

September 1, 2007

Recently, the Illinois Appellate Court in Steadfast Insurance Company v. Caremark, Rx, Inc., 373 Ill.App.3d 895, 869 N.E.2d 910 (1st Dist. 2007), indicated that an avenue may be available for insurers to recover defense costs, even though the Illinois Supreme Court previously closed the door on many insurers seeking reimbursement for defense costs. The Steadfast court held that an insurer was entitled to seek recovery of costs expended in defending an underlying lawsuit in certain situations. This decision provides a potential vehicle insurers seeking to recoup monies spent defending actions after a determination of non-coverage is made by the court.

Steadfast appealed from an order of the circuit court denying its motion for restitution of costs it paid defending Caremark Rx, Inc., in two underlying actions. Steadfast issued a managed care professional liability policy to Caremark. The policy excluded claims for intentional, criminal, or fraudulent acts. Steadfast was required to defend any claim against Caremark that raised the potential for coverage, even if the allegations were groundless, false, or fraudulent.

The two lawsuits against Caremark were tendered to Steadfast, who denied coverage and filed a complaint for declaratory judgment seeking a declaration that it had no duty to defend or indemnify Caremark in the two actions. Caremark filed a counterclaim seeking a finding that Steadfast had an obligation to defend and indemnify. It also sought attorney's fees pursuant to Section 155 of the Illinois Insurance Code.

Steadfast and Caremark filed cross motions for summary judgment. The circuit court entered judgment in favor of Caremark and denied Steadfast's cross motion for summary judgment, finding that Steadfast had a duty to defend. Steadfast appealed, but the court refused to stay enforcement of the order pending the outcome of an appeal. Thus, Steadfast was forced to pay \$964,846.43 for Caremark's defense.

The Appellate Court reversed the circuit court and concluded that the underlying complaints failed to assert conduct constituting a negligent act, error, or omission, and, therefore, Steadfast had no duty to defend or indemnify Caremark. The claim for Section 155 damages was remanded.

On remand, Steadfast filed a motion for restitution seeking to recover defense costs. The circuit court denied the motion and determined that Steadfast's filing of a complaint for declaratory judgment was equivalent to agreeing to defend Caremark, pursuant to a reservation of rights. It based its ruling on the Illinois Supreme Court decision General Agents Insurance Company of America, Inc., v. Midwest Sporting Goods Company, 215 Ill.2d 146, 828 N.E. 2d 1092 (2005). ("Gainsco")

The Gainsco court held that an insurer cannot recover defense costs paid pursuant to a reservation of rights absent a provision in the policy entitling it to such relief. This decision foreclosed an insurer's ability to recoup defense costs expended while defending under a reservation of rights, unless the policy specifically sets forth that the insurer retains the right to recoup any defense costs.

After the circuit court denied Steadfast's motion seeking to recoup defense costs, Steadfast filed a motion for reconsideration along with a motion for leave to add a claim for recovery of defense costs on the basis of restitution, recoupment and/or unjust enrichment. Both motions were denied and Steadfast appealed.

On appeal, Steadfast contended that the circuit court erred in denying its motion for restitution and its motion for leave to add a claim for unjust enrichment. The Appellate Court distinguished the Gainsco decision based upon the fact that Steadfast did not agree to defend Caremark under a reservation of rights, but rather refused to defend and filed a complaint for declaratory judgment. Thus, the lack of a reimbursement provision in the policy had no effect on the disposition of the case.

The court noted that there was no duty to defend because the Appellate Court in the prior appeal determined that the allegations in the underlying complaints failed to assert conduct within the policy's coverage. Steadfast's duty to defend Caremark during the appeal of its declaratory judgment action did not arise out of its contractual obligations under the policy. Instead, it arose out of the circuit court's erroneous order declaring that Steadfast had a duty to defend Caremark.

Under Illinois law, if a party has received a benefit from an erroneous decree or judgment, it must, after reversal, make restitution. Buzz Barton & Associates, Inc., v. Giannone, 108 Ill.2d 373, 382, 483 N.E. 2d 1271 (1985). However, a party may not seek summary judgment on a theory that was never pled in the complaint. The Appellate Court determined that it was appropriate to allow Steadfast to add a claim for unjust enrichment and remanded the case to the circuit court.

Although the Steadfast decision relates to a relatively narrow set of facts, it acknowledges that an insurer is not entirely precluded from recovery in the event that it has expended defense costs and seeks recovery after a determination of no coverage under the policy. An insurer may either seek reimbursement, based upon its policy language, or pursue a claim for unjust enrichment to the insured.

Please contact C. William Busse, Jr., Ed Grassé or Jason DeVore if you have questions related to any of the issues discussed.

Very truly yours,

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