill. 2d 307, 316, 821 N.E.2d 269 (2004). Thus, Illinois views contribution as an equitable principle, but has also enacted a statute regarding contribution claims, as reviewed below.

Elements

To state a claim for equitable contribution, an insurer must establish that it has paid the entire loss, or greater than its share of the loss, and that the other is also liable for the loss. Contribution applies to “multiple, concurrent insurance situations and is only available where the concurrent policies insure the same entities, the same interests and the same risks.” *Home Insurance*, 213 Ill.2d at 316. When two insurers cover separate and distinct risks, there can be no contribution, even if both would be liable for the loss. *Id.* For example, where one insurer provides additional insured coverage to a general contractor for all liability arising out of the work of one subcontractor, and another insurer provides additional insured coverage to the same general contractor but for the work of a separate subcontractor, there is no contribution even if both would be liable to the general contractor for the loss. *Id.*

DUTY TO SETTLE

An insurer’s duty to settle arises when (1) a claim has been made against the insured; (2) there is a reasonable probability of recovery in excess of policy limits; and (3) there is a reasonable probability of a finding of liability against the insured. *Haddick ex rel. Griffith v. Valor Insurance*, 198 Ill.2d 409, 417, 763 N.E.2d 299, 304 (2001). Importantly, the duty to settle does not arise until a third party demands settlement within the policy limits. *Id.* at 417, 763 N.E.2d at 305. An insurer that refuses to settle may be liable for the full amount of the judgment against the policyholder regardless of policy limits. *Cramer*, 174 Ill.2d at 525, 675 N.E.2d at 903.

An insurer has a duty to act in good faith in responding to settlement offers. The basis for the duty to settle is the insurer’s exclusive control over settlement negotiations and defense of litigation. *Haddick*, 198 Ill.2d at 414, 763 N.E.2d at 303. Although the insurance company, in determining whether to accept or reject a settlement offer, may properly consider its own interests, it must, in good faith, give at least equal consideration to the interests of the insured. A failure to do so constitutes bad faith. *Cernocky v. Indemnity Ins. Co. of North America*, 69 Ill.App.2d 196, 207-08, 216 N.E.2d 198, 204-05 (2nd Dist. 1966).

LH&D BENEFICIARY ISSUES

Change of Beneficiary

In changing form of beneficiary, the insured must do everything reasonably possible to carry out his intention to

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change the beneficiary in order for the change to be effective. *Aetna Life Ins. Co. v. Wise*, 184 F.3d 660, 663 (7th Cir. 1999). If a policy provision establishes a method for changing beneficiary designation, the insured must substantially comply with this provision for change of beneficiary to be effective. *Kniffin v. Kniffin*, 119 Ill. App. 3d 106, 108-09, 456 N.E.2d 659, 661 (1st Dist. 1983).

Effect of Divorce on Beneficiary Designation

Following a divorce, as long as the insured does everything reasonably possible in his power to carry out his intention to change beneficiary from his former spouse to a new beneficiary, the change will be effective under Illinois law. *Aetna Life Ins. Co. v. Wise*, 184 F.3d 660, 664 (7th Cir. 1999). If a divorce judgment is entered after an insured has designated the insured's spouse as a beneficiary under a life insurance policy in force at the time of entry, the designation of the insured's former spouse as beneficiary is not effective unless:

- The divorce judgment designates the insured's former spouse as the beneficiary;
- The insured re-designates the former spouse as the beneficiary after judgment entry; or
- The former spouse is designated to receive the proceeds in trust for, or on behalf or, or for the benefit of a child or a dependent of either former spouse.

750 ILCS 5/503. If a designation is not effective under one of the foregoing examples, the proceeds of the policy are payable to the named alternative beneficiary, or if there is not a named alternative beneficiary, to the estate of the insured. *Id.* The provisions of this relatively new statute do not apply to life insurance policies subject to regulation under ERISA, the Federal Employee Group Life Insurance Act, or any other federal law that preempts application.

INTERPLEADER ACTIONS

Availability of Fee Recovery

Illinois does not have a statute that allows for fee recover in interpleader actions. Specifically, the Illinois rule is that attorney's fees are not allowable to a party filing an interpleader. *Ill. Bankers Life Assurance Co. v. Blood*, 69 F. Supp. 705, 706 (N.D. Ill. 1947), citing *Metropolitan Life Insurance Co. v. Kinsley*, 269 Ill. 529, 109 N.E. 1011 (1915).

Differences in State vs. Federal

In Illinois Interpleader is controlled by statute. Section 2-409 of the Code of Civil Procedure, 735 ILCS 5/2-409, provides as follows:

Persons having claims against the plaintiff arising out of the same or related subject matter may be joined as defendants and required to interplead when their claims may expose plaintiff to double or multiple liability. It is not a ground for objection to interpleader that the claims of the several claimants or the titles upon which their claims depend do not have a common origin or are not identical, or are adverse to or independent of one another, or that the plaintiff avers that he or she is not liable in whole or in part to any or all of the claimants. A defendant under similar circumstances may obtain like relief by counterclaim. The provisions hereof are not a limitation upon the joinder of parties or causes of action.

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Under §2-409 of the Illinois Code of Civil Procedure, there are only two elements to an interpleader cause of action:

1. The claims must arise out of the same or related subject matter; and
2. The claims must be such that they may expose the interpleader to double or multiple liability.

For a discussion on the elements to an interpleader action, See, *Continental Casualty Co. v. Pipeco, Inc.*, 98 Ill.App.3d 637, 4221 N.E.2d 971, 979 (5th Dist. (1981).