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Illinois Coverage Basics

Illinois Appellate Court Holds That a Liability Insurer May Owe a Duty to Defend to an Entity That Does Not Qualify as an Insured

An unquestioned assumption of Illinois coverage law has always been that a liability insurer does not owe a duty to defend to anyone other than its own insureds. However, that is no longer a safe assumption. In a recent opinion the Illinois Appellate Court ruled that a liability insurer may be required to defend to an entity that does not qualify as an insured. This is a groundbreaking change in the law of Illinois that could have far-reaching consequences.

ITW's Tenders of Defense

In Illinois Tool Works v. Commerce and Industry Insurance Company, 2011 IL App (1st) 093084 (filed December 12, 2011), the defendant liability insurers insured Binks, a manufacturing company, during policy periods that Binks was alleged to have caused environmental contamination. Binks later sold its assets to Illinois Tool Works ("ITW"), which included an assignment to ITW of Binks' rights to defense and indemnity under the liability policies. The liability insurers did not know of Binks' assignment and did not consent to the assignment.

When Binks and ITW were subsequently sued for the alleged environmental contamination, ITW tendered its defense to the liability insurers that had insured Binks. In support of the tenders, ITW relied upon the assignment of Binks' policy benefits to ITW. The insurers declined to defend ITW, and in response ITW filed a declaratory judgment action. The Chancery Court ruled in favor of the insurers, holding that the insurers had no duty to defend ITW, because ITW did not qualify as an insured under those policies.

The ITW Appeal

On appeal, the First District Appellate Court reversed the Chancery Court judgment and held that the insurers owed ITW a duty to defend based upon Binks' assignment of benefits under the policies. The Appellate Court reached this result even though it was undisputed that: (a) ITW did not qualify as an insured under the policies; (b) the policies contained provisions that unambiguously prohibited the assignment of any interest thereunder without the insurers' consent; and (c) the insurers had no prior notice of and did not consent to the assignment. No other Illinois court of review has ever held that a liability insurer can be compelled to defend an entity that does not qualify as an insured under the terms of a policy.

The Appellate Court's Rationale

The Appellate Court in ITW found that all that is needed to create an effective assignment of policy benefits is evidence of a clear intent on the part of the assignor to make an assignment. There was no doubt that, based upon the language of the asset purchase agreement, Binks intended to assign ITW its rights to defense and indemnity under the policies. (The assignment stated that it transferred Binks' "benefits, including all rights to defense and indemnity coverage, under any and all liability insurance.") The Appellate Court found that due to Binks' assignment of its rights under the policies -- to which the insurers had not consented, but had objected -- the insurers became obligated to defend ITW.

The ITW Court acknowledged that the policies contained provisions prohibiting the assignment of any interest under the policies without consent of the insurers. Nonetheless, the Court held that no consent was necessary because the assignment of the policy benefits was made after the loss had occurred. The Court derived this rule from law governing assignments of benefits under first-party policies. The Appellate Court found that the same rule should apply to assignments made of third-party policy benefits.

The Court found under the facts of the case that Binks' assignment had taken place after the occurrence of the loss, although the record was clear that no claim or suit had been asserted against ITW before the assignment. The Appellate Court concluded that for purposes of the liability policies the "loss" had occurred when the alleged environmental contamination took place, years before any claim or suit was asserted against either Binks or ITW. Going further, the ITW Court found that Binks possessed an assignable right to defense and indemnity under the policies from the time that it paid the policy premiums.

The Appellate Court's opinion all but deletes non-assignability clauses from liability policies. The ITW opinion essentially holds that benefits under a liability policy may be assigned over an insurer's objection at any time after the insured makes a premium payment. Even if these doubtful legal developments could be justified, the Court's rationale suffers substantial analytical gaps that the Court did not even address, much less attempt to resolve.

The most obvious analytical gap in the ITW decision concerns the nature of the right that was assigned to ITW. By definition, an assignment can convey no more than the interests held by the assignor. In the ITW case, before the assignment, the insurers owed a duty to defend Binks. However, Binks never possessed a right to compel the insurers to defend ITW, so there was no way that it could assign such a right to ITW. Nonetheless, without explanation, the Appellate Court held that the assignment created a duty on the part of the insurers to defend ITW.

If taken at face value, the ITW opinion could require liability insurers to investigate and carefully evaluate tenders made by persons or entities that do not qualify as their insureds. A tender made by one who does not qualify as an insured may yet be a valid tender under the ITW rationale, if the tender is based upon an insured's assignment of policy benefits. The Appellate Court denied rehearing; however, the time for seeking Supreme Court review of the ITW opinion has not yet expired.

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This newsletter provides information on recent legal developments. It is not intended to provide legal advice for a specific situation or to create an attorney-client relationship. If you have questions, please feel free to contact Jim Horstman (312.332.8494; jkh@crayhuber.com).