Querrey & Harrow

When Results Count.SM

www.querrey.com

TENDERS OF DEFENSE[1]

By Bruce H. Schoumacher

In order for the insured to be covered by his or her liability insurance policy, he or she must give notice of the claim to the insured. Insurers' require notice of claims because they are obligated to defend the insured under most insurance policies. In addition, insurers expect prompt notices of claims in order to conduct an adequate investigation and prepare a proper defense. Thus, most insurance policies provide that the insured will give the insurer notice of any claim "as soon as practicable."

Many liability insurance policies also require the insured to give the insurer notice of any circumstances which could likely result in a claim. Under such circumstances, whether notice should be, or should have been, given is judged by an objective standard. However, some insurance policies follow a subjective standard.

An insured should give notice of a claim or circumstances likely to arise in a claim to all applicable insurers, such as umbrella liability insurers and companies which have covered a person or firm as an additional insured. Additional insureds also should make claims to the insurers and not rely upon merely making a claim to the insured.

Illinois Law Requires Prompt Notice

Under Illinois law, prompt notice of a claim is a condition precedent for coverage. An unexcused delay in reporting the claim results in loss of coverage. Equity General Insurance Co. vs. Patis, 119 Ill. App. 3d 232, 456 N.E.2d 348, 352 (1983). Illinois does not consider whether the late notice prejudiced the insurer. In one case, the court held that a general contractor which was an additional insured under a commercial liability policy purchased by a subcontractor was not covered by the subcontractor's insurance policy because the general contractor had reported the claim to the subcontractor and not the subcontractor's insurer. American National Fire Insurance Co. v. National Union Fire Insurance Co. of Pittsburgh, (343 Ill. App.3d 93, 796 N.E. 2d 1133 (1st Dist. 2003).

[1] Copyright© Bruce H. Schoumacher. All rights reserved. The author thanks Nicholas Johnson, a student of the Thomas M. Cooley Law School, for his assistance in preparing this paper.

Failure to give prompt notice to the insured may be excused under certain circumstances. For example, the insured may not have been aware that it was an additional insured under a insurance policy. However, the insured must exercise due diligence to determine whether there are any insurance policies which may protect it. INA Insurance Co. vs. City of Chicago, 62 Ill. App. 3d 80, 379 N.E. 2d 34 (1st Dist. 1978). The fact that an insured does not have a copy of the policy is not grounds for not reporting a claim to the proper insurer.

In addition, an insured may be excused for failure to give prompt notice of the claim for the following reasons.

1. The insured had no knowledge of the claim.

2. The insured reasonably believed that the occurrence was trivial and would not result in a claim.

3. The insured reasonably believed that the claim was not covered by the policy.

4. The insured reasonably believed that its actions were not responsible for the damage or injury to the claimant.

5. The insured reasonably believed that the claimant would obtain compensation from a third party, which in turn would not seek subrogation.

6. The insured reasonably believed it was not liable, although the insured believed that he or she would be sued.

7. The insured is a minor.

8. The insured is physically incapacitated.

9. The insured reasonably believed that notice had been given or would be given to the insurer.

10. The insured was unable to obtain a copy of the insurance policy, even though it exercised due diligence.

Notify Excess Insurers

Besides notifying the primary liability insurer of a claim or circumstances likely to result in a claim, the insured also should notify any umbrella or excess liability insurers. If the insured has no reason to believe that the claims will exceed the amount of primary insurance available, the insured is under no duty to report the claim to any excess insurer. However, in order to defend against an allegation of late notice to the excess insured, the insured must be able to show that he or she could not have reasonably anticipated that the claim would involve the excess liability policy. Further, if the insured is on notice that the amount claimed exceeds the primary policy limits, then the insured must report the claim to the excess insurer. Atlanta International Insurance Co. vs. Yellow Cab Co., 962 F. 2d 657, 659 (7th Cir. 1992) (Applying Illinois law).

In a recent case, the court stated that under the circumstances the insured's failure to report a claim to the excess insurer until five years after an accident in which four people had been injured was excusable and denied the excess insurer's attempt to avoid coverage for the claims. Zurich Insurance Co. v. Walsh Construction Co., 2004 Ill. App. LEXIS 1109 (1st Dist., Sept. 16, 2004). The excess policy stated that the insured would report any occurrences to the insurer "as soon as practicable" and lawsuits to the insurer "immediately." The court reasoned "as soon as practicable" and "immediately" meant a reasonable time, considering all the relevant facts and circumstances. The court stated that the "reasonably prudent person" standard should be used to determine whether notice had been given as soon as practicable or immediately.

In Zurich Insurance Co., the insured had been defended in the lawsuit under wrap-up insurance policies, which provided over $100,000,000 of coverage for the claims. When the accident happened and the suits were subsequently filed, the insured reported the claims to the wrap-up insurer. Subsequently, the wrap-up insurer became insolvent. Accordingly, the insured reported the pending suits to its own excess insurer within twelve days of learning that an order of liquidation had been entered against the wrap-up insurer. The court found that the insured had acted reasonably and held that the excess insurer owed the insured a defense.

Obviously, the safest course for the insured to follow is to report all claims which may be covered by insurance not only to its primary insurer, but also all umbrella and excess insurers, regardless of the amount of the claim.

Reporting Claims to Broker

Most insureds rely upon their insurance broker to give notice to the insurance company. However, notice to the broker is not necessarily notice to the insurer. In order for notice of a claim made to the broker to be effective, the broker must be an agent of the insurance company who has authority to receive notices of claim. If the broker is also an agent of the insured, then notice of the claim to the broker should be sufficient. To avoid any risk of a claim being denied because notice was not given to the insurer, the insured should follow the notice of claim provision of the insurance policy. If the provision provides that notice should be made directly to the insurer, then the insured cannot go wrong if it gives notice directly to the insurer. However, most times, the insured can rely upon its broker in relaying notice of the claim to the insurer.

Report Suits

Many policies provide that not only should notice of a claim or circumstances likely to result in a claim be made to the insurer, but they also state that any suit filed against the insured should be reported to the insurer. Under such provisions, even though the insured may have given notice of the occurrence to the insurer, the insured also must give additional notice to the insurer when it is sued. Rice vs. AAA AeroStar, Inc., 294 Ill. App. 3d 801, 690 N.E.2d 1067, 1072 (4th Dist. 1998).

Actual Knowledge of Insurer

Despite the cases requiring the insured to comply with the notice provisions of his or her insurance policy, the insured need not notify its insurer of a claim or loss, if the insurer otherwise learns of the claim. Cincinnati Companies v. West American Insurance Co., 183 Ill. 2d 317, 701 N.E.2d 499 (1998). In Cincinnati Companies, West American had issued a policy covering its insured and an additional insured. The insured reported a personal injury suit to West American in which both the additional insured and the insured had been named as defendants. The additional insured did not notify West American of the claim. The court concluded that, because West American had actual notice of the suit, it was not required to defend the additional insured, but at a minimum it was required to contact the insured to determine whether the insured wanted West American Insurance to participate in the defense.

Prior to Cincinnati Companies, the courts drew a distinction between "unsophisticated" and "sophisticated insureds" when determining whether the insured had to report a claim or lawsuit to its insurer in order to enforce coverage. Initially, the courts determined that tender by an unsophisticated insured was complete when the insurer received actual notice of the claim of lawsuit. The courts reasoned that it would be unfair to deny the unsophisticated insured coverage because he or she did not tender the notice of claim or lawsuit to the insurer, even though the insurer has actual notice of the claim from another source, because the insurer has "superior knowledge about the scope of its policies and that the insured may not be aware of the tender requirement." Aetna Casualty & Surety Co. v. Chicago Insurance Co., 99 F.2d 1254 (7th Cir. 1993). The courts ruled, however, the sophisticated insured was still required to tender notice of the claim or lawsuit to its insurer, since the sophisticated insured would have more knowledge of how insurance works and would have better access to legal advice. Long v. The Great Central Insurance Co., 190 Ill. App. 3d 159, 546 N.E.2d 739 (4th Dist. 1989).

In Cincinnati Companies, the courts removed the distinction between sophisticated and unsophisticated insureds because of problems with proving who was a sophisticated or unsophisticated insured. The court reasoned that it was not unfair to place this burden on the insurance companies because "telling the insurer something it already knows...injects a degree of gamesmanship into the insurer-insured relationship without providing any valid corresponding benefit." Further, the court noted that the insurer received a premium for the policy and that it should not be permitted to evade its responsibility because of the insured's ignorance and failure to report a claim or lawsuit to the insurer of which the insurer has actual knowledge.

Targeted Tenders

Under Illinois law, when the insured is covered by more than one insurance policy, the insured can select the policy under which it will be defended. In the case of Institute of London Underwriters v. Hartford Fire Insurance Co., 234 Ill. App. 3d 70, 599 N.E.2d 1311 (1st Dist. 1992), the general contractor was sued for negligence by an injured employee of a subcontractor. The general contractor put its own insurer on notice but advised its insurer that it did not want a defense from it. Instead, because the general contractor was an additional insured under the subcontractor's commercial liability policy, the general contractor tendered its defense to the insurer of the subcontractor, requesting that insurer defend it. The subcontractor's insurer stated

that, because of the other insurance clause of its policy, the general contractor's own insurer should participate in the defense. The court rejected this argument, finding that the general contractor could select the insurer to defend it.

In a subsequent case, the court held that once the insured selected the insurer to defend it the defending insurer could not seek equitable contribution from any other insurers which may cover the insured. Alcan United, Inc. v. West Bend Mutual Insurance Co., 303 Ill. App. 3d 72, 707 N.E.2d 687 (1st Dist. 1999). Then, the Illinois Supreme Court ruled that the insured can select which of two or more potential insurers will defend it in a specific lawsuit. Burns v. Indiana Insurance Company, 189 Ill. 2d 570, 727 N.E.2d 211 (2000).

Recently, an Illinois Appellate Court ruled that an insured may "deactivate coverage" after it tenders its defense to its insurer. Legion Insurance Co. v. Empire Fire and Marine Insurance Co., 2004 Ill.App. LEXIS 1539 (1st Dist., Dec. 23, 2004). There, the insured had tendered defense of a third party complaint for contribution to its employer liability and general liability insurers. Subsequently, the insured wrote its general liability insurer indicating that it was not requesting a defense from that insurer, but rather it merely was placing the general liability insurer on notice of a "potential claim." As a result of this letter, the Appellate Court concluded that the employer liability insurer had to exclusively defend the contribution claims.

Because of these "targeted tenders," some insurers have placed endorsements in their policies requiring the insureds to give notice of any claim or loss to any insurer which may cover them and to tender their defense to any insurer who may cover them. Such endorsements are valid. American Country Insurance Company v. Kraemer Bros., 298 Ill. App. 3d 805, 699 N.E.2d 1056 (1st Dist. 1998).