

December, 2007

Re: Selective Tender Update

On November 29, 2007 the Illinois Supreme Court affirmed the judgment of the Appellate Court by filing its decision in Kajima Construction Services, Inc. v. St. Paul Fire and Marine Ins. Co., Docket No. 103588 (2007).

The Supreme Court found that the targeted tender rule does not preempt horizontal exhaustion. Consequently, to the extent that defense and indemnity costs exceed the primary limits of a targeted insurer, the deselected insurer or insurers' primary policy must answer for the loss before an insured can invoke coverage under an excess policy. The court considered the history of the horizontal and vertical exhaustion principles of Illinois Law. The court discussed the fact that horizontal exhaustion requires an insured to first exhaust all available primary insurance coverage, including self-insured periods, before an excess policy may be reached. Conversely, the "targeted" or "selective" tender doctrine allows an insured covered by multiple insurance policies to select or target which insurer will defend and indemnify it with regard to a specific claim. The Appellate Court first addressed targeted tender in Institute of London Underwriters v. Hartford Fire Insurance Co., 234 Ill.App.3d 70 (1992). The London Underwriters' court first held that because the insured told Hartford that it did not want Hartford to respond to the claim Hartford's knowledge of the wrongful death claim did not constitute a tender. The Appellate Court rejected the argument that London Underwriter's "other insurance" clause required Hartford to contribute to the settlement, holding that if the Hartford policy was never triggered, "the issue of liability under the "other insurance" clause does not arise." The Long Underwriters' court recognized that an insured's actions after a loss may foreclose his right to coverage under a policy and, thus, defeat a claim for equitable contribution by another insurance carrier.

The court in Cincinnati Cos. v. West American Insurance Co., 183 Ill.2d 317 (1998) discussed the London Underwriters' decision with approval. Targeted tender was not an issue in Cincinnati, however, the court discussed targeted tender in addressing whether an insurer's duty to defend its insured arose upon receipt of actual notice of the suit against the insured, or whether the duty to defend was triggered only upon the insured's tender of its defense to the insurer. The court rejected the argument that allowing actual notice of an underlying suit trigger an insurer's duty to defend would deprive an insured of the right to forego coverage under a policy. Instead, the court cited London Underwriters and held that an insured may forego an insurer's assistance for various reasons, including fear that its premiums would be increased or the policy cancelled in the future. The court also held that an insured's ability to forego an insurer's assistance should be protected, and concluded that an insured may knowingly forego an insurer's assistance by instructing the insurer not to involve itself in the litigation. At that point the insurer would be relieved of its obligation to the insured with regard to that claim.

The Kajima Supreme Court also discussed Alcan United Inc. v. West Bend Mutual Insurance Co., 303 Ill.App.3d 72 (1999). The Alcan Appellate Court held that an insured could "deactivate" coverage with an insurer it had previously selected in order to invoke exclusive coverage with another insurer. In that matter Alcan initially tendered to one insurer, Reliance but later tendered to another insurer, West Bend. When the initial tender to Reliance was made Alcan did not know of the existence of simultaneous coverage through the West Bend policy. Consequently Alcan did not make a knowing choice to exclusively tender the claim to Reliance

when it made that tender. After Alcan discovered the West Bend policy, it tendered the suit to West Bend seeking exclusive coverage under that policy and deactivating its tender to Reliance. The Alcan Appellate Court held that “an insured has a paramount right to choose or not to choose an insurer’s participation in a claim.” This right includes deactivating coverage with a carrier previously selected for the purposes of invoking exclusive coverage with another carrier. The Illinois Supreme Court ratified the Alcan decision in John Burns Construction Co. v. Indiana Insurance Co., 189 Ill.2d 570 (2000). The Burns Court held that an “other insurance” provision does not in itself overcome an insured’s right to tender defense of an action to one insurer alone.

The Supreme Court in Kajima addressed whether the Appellate Court correctly held that targeted tender does not supersede horizontal exhaustion in the context of primary and excess insurance. The court initially addressed St. Paul’s claim that the case does not involve horizontal exhaustion. The court noted that although horizontal exhaustion originated in cases involving a continuous tort or long-term environmental and hazardous waste claims, the court found no evidence that horizontal exhaustion is limited to such claims. Given that the crux of horizontal exhaustion is the difference between primary and excess insurance, the Supreme Court saw no reason to depart from horizontal exhaustion in the Kajima case.

The Supreme Court next addressed Kajima’s claim that the targeted tender doctrine prevails over horizontal exhaustion. The court referred to Justice Freeman’s discussion of primary and excess insurance in Roberts v. Northland Insurance Co., 185 Ill.2d 262, 275 (1998). Justice Freeman explained that when excess insurance exists as part of an overall insurance package, it provides a secondary level of coverage to protect the insured where a judgment or settlement exceeds the primary policy limits. Consequently, until the limits of primary insurance coverage are exhausted secondary coverage does not provide any “collectable” insurance. The St. Paul excess policy in the Kajima case was entitled “Umbrella Excess Liability Protection Coverage.” However, the wording of the St. Paul policy made it a true excess policy which was written as a “following form” or “specific excess coverage” basis.

The Supreme Court in Kajima stated that given the clear distinctions between primary and excess insurance coverage we decline to extend the targeted tender doctrine to require one insurer to vertically exhaust its primary and excess coverage limits before all primary insurance available to the insured has been exhausted. Extending the targeted tender rule to require an excess policy to pay before a primary policy would eviscerate the distinction between primary and excess insurance. The court found 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. The Kajima Supreme Court decision preserves the distinction between primary and excess policies.

Please contact Bill Busse, Jr., Ed Grassé or Jason DeVore of Busse, Busse & Grassé if you have questions or need assistance related to any of the issues discussed.