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Illinois Coverage Basics

Can an Insured Settle a Claim without Its Insurer's Consent and Force the Insurer to Pay?

In Illinois, an insured can settle a claim without its insurer's consent and force the insurer to pay. But, (under the majority rule) not unless the insurer has already breached of its duty to defend. If an insurer is not in breach, the insured is required (under the majority rule) to strictly comply with the policy's voluntary payments-consent to settle provisions.

The *Arbor Homes* Opinion from the Federal Court of Appeals

A recent opinion from the Seventh Circuit Court of Appeals illustrates the majority rule. In West Bend Mutual Insurance Co. v. Arbor Homes, (No. 12-2274, January 8, 2013), the insured was a homebuilder that sold a house with serious plumbing system defects. Within one month of confirming the existence of the construction defects, the builder agreed to perform substantial remediation work. One month later, the builder agreed to provide the claimants with a new house and pay their moving expenses. The builder did not give its insurer advance notice of the settlement agreements, and the insurer did not consent to the settlement.

When the builder sought coverage from its general liability insurer for the settlement, the insurer denied payment on the grounds that the insured failed to comply with the voluntary payments provision of the policy. The builder responded that it would have been futile to seek the insurer's consent to the settlement, because the insurer had raised multiple coverage defenses and would not have participated in the settlement negotiations. Siding with the insurer, the District Court ruled that the insurer had no legal obligation to reimburse the insured for the settlement.

On appeal, the Seventh Circuit agreed, characterizing the requirements of the voluntary payments provision as a "reasonable and prudent" limitation on coverage. The court found that the purpose of the provision is to protect the insurer by providing it with an opportunity to investigate and participate in settlement negotiations. The insurer's assertion of coverage defenses did not relieve the insured of its obligation to comply with the voluntary payments provision. Nor was the insurer required to prove that it was prejudiced by the settlement in order to enforce the voluntary payments provision. The Court of Appeals ruled that it was irrelevant whether the insurer would have obtained a better result in the settlement negotiations. Consent to settlements, the Court ruled, is a condition precedent for coverage.

The *Guillen* Opinion of the Illinois Supreme Court

Although the Arbor Homes case was decided under Indiana law, the Seventh Circuit's ruling is consistent with Illinois law. Under Illinois law, as articulated by the Illinois Supreme Court, an

insured must obtain the consent of its insurer before settling with an injured plaintiff, unless the insurer has breached its duty to defend. Guillen v. Potomoc Insurance Co., 203 Ill.2d 141, 149 (2003). If an insurer breaches its duty to defend, the insured may then enter into a reasonable settlement without forgoing its right to later seek indemnification from the insurer.

Under Guillen, the first question when determining an insured's right to settle is whether the insurer owed a duty to defend in the first instance. In Arbor Homes, for example, the insurer did not owe a duty to defend because the insured had settled the claim before a suit was filed; the insurer was not in breach, so the insured had no right to enter into a settlement without the insurer's consent. More commonly, an insurer may not have a duty to defend because the suit filed against its insured does not trigger coverage. If an insured settles a claim under those circumstances, it cannot bind the insurer to the settlement.

If an insurer owes a duty to defend or there is a dispute as to whether it owes a duty to defend, the insurer has two options to avoid breaching its contractual obligations without acknowledging coverage. An insurer does not breach its contractual obligations if it defends its insured under a reservation of rights or if it files a declaratory judgment action to obtain a coverage ruling. Consequently, (under the majority rule) an insured cannot settle without the insurer's consent if the insurer is defending under reservation or has filed a declaratory judgment action.

The Minority Rule

Inexplicably, certain panels of the Illinois Appellate Court have chosen not to follow Guillen. Under some Appellate Court rulings, an insured may enter into a reasonable settlement without forgoing its right to seek indemnification from its insurer, if the insurer is defending the insured through independent counsel under a reservation of rights. *See* Myoda Computer Ctr., Inc. v. American Family Mut. Ins. Co., 389 Ill. App. 3d 419 (1st Dist. 2009); Pekin Ins. Co. v. XData Solutions, Inc., 2011 IL App (1st) 102769, 958 N.E.2d 397.

Limitation When an Insured Has a Right to Settle

When an insured seeks reimbursement from its insurer for a settlement made without the insurer's consent, the insured must show that the settlement was made "in reasonable anticipation of liability." Commonwealth Edison v. National Union Fire Ins. Co., 323 Ill.App.3d 970, 984-985 (1st Dist. 2001). This standard requires the insured to prove "that the allegations in the underlying complaint are covered under the policy language, and … [not] that the allegations could actually have been proved at trial." Continental Casualty Company v. Coregis Ins. Co., 316 Ill.App.3d 1052, 1063 (1st Dist. 2000). In most cases, the "reasonable anticipation" standard imposes no genuine limitation on a settling insured. When an insurer challenges a settlement made by its insured without its consent, the burden is on the insurer to show prejudice or that the settlement was the result of collusion. *See* Myoda Computer.

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