

MBT Insurance Law E-Alert



Insurance Law News Update

February 2010

We are pleased to launch our new MBT Insurance Law E-Alert. These newsletters will provide helpful information related to recent developments in insurance and reinsurance law. We welcome your feedback, so please feel free to contact us with any questions or comments.

Recent Developments In The Area Of "Selective" Or "Targeted" Tender

Issues of coordination of insurance coverage are presented on several fronts, including: allocation between and among the policyholder and its consecutive insurers; coordination between claims-made and occurrence-based coverage; obligations among insurers through analysis and interplay of "other insurance" clauses; and other doctrines that may apply to determine how potentially applicable coverage may respond to a particular claim or loss. The focus of this volume is on the "selective" or "targeted" tender rule.

There is a line of cases that, under certain circumstances, allows a policyholder to select a primary insurer to provide it with a defense and/or to indemnify it with respect to a particular claim. The selected or targeted insurer then has the sole responsibility to defend or indemnify the policyholder up to its limit of liability and is foreclosed from seeking equitable contribution from the other insurer that was not so designated by the policyholder, thereby effectively trumping the "other insurance" clause in the targeted insurer's policy. See, e.g., *John Burns Construction Co. v. Indiana Ins. Co.*, 189 Ill.2d 570, 574 (2000). Most of these decisions involve Illinois law and involve construction-related coverage claims.

Illinois courts have limited the application of the targeted tender rule to situations involving insurance policies providing coverage on the same level. Indeed, in *Kajima Construction Co. v. St. Paul Fire & Marine Ins. Co.*, 227 Ill.2d 102 (2007), the Illinois Supreme Court held that a targeted tender does not override the requirement of horizontal exhaustion and, thus, rejected the insured's attempt to target an excess insurer before all primary coverage was exhausted. After analyzing the law regarding horizontal exhaustion and the distinctions between primary and excess policies, the *Kajima* Court concluded that the better rule is "that targeted tender can be applied to circumstances where concurrent primary insurance coverage exists for additional insureds, but to the extent that defense and indemnity costs exceed the primary limits of the targeted insurer, the deselected insurer or insurers' primary policy must answer for the loss before the insured can seek coverage under an excess policy." *Id.* at 117.

Two recent decisions from the First District of the Appellate Court of Illinois have focused on the policyholder's right to "deactivate" coverage with an insurer or to rely on an insurer for "standby" coverage in the event the targeted insurer refuses the tender. Another recent decision from that same court has addressed the issue of what constitutes primary coverage as opposed to excess insurance for horizontal exhaustion purposes in a targeted tender situation

The Fourth District of the Appellate Court of Illinois recently held that a policyholder is not required to send a "targeted tender" letter or a letter with "magic words" in order to make an effective targeted tender to an insurer.

Recent First District Decisions De-tender & Primary Versus Excess

In *Chicago Hospital Risk Pooling Program v. Illinois State Medical Inter-Insurance Exchange*, No. 1-07-2195 (Ill. App. 1st Dist Jan. 26, 2010), *petition for leave to appeal filed*, the First District explained, in a case that did not involve construction defect claims, that a policyholder's right to target tender a claim "encompasses the right to deactivate coverage with an insurer previously selected for purposes of invoking exclusive coverage with another insurer." *Id.* at p. 29. Stated differently, a policyholder can still make a targeted tender even though it may have relied upon other insurance to protect it with respect to the claim.

In the underlying case, a physician, hospital and others were sued for the wrongful death of a baby and severe neurological damage to his twin. *Id.* at p. 3. The hospital and doctor were insured under a trust agreement administered by the Chicago Hospital Risk Pooling Program ("CHRPP"). The physician also was insured under a professional liability policy issued by the Illinois State Medical Inter-Insurance Exchange ("ISMIE"). *Id.* at p. 5. The physician took the position, under the then current decision of *Institute of London Underwriters v. Hartford Fire Insurance Co.*, 234 Ill. App. 2d 70 (1st Dist. 1992), that his insurance coverage through the hospital - the CHRPP policy - should apply first and that the coverage issued directly to him - the ISMIE policy - should remain secondary. *Id.* at p. 30-31. Following many years of coverage litigation and a prior appeal, the First District addressed whether the physician had made a targeted tender. CHRPP asserted that the physician did not sufficiently renounce his coverage with ISMIE to show that he was looking exclusively to CHRPP to defend and indemnify him, but rather was merely attempting to reprioritize his coverage.

The First District held that the physician unequivocally demonstrated his intent to forego assistance from ISMIE and have CHRPP defend and indemnify him for the loss. *Id.* at p. 32. In so holding, the court explained: "A targeted tender is not negated merely by an expressed desire to keep the deactivated insurer on notice as standby coverage in the event that the selected insurer refuses the tender ... or in the event that the selected primary coverage has been exhausted." *Id.* Moreover, the court held that Illinois law did not require the policyholder to "renounce or completely abandon his coverage under his ISMIE policy." *Id.* Nonetheless, the court recognized under *Kajima* that the policyholder must exhaust all primary coverage before any excess coverage was implicated. *Id.* at 33. The court explained that, once the physician exclusively sought coverage from CHRPP, CHRPP had the sole duty to defend and indemnify him, and ISMIE's duty was to provide standby coverage in the event CHRPP refused to provide coverage or to the extent the defense and indemnity costs did not exceed CHRPP's primary policy limit. *Id.* Thus, even though the policyholder relied upon the ISMIE coverage given CHRPP's coverage position, the court held a targeted tender was made to CHRPP.

In *Statewide Insurance Co. v. Houston General Insurance Co.*, No. 1-07-1798 (Ill. App. 1st Dist. Dec. 14, 2009), the First District again ruled that a policyholder sufficiently target tendered a claim to one insurer even though the policyholder relied upon other insurance on a standby basis.

The insurance coverage dispute arose after a worker was injured at a construction project and filed suit for his personal injuries. The general contractor at the project, Joseph Construction

Company ("JCC"), had subcontracted with Dryden Contractors, Inc. and RC Plumbing, Inc. JCC was the named insured under a policy issued by Statewide Insurance Company, and an additional insured under a policy issued by Houston General Insurance Company to Dryden as well as under a policy issued by Westfield Insurance Company to RC. *Id.* at p. 2. JCC had placed Statewide on notice of the claim, but it also sent a letter to Houston General and Dryden and a separate letter to Westfield and RC requesting that they each defend and indemnify JCC. Both Houston General and Westfield disclaimed coverage, but Westfield instituted a declaratory judgment action against JCC, Statewide, and the underlying plaintiff. *Id.* at p. 5. Statewide also filed a separate declaratory judgment action against JCC, Houston General and the underlying plaintiff, but not Westfield. *Id.* at p. 6.

During the coverage litigation, JCC sent Houston General a letter stating that it was "de-tendering" the underlying case to Statewide and demanding that Houston General defend and indemnify JCC "exclusively." *Id.* at 6. However, Houston General did not accept the tender. Subsequently, JCC, Statewide, and Westfield - in an effort to resolve Westfield's declaratory judgment action - reached a settlement funding agreement for the settlement of the underlying action. *Id.* at p. 7. Westfield and Statewide paid \$840,000 each for a total of \$1.68 million to settle the underlying suit. Moreover, Westfield, Statewide, and JCC agreed to pursue a suit to recover the settlement payments from Houston General, with JCC expressly stating its desire that Houston General bear the entire cost of that settlement and that Westfield's and Statewide's payments were made only because Houston General breached its obligations. JCC, Westfield, and Statewide in turn reserved all of their rights to recover monies paid in defense and settlement from Houston General. Westfield was then added as a party to the Statewide declaratory judgment action which led to this appeal.

The First District initially held that Houston General had breached its duty to defend JCC and was estopped from raising any policy defenses to coverage, including waiver. *Id.* at p. 19. In seeking to enforce a targeted tender made on Houston General, Statewide and Westfield argued that JCC had deactivated its tenders to them. They argued that their letters, along with the settlement funding agreement, made clear JCC's intention to hold Houston General exclusively liable for defense costs and indemnity. *Id.* at p. 25. Citing *Alcan United, Inc. v. West Bend Mutual Insurance Co.*, 303 Ill. App. 3d 72, 83 (1st Dist. 1999) and *Richard Marker Associates v. Pekin Insurance Co.*, 318 Ill. App. 3d 1137, 1143 (2d Dist. 2001), the court held that the "insured's right to choose encompasses the right to deactivate coverage with an insurer previously selected for purposes of invoking exclusive coverage with another insurer." *Id.* at p. 25-26. Moreover, the court held that the policyholder may tender his defense and forgo coverage even after settlement of the underlying dispute. *Id.* at p. 26.

The court found that, although JCC initially tendered its defense of the underlying suit to Statewide, Westfield, and Houston General, JCC later sent a letter stating it was looking solely to Houston General for defense and indemnity. Moreover, the court found that JCC also deactivated its prior targeted tender to Westfield through the settlement funding agreement. As a result, the court held that JCC had deactivated its tenders to Statewide and Westfield, that their duties had been relegated to providing standby coverage in light of Houston General's refusal to provide coverage, and that Houston General was solely liable for the defense and indemnification of the claim up to its policy limit. *Id.* at p. 19, 29. The court further held that Houston General was not entitled to any reduction of the defense costs that Statewide paid in the underlying suit. *Id.* at p. 20. The court additionally awarded damages to Statewide and against Houston General under Section 155 of the Illinois Insurance Code, reasoning Statewide as the policyholder's assignee was forced to bring suit to enforce coverage rights. *Id.* at p. 22-23.

In *River Village I, LLC v. Central Insurance Cos.*, No. 1-08-3529 (Ill. App. 1st Dist. Nov. 20, 2009), *petition for leave to appeal filed*, No. 109630, the First District addressed what constitutes primary versus excess coverage for targeted tender purposes. In that case, Harleysville Lake States Insurance Company issued a primary policy of commercial general liability insurance to the general contractor, River Village I, LLC. River Village had entered into a subcontract with First Choice Drywall, Inc. for drywall work at the project, and River Village was added as an additional insured to First Choice's primary commercial general liability policy issued by Central Insurance Companies. *Id.* at p. 2. An employee of First Choice was injured at the construction project and sued River Village for his injuries. River Village tendered its defense to First Choice, noting that it was instructing its own insurer, Harleysville, not to respond to the suit or provide coverage unless and until the Central policy was exhausted. Central failed to respond, so River Village tendered its defense directly to Central. *Id.* at p. 3.

River Village filed a declaratory judgment action against Central, claiming that it owed coverage for the underlying litigation. Central contested coverage on multiple grounds, including that its policy applied only on an excess basis. Harleysville was not originally a party to the case. However, it funded a settlement of the underlying action and was then added to the case. *Id.* at p. 5. At the trial court, Central argued its policy applied as excess insurance because the subcontract between River Village and First Choice was silent as to whether the insurance was to be primary and because there was an excess "other insurance" clause in the Central policy. Central contended that, according to the policy's other insurance condition, its policy applied on an excess basis unless the subcontract stated that its policy was to apply on a primary basis. In response, River Village argued the Central policy was primary based on the targeted tender of the claim and that its "other insurance" clause was irrelevant under targeted tender case law. *Id.* at p. 5-6. Nonetheless, the trial court found the targeted tender case law to be inapposite, and held that the Central policy applied as excess insurance. *Id.* at p. 6.

On appeal, River Village and Harleysville contended that the trial court erred and asserted that, under Illinois law, their targeted tender to Central prohibits any consideration of the excess "other insurance" clause in the Central policy. *Id.* The First District discussed the rule under *John Burns* that, where a policyholder has maintained primary insurance among multiple insurers, the presence of an "other insurance" clause does not overcome a policyholder's right to make a targeted tender. *Id.* at p. 10. However, the court still held that "an insured cannot use his targeted tender right to choose to impose a coverage duty on an insurer with an 'other insurance' excess provision in its policy to the exclusion of other co-insurers with which he holds primary policies." *Id.* at p. 11 (*citing Kajima*, 227 Ill.2d at 117). Thus, the court relied upon the "other insurance" condition in the Central policy to determine that it was an excess policy and accordingly held that the targeted tender doctrine did not apply as between the Central policy and the Harleysville policy. *Id.* at p. 14. A petition for leave to appeal to the Illinois Supreme Court has been filed in that case.

Recent Fourth District Decision No "Magic Words" Required For Targeted Tender

In *State Auto Property & Casualty Co. v. Springfield Fire & Casualty Co.*, No. 4-08-0977 (Ill. App. 4th Dist. Sept. 30, 2009), *petition for leave to appeal denied*, No. 109399 (Ill. Jan. 27, 2010), the Fourth District held that, in order to make a targeted tender, a policyholder does not need to send a letter with any "magic words." In that case, a construction company named Swearinger Brothers, Inc. was sued for personal injuries and wrongful death due to an accident during a demolition project. *Id.* at p. 3. State Auto Property & Casualty Company had issued a commercial general liability policy to Swearinger Brothers, which had procured an

additional primary policy for the project from Springfield Fire & Casualty Company.

It appears that the policyholder at one time had notified both insurers of the suit. In the coverage litigation, State Auto asserted that its coverage was excess to that of Springfield Fire on the basis of the "other insurance" clauses of the policies. Springfield Fire countered that, because the policyholder had "deselected" Springfield Fire from providing any insurance coverage, it had no responsibility for the loss. *Id.* State Auto then argued that, even if the policyholder had properly deselected the Springfield Fire coverage, it had failed to make a targeted tender to State Auto. *Id.* at p. 4.

The Fourth District held that Swearinger Brothers "had the right to deselect its coverage under the Springfield Fire policy in favor of its coverage under the State Auto policy." *Id.* at p. 11. It explained that State Auto's "other insurance" provision did not supersede the policyholder's right to deselect coverage under the Springfield Fire policy. State Auto also asserted that the policyholder was required to send a "targeted tender" letter to State Auto, stating that it was looking solely to State Auto to defend and indemnify the claims in issue. *Id.* The court disagreed, stating it was "not relevant" whether Swearinger Brothers had informed State Auto that it was looking solely to State Auto for coverage because "Swearinger Brothers was required only to file its claim for coverage with State Auto, which it did." *Id.* at p. 12. It reasoned that a letter with "magic words" would not have better notified State Auto than the policyholder's filing of its claim with the insurer which was an active tender. *Id.* at p. 13.

Application Of The Targeted Tender Rule In Other States & Alternative Methods Used

Although most of the decisions involving the targeted tender rule are Illinois cases, some courts in other jurisdictions have addressed the targeted tender rule. *See, e.g., Mutual of Enumclaw Insurance Co. v. USF Insurance Co.*, 191 P.3d 866 (Wash. 2008) (Washington Supreme Court acknowledged the targeted tender rule, excusing a non-selected carrier from liability for contribution or coverage); *Casualty Indem. Exchange Ins. Co. v. Liberty Nat. Fire Ins. Co.*, 902 F. Supp. 1235, 1239 (D. Mont. 1995) (applying Montana law).

In *Cargill, Inc. v. ACE American Insurance Co.*, 766 N.W.2d 58 (Minn. App. 2009), *appeal granted*, No. A08-1082 (Minn. Aug. 11, 2009), the policyholder targeted coverage for its defense from one primary insurer and refused to enter into loan receipt agreements allowing the targeted insurer to seek contribution from other non-targeted insurers. The court held that equity requires a court to impose a constructive loan receipt agreement that allows a primary insurer to obtain equitable apportionment of defense costs among all primary insurers with a duty to defend. -

Some courts in other states effectively reach the same result in the construction claim context without invoking any targeted tender rule by holding that co-insurers' "other insurance" clauses have no impact on their respective rights and obligations when the underlying parties' hold harmless and indemnity agreements address how the risk of loss is to be borne. *See, e.g., Ross v. Prevost*, 200 Cal. App. 2d 570, 19 Cal. Rptr. 449 (1st Dist. 1962) (en banc) (holding that the indemnification agreement in a construction contract between a property owner and a contractor controlled the coordination of coverage between the property owner's insurer and the contractor's insurer, whose insurance contract included the property owner as additional insured, reasoning that "to apportion the loss in this case pursuant to the other insurance clauses would effectively negate the indemnity agreement and impose liability on [the property owner's insurer] when [the property owner] bargained with [the contractor] to avoid that very result as part of the consideration for the construction agreement"). *American*

Indem. Lloyds v. Travelers Property & Cas. Ins. Co., 335 F.3d 429 (5th Cir. 2003) (applying Texas law) ("an indemnity agreement between the insureds or a contract with an indemnification clause, such as is commonly found in the construction industry, may shift an entire loss to a particular insurer notwithstanding the existence of an 'other insurance' clause in its policy.").

Conclusions

The targeted tender rule presents opportunities and challenges for insurers who must consider their portfolio interests as well as the applicable law, contract language, and claim specific facts. Insurance claims professionals and coverage counsel must be familiar with the targeted tender rule and with other issues impacting the coordination of coverage in a variety of contexts. These issues also present opportunities and challenges on the underwriting side. After all, insurers can include language in the insurance contract to avoid the potential impact of the targeted tender rule. See *American Country Ins. Co., v. Kramer Bros., Inc.*, 298 Ill. App. 3d 805 (1st Dist. 1998).

For a more detailed analysis of Illinois' targeted tender doctrine, see Scott M. Seaman and Jason R. Schulze, "The Illinois Supreme Court's Decision in *Kajima* Limits Illinois' 'Targeted Tender' Rule And Establishes Illinois as a *Pro Rata* Allocation Jurisdiction," MEALEY'S LITIGATION REPORT: INSURANCE, Jan. 17, 2008 at 28. Please contact the MBT lawyers you work with for more information regarding targeted tender, coordination of coverage, allocation, or "other insurance" clause issues.

EVENTS & PUBLICATIONS

Meloney Perry will present on "Privilege Issues and Electronic Discovery: What Adjusters Need to Know," at the PLRB/LIRB 2010 Claims Conference starting on March 21, 2010 in San Antonio, Texas.

Bruce Meckler will serve as a panelist on "Rethinking Legal Strategies in the New World" at the Council on Litigation Management conference in Ponte Vedra, FL on March 24-26, 2010.

Mari Henry Leigh will serve as a panelist on "Keeping The Lid On Litigation Costs: Strategies That Work" at the Council on Litigation Management conference in Ponte Vedra, FL on March 24-26, 2010.

Mike Marick will speak on "Evaluating the Excess Carrier's Rights and Obligations" at the 2010 Claims & Defense Tactics Symposium, presented jointly by the Illinois Insurance Association and the Illinois Association of Defense Trial Counsel on March 25, 2010 in Oak Brook, IL.

Mike Marick will speak on "Five Emerging Coverage Controversies" at the DRI Insurance Coverage & Claims Institute on April 14, 2010 in Chicago.

Scott Seaman will speak on "Bad Faith Damages & Strategies To Minimize Bad Faith Exposure" at the DRI Insurance Coverage & Claims Institute on April 16, 2010 in Chicago.

Scott Seaman will speak on nationwide bad faith issues at the Chicago Bar Association on April 20, 2010.

Thomson West Legalworks recently released the latest supplement to Seaman, S.M., & Schulze J.R., "Allocation of Losses in Complex Insurance Coverage Claims."

MBT is a leading litigation firm with 90 attorneys and offices in Chicago, Dallas and Phoenix. In addition to concentrating in insurance and reinsurance law and litigation, our attorneys focus on commercial litigation, employment and labor law, professional liability defense, attorney fee disputes and environmental law.

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