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NEWSLETTER

Failure To Defend or File Declaratory Judgment Action Estops Insurer from Denying Coverage; Related Claims Not a Single Claim Unless Policy So Provides

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An Illinois appellate court recently found that an insurer had a duty to defend an insured executive of a company and was estopped from denying coverage to the company even though the company failed to provide timely notice of the claims against it. *Uhlich Children's Advantage Network v. Nat'l Union Fire Ins. Co.*, 2010 WL 394645 (Ill. App. Feb. 3, 2010).

The insurer issued two identical claims-made-and-reported policies covering the company and its directors and officers. The first policy was in effect from July 1, 2004 to July 1, 2005, the second from July 1, 2005 to July 1, 2006. Each policy provided that a single retention would apply to loss arising from all claims alleging the same or related wrongful acts, but did not expressly state that claims arising out of related wrongful acts would constitute a single claim under the policy.

In January 2005, while the first policy was in effect, a former employee of the company filed an employment discrimination charge against the company with the Equal Employment Opportunity Commission (EEOC). On September 29, 2005, during the second policy period, the former employee filed a federal lawsuit naming both the company and its vice president as defendants. The company promptly tendered the complaint in the lawsuit to its insurer. The carrier denied coverage for the lawsuit on the grounds that the claim in question was first made in January 2005 but was not reported to the insurer during the first policy period.

The court found that the claim against the vice president was first made during the second policy period when the lawsuit added her as a defendant. The court acknowledged that this claim arose from the same facts as the January 2005 EEOC charge, but found that the claim against the vice president did not relate back to the earlier charge because the policies did not specify that claims arising out of related wrongful acts would constitute a single claim. The court opined that the insurer "want[ed] the instant policies to say that related wrongful acts constitute a single claim, but they simply do not." Accordingly, the court held that notice to the insurer of the vice president's claim during the second policy period was timely, and the insurer owed a duty to defend the vice president.

As to the company, the court found that the claim against it was first made in the January 2005 EEOC charge. Because the company did not alert the insurer to the claim until October 2005, the company's notice was made after the policy period ended and therefore was untimely. However, under Illinois law, if an insurer with a duty to defend believes that coverage for a claim is unavailable, the insurer must either defend under a reservation of rights or seek a declaratory judgment to determine its coverage obligations. Because the insurer failed either to represent the company under a reservation of rights or to file a declaratory judgment action, it was estopped from disclaiming coverage for untimely notice. Accordingly, the insurer was required to defend the company as well as the vice president.

Although the insurer's denial of a defense was improper, the court held that the insureds did not state a claim for bad faith under the Illinois Insurance Code because there was a genuine dispute regarding coverage, and the insurer's denial therefore was neither vexatious nor unreasonable.