



## DEFENDING EMPLOYERS IN THIRD PARTY LIABILITY LITIGATION: THE NEW MILLENNIUM

### An Analysis of Kotecki Protection, Waiver, Strategy, and Coverage Issues

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As in the majority of jurisdictions, Illinois employers have enjoyed statutory immunity from most direct employees actions since the passage of the Illinois Worker's Compensation Act in 1913. Since that time, the employer was able to limit its exposure in work-related accidents involving its own employees to those benefits awarded by the Illinois Industrial Commission. The present relevant provisions of the Worker's Compensation Act, 820 ILCS 305/5, is interpreted to be the exclusive remedy by an employee against an employer, barring most common law suits. From 1913 until 1978, not only did the employer enjoy liability from direct suit, but also a shield from third party contribution actions.

The hiatus from common law liability enjoyed by the employer came to an abrupt end with the 1978 Illinois Supreme Court decision of Skinner v. Reed-Prentice, 70 Ill.2d 1, 374 N.E.2d 437, 15 Ill.Dec. 829 (Ill.1978). The Illinois Supreme Court in Skinner held that a manufacturer sued in strict tort liability had a right of contribution against the employer. This seminal ruling was later codified in the Illinois Joint Tortfeasor Contribution Act, 740 ILCS 100/0.01 et seq. The Illinois Supreme Court, in Doyle v. Rhodes, 101 Ill.2d 1, 77 Ill. Dec. 759, 461 N.E.2d 382 (Ill.1984), dealt the final blow to the employer's immunity. The Doyle decision broadened the theories defendants were able to assert against the employer in actions brought pursuant to the Illinois Joint Tortfeasor Contribution Act. This sudden and dramatic expanding of the civil liability of employers wasted little time in manifesting itself in the form of lopsided verdicts. Many factors, such as culpability and bias, contributed to the erosion of the ability of the employer to successfully defend itself at trial. Whether a serious injury existed or not, it became a standard practice at pre-trials for the employer to be expected to waive its lien for workers' compensation benefits and also contribute substantial fresh money to any offer by the defendant. In many cases, the stakes were so high that there was little alternative for the employer but to cede to whatever demands were forced upon it.

In 1991, the Illinois Supreme Court "capped" the employers liability for contribution. Kotecki v. Cyclops Welding Corp., 146 Ill.2d 155, 585 N.E.2d 1023, 166 Ill.Dec. 1 (1991). Kotecki holds that an employer's maximum exposure is limited to the amount of its workers' compensation liability (statutory indemnity and medical payments). The Court has in effect capped the liability faced by employers which Skinner heretofore had allowed to be unlimited. It should be noted that the cap afforded employers under the Worker's Compensation Act, 820 ILCS 305/11, which was recognized in Kotecki as limiting an employer liability, is not an automatic defense. Rather, it is an affirmative defense that must be pleaded in answer and proven. In Herington v. J.S. Alberici Construction Company, Inc., 266 Ill.App.3d 489, 639 N.E.2d 907, 203 Ill.Dec. 348 (5th Dist. 1994) (citing Doyle v. Rhodes), the Illinois Appellate Court ruled that an employer, to gain the benefits of the defense, must raise it. In the event that timely defense is not raised by the employer in its pleading, it is waived.

The Kotecki opinion itself is very pedestrian in terms of its application. Many issues have arisen both with respect to when the employer may invoke Kotecki and what will be its ultimate protection. Despite these uncertainties, Kotecki affords the employer leverage and strategies in its defense. The following will address that strategies should be considered in defending the employer.

Over the years, the allegations pleaded against the employer for contribution have become "boilerplate". For example, irrespective of the tort action (products, MVA, premises) one should expect the following allegations against the third party employer: failure to train; failure to supervise; failure to control; failure to provide safe place to work; failure to maintain the subject materials or equipment. The nature of the allegations provide an outline for your investigation. The investigation should then proceed with the interview of the individuals with knowledge of the accident and of the issues raised by the third party complaint. The underlying action (plaintiff employer versus third party defendant) may also have been pending for a considerable amount of time prior to the filing for contribution since the defendant's statute of limitations doesn't begin to run until it's served with summons. Assuming plaintiff and third party plaintiff "push the envelope" it may be several years from the date of accident since there is a four-year construction statute of limitations! Accordingly, in the initial investigation, all the discovery, including deposition transcripts, should be obtained through production requests and interrogatories. This information, along with the results of your investigation with the employer, will provide the data to evaluate the liability of the employer.

Various sections of the Workers' Compensation Act, including §§5(b) and 8(a) (820 ILCS 305/5(b) and 8(a)), establish the amounts that comprise the gross and net recoverable lien. Under Section 5(b), the party protecting the lien (usually the plaintiff's attorney) is entitled to a 25% statutory fee. Thus, the employer (assuming no third party liability) only recovers \$.75 for each lien dollar.

Until December 31, 1998, the case law was confusing as to the employer's cap vis a vis gross or net lien; and, as to the possible premium of attorney's fees (i.e., the lien plus 25%) after trial. On December 31, 1998, the Illinois Supreme Court in the case of LaFever v. Kemlite Co., 185 Ill.2d 380, 706 N.E.2d 441, 235 Ill.Dec. 886 (1998), held that employers who waive Worker's Compensation liens after civil trial do not owe fees to the injured plaintiff's attorneys. The LaFever decision now enables the employer (in a case in which the worker's compensation action is settled and where their liability is capped pursuant to Kotecki), to await the outcome of the trial prior to deciding to waive its lien. Should the verdict result in a finding that the third party defendant's contribution exceeds its lien amount, the employer may present a post-trial motion to waive its lien. The significance of the holding can be demonstrated by illustrating the underlying facts in the LaFever case. The employer, Kemlite, avoided having to pay the plaintiff's attorney a "premium" of 25% of the \$222,267.02 worker's compensation lien, plus \$3,033.17 for its pro rata share of the trial cost. Combined this was a savings of \$58,599.92.

In many cases, particularly those involving serious injuries to the employee, the workers' compensation action may still be active before the Illinois Industrial Commission with temporary or permanent benefits outstanding and/or periodic permanency payments ongoing. For example, the employee may be receiving temporary total or permanent total benefits for lost wages that will be paid or litigated for a considerable time in the future. The employer may also be responsible for medical expenses that arise in the future. This common scenario raises the question whether the benefits payable in the future are subject to the contribution claim. In Kotecki, the workers' compensation action had been settled before the trial of the common law action and therefore this question was not addressed. "Open compensation claims" complicate an evaluation of the contributory cap and the employers ongoing exposure under the Act. In general, most of these situations are resolved when the lien waiver by the employer for dismissal of the third party action is contingent upon the

simultaneous resolution of all matters at the Illinois Industrial Commission pursuant to an agreed order of dismissal (Settlement Contract Lump Sum Petition and Order).

Evaluation of cases simultaneously open at the Commission and circuit court require the extrapolation of a simultaneous linear equation to project effective loss management. In general, the formula for evaluation requires plugging in the following values:

1. Total compensation paid to date (lien to date).
2. Present value future compensation (projected lien).
3. Third party contribution exposure.

Procedurally, when a case proceeds to trial with open compensation liability, the following rules apply:

1. Our Supreme Court has held that Section 5(b) of the Act imposes the duty of protecting an employer's lien upon trial court, not the Industrial Commission. Freer v. Hysan Corp. 108 Ill. 2d 421, 325, 92 Ill. Dec.221, 484 N.E. 2d 1076.
2. Absent an agreement of the parties, the court may not credit non-settling parties with a set-off for future workers' compensation liability. Branum v. Slezak Construction Co., 289 Ill. App. 3d 948, 225 Ill. Dec.88, 82 N.E. 2d 1165 (1996); Stickler v. American Augers, Inc., 708 N.E. 2d 403, 236 Ill. Dec. 817.
3. Post verdict, if the court calculates the "present value offset" of the employers maximum liability, the determination of present cash value is not an adjudication of the amount to be paid to the plaintiff. Rather, it's a cap or limitation on the amount of contribution for purposes of set-off only to the defendant/third party plaintiff in the common law action. Branum v. Slezak Construction Co., supra.

For example, let's assume that the plaintiff's case is tried with a verdict of \$2,000,000.00, of which \$600,000.00 is apportioned to the employer for contribution. Further, assume that the employer has paid \$100,000.00 in temporary disability and medical through the common law trial date and that the open workers' compensation claim has exposure for permanent and total disability. Assuming the Kotecki cap to apply, the court will extrapolate the present value of the remaining permanent total exposure to calculate the Kotecki cap, as follows:

Benefits to date: \$100,000.00  
Present value benefits of  
300/week for life 80,000.00

Total Kotecki cap: \$180,000.00

Since the employer's liability is capped at \$180,000.00, the defendant/third party plaintiff will now be liable for additional damages of \$420,000.00 (600-180,000) since the employer's liability is limited to \$180,000.00.

Now that you have evaluated the contribution liability issues and Kotecki exposure, your litigation strategy is ready for consideration. Your strategy should include whether the employer should defend the third party action or approach the plaintiff or defendant with an offer to settle. The advantage of defending the action is that if the plaintiff succeeds against the defendant and the employer is found not liable, the workers' compensation payments (less the statutory twenty-five percent attorneys' fees and pro rata costs) must be reimbursed to the employer. However, if the employer loses, and the

contribution share equals its workers' compensation liability, then the additional costs will be the incurrence of additional defense litigation expenses. If the facts do not appear to lend themselves to a favorable verdict for the employer, then an offer of settlement should be considered. Since the maximum exposure is its recoverable lien, all the employer needs to decide is the portion of lien to be waived and to whom it should be offered. The primary goal in structuring any settlement offer is to pay the least amount of money. This principle as it applies to the employer translates into waiving the least amount of the lien as possible. The tricky part is in determining which party, i.e., the plaintiff or defendant, will accept your terms.

The following is a checklist of considerations for each party that should be evaluated before negotiating the offer:

### **A. NEGOTIATING WITH PLAINTIFF**

1. Strength of plaintiff's case against defendant
2. Contributory negligence of plaintiff
3. Application of § 2-1117 (joint and several liability)
4. Impact of "empty chair" defense
5. Eliminating set-off to defendant
6. Ability of employer's presence to affect the verdict against the direct defendant
7. Impact on statutory liability of plaintiff and defendant
8. Impact on employer's presence at trial
9. Other considerations

### **B. NEGOTIATING WITH DEFENDANT**

1. Strength of defendant's case against employer
2. Avoidance of adversity between defendants to increase total verdict
3. Application of § 2-1117

In Lilly v. Marcal Rope & Rippling, Inc., 224 Ill. Dec. 920, 682 N.E.2d. 481 (Ill.App. 5th Dist. 1997), the Appellate Court Fifth District held as matter of first impression that plaintiff's employer is not a third party defendant who could have been sued by plaintiff for purposes of the joint liability law, providing that any defendant whose fault is less than 25% of total fault attributed to plaintiff, defendant's sued by plaintiff, and any third party defendant who could have been sued by plaintiff/employees shall be severally liable for all other damages. As the plaintiff cannot sue his employer under Illinois law, Section 5/2-1117 does not apply. In the Lilly case, the third party plaintiff was attempting to reduce the judgment entered against it, arguing that Section 2-1117 makes it severally liable since on the contribution action the jury found it only 10% responsible for Lilly's injuries and found the employer 90% responsible for the plaintiff's injuries. The Lilly court rejected the third party plaintiff's argument and held that "for purposes of the Section 2-1117 an employer is not a third party defendant who could have been sued by the plaintiff. Therefore, third party plaintiff's percentage of responsibility under Section 2-1117 is not below 25%, and it is jointly liable for all damage to plaintiff."

Section 2-1117, Joint and Several Liability, does not apply to Structural Work Act cases. The plain language of 2-1117 provides that the section applies to "actions on account of bodily injury or death or physical damage to property, based on negligence or product liability based on strict liability." Accordingly, plaintiff's claims under the Structural Work Act do not fall within the express categories to which Section 2-1117 apply. Branum v. Slezak Construction Company, supra.

1. Impact of "empty chair" defense

2. Attraction of set-off
3. Availability of Good Faith Release as to ancillary issues such as contract claims or Braye waiver
4. Other considerations

The employer is always a favorite target for a third party action by any defendant in the primary action. In order to avoid further suit once a settlement is reached, the employer needs to avail itself of the provisions of the Illinois Joint Tortfeasor Contribution Act, 740 ILCS 100/0.01 et seq. The Act specifically provides that the tortfeasor who settles with a claimant pursuant to its provisions is discharged from all liability for any contribution to any other tortfeasor. Therefore, even though the employers liability is limited, it is good practice to obtain a specific finding by the court that the settlement is in good faith in accordance with the provisions of the Act. The settling employer cannot always expect that the remaining parties will not object to the good faith motion. The plaintiff may object if his case has suddenly dissolved with the exit of the employer. The defendants may object if their exposure has dramatically increased with the dismissal of the employer. Whatever the circumstances, the employer should ensure that all settlement negotiations be conducted at arms length and in good faith.

The following cases provide a good example of the issues raised by good faith settlements:

1. Doellman v. Warner and Swasey Company, 147 Ill. App.3d 842, 498 N.E. 2d 690 (1st Dist. 1986). The Illinois Contribution Act is intended to protect those who settle from the hardest bargainer who might hold the other litigants hostage to its own intransigence.
2. Foster v. Devilbiss Company, 174 Ill. App.3d 359, 529 N.E.2d 581 (1st Dist. 1988). Appears to recognize the assignment of the lien from the employer to a defendant.
3. McKanna v. Duo Fast Corp., 161 Ill. App.3d 518, 515 N.E.2d 157 (1st Dist. 1987). Illinois public policy favors peaceful and voluntary claims through settlement agreements. To establish invalidity of such an agreement, clear and convincing evidence is required.
4. Wasmund v. Metropolitan Sanitary District of Greater Chicago, 135 Ill. App. 3d 926, 482 N.E.2d 351 (1st Dist. 1985). Party challenging a release carries the burden of proving any assertion of invalidity.
5. Higginbottom v. Pillsbury Company, 173 Ill.Dec. 219, 596 N.E.2d 843 (5th Dist. 1991). The Plaintiff must receive consideration in any settlement with the employer.
6. Wilson v. Hoffman Group, Inc. 131 Ill.2d 308, 546 N.E.2d 524 (1989). The employer can settle with the plaintiff directly.
7. Bituminous Insurance Companies v. Ruppenstein, 150 Ill. App.3d 402, 501 N.E.2d 907 (1st Dist. 1986). There is no need to obtain a good faith finding before suit is filed.
8. Smith v. Texaco, Inc. 232 Ill.App. 3d 463, 597 N.E.2d 750 (1992). It is within the discretion of the trial court to determine whether the settlement is in good faith. The totality of circumstances test is the proper test for this determination.
9. Readel v. W.S. Town 302 Ill.App.3d 714, 706 N.E.2d 99, 235 Ill.Dec. 839 (2nd Dist. 1999). The Illinois Appellate Court, Second District, has held that when reviewing a proposed settlement, the trial judge should consider, in addition to the good faith elements, the percentage of the settlement to be

allocated with respect to the particular cause of action. When a law suit involves claims under both the survival and wrongful death statutes, the allocation should be made according to the weight of each claim. Expenses for lost earnings and conscious pain and suffering of the decedent should be allocated to survival action, and the loss of benefits of the survivors should be allocated to the action for wrongful death. A good faith finding should not be entered before a hearing to evaluate both the settlement and the apportionment of the settlement between the two types of claims.

In an extremely limited number of cases an employer may be asserting a technical defense to a workers' compensation claim such as "arising out of," and/or "in the course of employment." Accordingly, you might be faced with an employer/employee scenario where there is no lien since statutory benefits are denied. Theoretically, Section 5 should bar an action by an employee against an employer irrespective of payment of benefits. Unfortunately, circuit and appellate courts are split and there is no controlling authority. No Illinois Supreme Court case has decided if Kotecki applies where no lien rights exist. The Workers' Compensation Act precludes direct actions against the employer whether by the employee, spouse, or personal representative. The policy behind the preclusion should be argued in favor of Kotecki protection where the lien does not apply. However, the following cases touch on that issue, and will be considered when the Illinois Supreme decides the issue:

1. The damages of a spouse as a result of an employee's injury or death are not subject to a workers' compensation lien. Page v. Hibbard, 119 Ill.2d 41, 518 N.E.2d 693 (1987).
2. Workers' compensation lien does not attach to proceeds paid in settlement of a death claim brought pursuant to the Structural Work act. Gramse v. Royal Crest Enterprises, Inc., 100 Ill. App.3d 100, 426 N.E.2d 614 (1981).
3. Widow and daughter's action brought pursuant to Dram Shop Act not subject to workers' compensation lien. Dillon v. Nathan, 10 Ill.App. 289, 135 N.E.2d 136 (1956).
4. Workers' compensation claim does not attach to settlement proceeds paid in action brought under Public Utilities Act. McDaniel v. Hoge, 120 Ill.App.3d 913, 458 N.E.2d 1963 (1983).
5. The Illinois Appellate Court Fourth District held that an employer may not assert lien under Worker's Compensation Act against damages employee receives in connection with legal malpractice action against attorney who handled underlying injury claim; employer may assert such liens only against third parties who may have been responsible for worker's injuries. Mosier, III et. al v. Warren E. Danz, P.C., 302 Ill.App.3d 731, 706 N.E.2d 83, 235 Ill.Dec. 823 (Ill.4th Dist. 1999).
6. It has long been a rule that an insurer may not assert a lien against an award to a minor because of medical payments it made under a policy of insurance with the parents. In re: Estate of Hammond v. Aetna Casualty (Aetna Life & Casualty Company), 141 Ill.App.3d.963, 96 Ill.Dec. 270 491 N.E.2d.84 (1st Dist.1986) and Estate of Woodring v. Liberty Mutual Fire Insurance Company, 71 Ill.App.3d. 158, 27 Ill.Dec.399, 389 N.E.2d.211 (2nd Dist.1979).
7. Insurer could set-off payments due under under-insured motorist coverage by workers' compensation benefits received by insured. Sulser v. Country Mutual Insurance Company, 208 Ill.App.3d.15, 556 N.E.2d. 851, 566 N.E.2d 851 (5th Dist. 1991).

Where the third party defendant employer's liability is limited by Kotecki, the third party complaint for contribution will be dismissed upon employer's waiver of its lien. The employer need only present a motion to dismiss. Lannom v. Kosco, 158 Ill.2d 535, 634 N.E.2d 1097 (1994).

As noted above, Kotecki is an affirmative defense available to an employer. Its protection can be waived. The two (2) most common waivers are: 1). failing to plead Kotecki as an affirmative defense. 2). pre-injury contractual waiver between the employer and either the general contractor or the project owner in the form of waiver of Kotecki and/or other indemnification. The leading Illinois case on the latter is Braye v. Archer-Daniels-Midland Co. 175 Ill.2d 201, 676 N.E.2d 1295 (1997), which held that an employer may waive Kotecki limitation of liability by contract. Such a situation is commonly referred to as a "Braye waiver." In the construction context, a party cannot contract for indemnity against its own negligence. However, contract provisions requiring indemnification only to the extent that the party indemnified is not negligent do not violate the Indemnification Act, and are interpreted as contracts for contribution without Kotecki protection, not indemnity. A contract provision calling for "indemnity" is not void if the actual terms and effects of the contract call for "contribution." Braye, supra, Liccardi v. Stolt Terminals (Chicago), Inc. 283 Ill.App.3d 141,669 N.E.2d 1192; Herington, supra.

Whether a contract calls for contribution or indemnification is determined by the court as a matter of law applying the principles of contract construction. As such, the contract is, if at all possible, construed in a manner rendering the agreement enforceable, and interpretations rendering the contract a nullity are avoided when possible. Braye v. Archer Daniels Midland, supra. The standard architects form for subcontract usually contains a Braye waiver. So do most general contractors purchase order terms and conditions. It is presumed that parties contract with knowledge of the law and Illinois public policy favors freedom of contract. Therefore, courts will not declare a contract illegal unless it expressly contravenes the law. Braye v. Archer Daniels Midland, supra. The implications of waiver are quite significant. For example, consider a construction death case. In a workers' compensation case, the present value of the employer's liability for a young decedent with a family is generally less than \$500,000.

In our example, the Kotecki cap limits the exposure even if the employer is 100% negligent, to \$500,000. Now with a waiver, what if the employer is held 50% liable for the 12 million verdict? Contribution exposure has increased twelve times to 6 million!!! An employer may contractually waive its limited liability under Kotecki and accept the full responsibility for the amount of the claim attributed to the employer's own negligence. Braye v. Archer Daniels Midland. In Braye, the section of the contract which stated that the employer "agreed to pay for all loss" constituted a waiver. Braye specifically dealt with a purchase order which allegedly governed the work in question. The purchase order states, in pertinent part: If [all Tri-R's] work under the order involves operations by [all Tri-R] on the premises of [ADM] or one of its customer [all Tri-R] shall take all necessary precautions to prevent the occurrence of any injury to person or damage to property during the progress of such work, and, except to the extent that any such injury or damage is due solely and directly to [ADM's] or its customers negligence, as this case may be, [all Tri-R] shall pay [ADM] for all loss that which may result in any way from any act or omission of [all Tri-R], its agents, employees or subcontractors.

The court in Herington v. J. S. Alberici Construction Company, Inc., supra, similarly held that a provision in the contract where the employer assumed "the entire liability" for its own negligence was a sufficient waiver of the Kotecki limit. The contractual language reviewed by the appellate court in Herington v. J.S. Alberici Construction Company, Inc. was based on paragraph 8(c) of the general conditions of the written subcontract between Alberici and Shield. Paragraph 8(c) stated:

For all Subcontract work performed in Illinois or performed by Illinois Subcontractors, the following

term is in effect: Subcontractor hereby assumes the entire liability arising from any alleged violation of the Structural Work Act (Chapter 48, Sections 60-69 Ill. Revised Statutes) that Subcontractor knew of or by the exercise of ordinary care should have known of; Subcontractor agrees to indemnify and save harmless Contractor and its agent, servants and employee, from and against all loss, expense, damage or injury, including legal fees, that Contractor may sustain as a result of any claims predicated or [sic] said allegations of Subcontractor's own negligence or on Subcontractor's alleged violation of the Structural Work Act as above set forth. This provision shall specifically not require Subcontractor to indemnify Contractor from Contractor's own alleged negligence in violation Chapter 29, Section 61 of the Illinois Revised Statutes. In the event claim of any such loss, expense, damage or injury, as above defined and limited, is made against Contractor, its agents, servants or employees, Contractor may: (1) withhold from any payment due or hereafter becoming due to Subcontractor under the terms of this contract, an amount sufficient in Contractor's judgment to protect and indemnify Contractor from all such claims, expenses, legal fees, loss damage or injury as above defined and limited; or (2) require Subcontractor to furnish a surety bond in such amount so determined; or (3) require Subcontractor to provide suitable indemnity acceptable to Contractor.

While both the Appellate Court and Supreme Court in the Liccardi case held that a provision where the employer "assumes the entire liability" is sufficient to constitute a waiver of the Kotecki limits, the Appellate Court and Supreme Court concentrated on two different sections of the contract in finding a waiver. In the Appellate Court decision, the Court focused on paragraph seven, and concluded that it allowed for indemnity of Stolt's own negligence and, therefore, violated the Indemnity Act. Since paragraph seven was unenforceable, it could not serve to prevent the Kotecki contribution limit from operating.

Paragraph seven stated:

If Vendor performs services . . . Vendor agrees to indemnify and hold harmless Stolt . . . Of all sums of money by reason of all accident, injuries, or damages to person or property that may happen or occur in connection therewith.

The Appellate Court found that paragraph eight of the contract was not a violation of the Indemnity Act and constituted a waiver of the Kotecki limitation. Paragraph eight stated:

Vendor represents and warrants that no Federal or State Statute . . . will be violated in the manufacturing, sale, and delivery of any article or service sold and delivered hereunder, and if such violations has or does occur, vendor shall indemnify and hold harmless Stolt Terminals (Chicago), Inc., from all loss, penalties, or the payment of all sums of monies on account of such violation.

The Court specifically held that "after comparing the restrictive nature of paragraph eight to the sweeping language of paragraph seven," we conclude that the phrase "manufacturing, sale and delivery" was likely meant to specifically limit all focus to vendor's contract. Assuming that "manufacturing, sale, and delivery" restrict the paragraph's application to vendor's action and statutory violations, the phrase "on account of such violation" further restricts liability to only those losses caused by vendors violations, thus preventing any possibility of Stolt being indemnified for its own actions.

The Supreme Court in Liccardi did not address whether or not paragraph eight of the contract constituted a waiver of the Kotecki limitation. They instead found that paragraph seven, in contrast to the Appellate Court's decision, was indeed a waiver of Kotecki limitation. The Liccardi Court, following Braye v. Archer Daniels Midland Company, found that "the literal terms of the contract are not

necessarily dispositive on the issue of whether it is void under the Construction Contract Indemnification Negligence Act." The contract "should not be deemed illegal unless it is expressly contrary to law or public policy. The law and the public policy of Illinois permit and require that competent parties be free to contract with one another. Whether a contract violates public policy depends on the peculiar facts and circumstances of each case, as well as the language of the contract itself." Citing Braye, the Court relied on the well-established principle of contract law that statutes and laws in existence at the time the contract is executed are considered part of the contract. The parties are presumed to have entered into their agreement with knowledge of the existing law. In addition, "construction of a contract which renders the agreement enforceable rather than void is preferred." It should be noted that outside the construction arena, one can indemnify the other for his or her own negligence. A contract to indemnify for one's own negligence should also be distinguished from a Braye waiver and a contract to procure insurance.

Where an agreement between parties provides that one will provide insurance to the other, it is construed as a mutual exculpation and generally bars contribution actions between them. Briseno v. Chicago Union Station Company, 197 Ill. App.3d 902, 557 N.E.2d 196 (1st Dist. 1990). The logic is that as a general rule of insurance law a carrier may not subrogate against itself. An insurer could not seek contribution from a general contractor for damages the owner paid to contractors' employer where the contractor had purchased insurance for owner pursuant to their construction contract, and the owner had been defended and fully protected by the policy for judgment within the policy limit. Monical v. State Farm Insurance Company, 211 Ill. App.3d 215, 569 N.E.2d 1230, 155 Ill.Dec. 619 (1991). In Monical, the trial court denied a third party defendant's Motion to Dismiss because the issue of liability had not yet been determined. However, once the plaintiff settled with the third party within the policy limits, and the policy paid the settlement, the trial court granted the Motion to Dismiss.

In Briseno, the issue of liability was resolved by settlement of the parties. Briseno specifically held that "under the circumstances where the liability of the parties has been determined and satisfied from the proceeds of an insurance policy provided [NWC] pursuant to the parties contractual agreement, [Chicago Unions'] contribution action was properly dismissed." Where the third party plaintiff's liability exceeds the limits of coverage provided by the third party defendant, a right of contribution exists for the third party plaintiff's excess liability. Kirinichich v. Jimi Construction Company, 267 Ill.App.3d.51 (1994). In Kirinichich, the court interpreted Briseno and found that the fact that [Chicago Union] had been fully protected and indemnified by the joint policy with [NWC] as fundamental to that court's holding.

It is our recommendation that a third party defendant employer should always assert Briseno as an affirmative defense where it has provided the third party plaintiff with insurance. As a caveat, Briseno is often times not applied until post verdict pursuant to post trial motion. Courts (except in extreme situations e.g. a broken finger with a 10 million policy) are reluctant to value the case pretrial. Even post trial, the savings to an employer and its Section 1(b) carrier are significant since a verdict of less than the policy provided allows recovery of the entire lien! In addition to pleading the affirmative defense, we further recommend the presentation of a Motion to Dismiss based on Briseno to preserve it as a partial defense, even if the Court denies it as being premature. This approach should preserve the issue should Illinois case law change the timing required.

The most common issue is whether an employer's commercial general liability [CGL] policy provides coverage for employer's Section 1(b) liability in excess of Kotecki limits in a Braye waiver situation (in which the employer's liability policy has denied coverage). This issue remains undecided in general terms and analysis depends upon the specific policy language (including: exclusions, riders and

endorsements). In general, to protect the employer a tender to the general liability carrier as well as any excess or umbrella carrier should be made to preserve rights and avoid conflicts. A defendant/third party plaintiff settling with the plaintiff may retain the right to proceed to trial on the contribution action. In such a case, the third party need prove only the employer's culpability, and not its own. The settling third party need only show that it reasonably anticipated liability to the injured party in the tort action. Sands v J.I. Case Company, 239 Ill.App.3d 19, 178 Ill.Dec. 920, 605 N.E.2d 778 (Ill.App.1st. Dist.1996). Further, the jury must be instructed that the third party has the burden of proving that it settled the underlying claim because it reasonably anticipated liability. Patel v. Trueblood, 281 Ill.App.3d 197, 666 N.E.2d 778, 217 Ill.Dec. 109 (1st Dist., 1st Div. 1996). The Patel Court found that the Sands case did not address the specific question of instructions to the jury about the plaintiff's claims and its burden of proof. The Patel Court specifically held that "[w]e find that juries in cases of contribution following settlement should be instructed that payment made in reasonable anticipation of liability is an element to the plaintiff's claim."

In the construction context, commonly an owner or general contractor will require that a sub-contractor name the owner or general contractor as an additional insured on a policy of insurance acquired and paid for by the sub-contractor. Doing so will have the effect of indemnifying the owner or general contractor for negligence of the sub-contractor that causes injury to persons on the site, including the employees of the sub-contractor or other sub-contractors. As long as the contract provision is not written to require indemnification for the owner or sub-contractor's own negligence, such a requirement will be held to be valid. In such a scenario, the usual procedure is for the owner or general contractor, upon receipt of summons and a lawsuit, to tender its defense to the insurer of the sub-contractor, naming it as an additional insured. However, as the owner or general contractor almost always has its own policy of insurance, issues involving coverage often arise. Perhaps the most common issue is whether the sub-contractor's insurer, with knowledge that the general is named as an additional insured, has a duty to provide a defense upon receipt of notice of the suit, or whether that insurer can wait for the general contractor to tender the defense to it. Further, issues also arise when the tender is outside the scope of the policy, as to what steps the insurer must take to effectively deny coverage.

In the context of tender, a few matters are clear. A duty to defend arises when the insurer has actual notice of the suit against its insured, and a formal tender is not required to trigger coverage. On a related note, an insured faced with two policies of insurance, both providing coverage, has the right to appoint one carrier to provide defense and indemnity, rather than the other carrier. As a practical matter, any denial of coverage optimally should be by a Reservation of Rights letter, followed by the filing of a Complaint for Declaratory Judgment.

In 1998, the Illinois Supreme Court in The Cincinnati Companies v. West American Insurance Company, 183 Ill.2d 317, 701 N.E.2d 499, 233 Ill.Dec. 649 (1998) decided that an insurer's duty to defend is triggered by actual notice to the insurer of the suit against its insured, and a tender is not required to invoke that duty. The facts in The Cincinnati Companies v. West American are common in the construction context. In that case, Baird and B&D were contractors. Baird was listed as an additional insured on a policy issued by The Cincinnati Companies ("Cincinnati"). Upon receipt of summons, Baird tendered its defense to its own carrier, who tendered to Cincinnati which provided a defense. Meanwhile, B&D had insurance through West American. On the eve of trial, it was discovered that Baird was listed as an additional insured on a policy issued to B&D by West American. Prior to that time, Baird did not realize that it was named on the West American policy. Counsel for Baird, retained by Cincinnati, then tendered the defense to West American, which rejected the tender.

The case settled, with Cincinnati paying Baird's share of the settlement. Cincinnati then filed suit to recover the settlement amounts and attorney fees incurred in the defense of Baird. The Illinois Supreme Court framed that issue as "whether West American's duty to defend Baird was triggered when it had actual notice of the suit against Baird, even though Baird did not tender its defense to West American." Upon those facts, the Court held "actual notice of a claim [triggers] the insurer's duty to defend, irrespective of the level of the insured's sophistication, except where the insured has knowingly forgone the insurer's assistance." In so ruling, the court found that the insurer is usually in a better position than even a sophisticated insured to know the scope of the insurance contract and its duties under it. In so ruling, the Court rejected contrary holdings in Institute of London Underwriters v. Hartford Fire Insurance Co., 234 Ill.App.3d 70, 175 Ill.Dec. 297, 599 N.E.2d 1311 (1992) and Hartford Accident & Indemnity Co. v. Gulf Insurance Co., 776 F.2d 1380, 1383 (7th Cir. 1985). Those cases held that a tender was a necessary prerequisite for a duty to defend. Note, however, that Institute of London Underwriters remains good law in the context of an insured who with knowledge of all coverage deliberately and knowingly selects one carrier over another.

The impact of The Cincinnati Companies on the insurer is that it places a burden on the insurer to review certificates of insurance and the underlying policies to determine whether any additional parties to the suit are also named as defendants. As a court will find actual notice when the documents exist, such a review will aid the insurer in more quickly and efficiently evaluating its position and its potential liability. While there appears to be no need for the carrier to voluntarily assume the defense (assuming that the party is being defended by someone in the underlying action) the insurer should be aware of and evaluate that potentiality. The next question, based on the above holding of The Cincinnati Companies, then becomes the definition of "actual notice" that would trigger the duty. The Court held that "actual notice" was notice sufficient to permit the insurer to locate and defend the lawsuit. Further, the Court ruled "in order to have actual notice sufficient to locate and defend the suit, the insurer must know both that a cause of action has been filed and that the complaint falls within or potentially within the scope of the coverage of one its policies.

In Illinois Founders Insurance Company v. Barnett, 304 Ill.App.3d 602, 710 N.E.2d 28, 237 Ill.Dec. 605 (1st Dist. 1st Div. 1999), the Court discussed the actual notice requirement. The Court found that such notice need not come from the insured. Instead, the notice requiring defense can arise from a letter or telephone call to the insurer from the injured party or his attorney. Cincinnati was followed and explained in four recent cases: Bituminous Casualty Corporation v. Royal Insurance Company of America, 301 Ill.App.3d 720, 704 N.E.2d 74, 234 Ill.Dec. 916 (3rd Dist. 1998); Alcan United, Inc. v. West Bend Mutual Insurance Company, 303 Ill.App.3d 687, 707 N.E.2d 687, 236 Ill.Dec. 560 (1st Dist. 2nd Div. 1999), and Dearborn Insurance Company v. International Surplus Lines Insurance Companies, 1999 WL 742694 (1st Dist. Sept. 23, 1999), and most recently in John Burns Construction Co. v. Indiana Insurance Co., 2000 WL 46031 (Ill.Sup.Ct. Jan. 21, 2000).

In John Burns, the Illinois Supreme Court reiterated its ruling that an insured, potentially covered by two policies of insurance, can direct one insurer to defend and indemnify. Further, an "other insurance" policy provision in the policy selected will not change that right to select and tender. In such a situation, the insurer to whom the tender is directed cannot seek contribution from the other insurer. The John Burns case affirmed the holding in Bituminous Casualty, which stands for the proposition that an insured can purposely direct one insurer to provide coverage, rather than another, and that in such circumstances, the latter insurer is relieved of its duty to defend or indemnify. Bituminous Casualty was decided on November 25, 1998, closely following the Illinois Supreme Court's September 24, 1998 filing of its Cincinnati Companies decision. In Bituminous, shortly after settling a personal injury suit against Johnson Construction, Bituminous brought suit against Royal in

an attempt to recover half the settlement monies expended. Royal, conversely, argued that there was directed tender to Bituminous, and as such, it was excused from coverage.

In Bituminous Casualty, Johnson Construction maintained a general liability policy through Royal. Johnson hired a subcontractor. The subcontract agreement required the subcontractor to name Johnson as an additional insured on the subcontractor's general liability policy. The subcontractor did so, naming Johnson as an additional insured on a policy issued by Bituminous. After an employee of the subcontractor was injured on the job site, Johnson notified both Bituminous and Royal of the claim. However, Johnson informed Royal that it was informing Royal to provide notice only, and that it intended to look to Bituminous to defend it in the litigation. Royal was to remain on notice as a potential excess insurer. The trial court, citing the "other insurance" provision in both policies, found that Bituminous had the right to trigger coverage through Royal. The Illinois Appellate Court reversed, indicating that in Cincinnati, the Illinois Supreme Court firmly established that an insured has a right to select exclusive coverage. Further, once an insured makes that selection, the insurer is then relieved of the obligation to defend or indemnify. Further, and importantly, the court in Bituminous also ruled that only the insured or someone acting at the specific request of the insured can properly tender and trigger a defense. Note, however, that the holding seems contrary to Cincinnati, which held that actual notice was all that was required to trigger coverage. We would expect courts in the future to limit that holding of Bituminous as qualified by Cincinnati to cases where an insured is aware of both carriers, and clearly elects to tender to one carrier as opposed to the other.

In Alcan United, Inc. v. West Bend Mutual Insurance Company, the First District ruled that an insured can, after selecting one insurer, turn around and designate another. In Alcan, the fact showed that initially Alcan tendered its defense to Reliance without knowledge of the existence of simultaneous coverage through West Bend. Upon learning of the West Bend coverage, Alcan then tendered its coverage to West Bend. The court found that the tender to Reliance was not a knowing choice. The court ruled that the insured has a paramount right to choose or not choose an insured's participation in a claim, and that the "other insurance" clause did not preclude the insured's right to choose.

In Dearborn Insurance Company v. International Surplus Lines, the First District discussed the "actual notice" requirement, and the directed tender. In Dearborn, the defendant denied any obligation to participate in the defense of a party (Canon), as that party had not tendered its defense to it. The court cited Cincinnati and Bituminous for the proposition that Illinois no longer requires a formal tender to trigger an insurer's duty to defend. The court found that in Dearborn, the defendant insurer had a copy of the actual complaint against Canon, and as such had sufficient notice. The next issue became whether there was a directed tender that would preclude coverage. The Dearborn court found that Canon gave the defendant insurer no specific instructions not to defend it. As Canon never instructed the insurer not to defend it, the court found that Canon did not knowingly forgo the coverage, and found that the defendant had a duty to defend Canon. The bottom line on the matter appears to be that where an insurer provides coverage for a general contractor and coverage for that general contractor is also available through insurance provided by another party, the insurer should notify its insured of available coverage. The insurer's interest in the matter is best protected keeping clean its own claims history.

Until recently, it was unclear as to whether an insurer, faced with a no-coverage scenario, could file a complaint for declaratory judgment and meanwhile refuse to provide a defense, or whether an insurer was obligated to both file the declaratory judgment and simultaneously defend the underlying action until such time as the insurer's rights were adjudicated in the declaratory judgment proceedings. However, on April 15, 1999, the Illinois Supreme Court in State Farm Fire & Casualty Company v.

Martin, 186 Ill.2d 637, 710 N.E.2d 1228, 238 Ill.Dec. 126 (1999) ruled that a duty to defend is not breached merely because the underlying case proceeds to judgment prior to the declaratory judgment being resolved, and held that in such a scenario, the insurer was not estopped from raising policy defenses to coverage. In Martin, State Farm sought a declaration as to whether it owed its insured a duty to defend and indemnify them in two wrongful death suits. Apparently, the insured had reached an agreement to destroy a building they owned. Pursuant to that agreement, one person ignited a fire which caused the death of two firefighters. The insured was subsequently indicted for the crime by a federal grand jury. A civil suit also resulted. The insured tendered the defense to State Farm. State Farm, however, refused to defend and filed a complaint seeking a declaration that it owed no duty to defend or indemnify. In the declaratory proceeding, over the objection of State Farm, the Court stayed the declaratory judgment litigation until the resolution of the criminal matter. The criminal matter continued forward and the insured was found guilty on the criminal charge. In the underlying civil matter, a default judgment was entered against the insured. Shortly thereafter, in the declaratory judgment action, the Court entered summary judgment in favor of the insured and against State Farm, apparently ruling that State Farm, by failing to secure a declaratory judgment prior to the default, was estopped from contesting coverage. The Appellate Court found that State Farm was estopped from contesting coverage, and also found that the State Farm policy substantively required State Farm to indemnify the insured. The Illinois Supreme Court reversed. As a general rule, when a complaint against the insured alleges facts within or potentially within the scope of coverage, the insurer taking the position that the complaint is not covered must defend the suit under reservation of rights or seek a declaratory judgment that there is no coverage. In the event that the insurer fails to take either of those actions, it will be estopped from raising defenses to coverage.

The Court, however, refused to take the next step and rule that a declaratory judgment must be secured before judgment in the underlying case. State Farm had argued that such a rule would require insurance companies to defend in all cases, including cases clearly outside the scope of the policy. The Supreme Court agreed with State Farm. The Court ruled that defending under reservation of rights, and filing a declaratory judgment action are separate and distinct options. The court stated:

For all of these reasons, we reaffirm that when a complaint against the insured alleges facts potentially within the scope of the policy coverage, an insurer taking the position that the complaint is not covered by its policy must defend the suit under a reservation of rights or seek a declaratory judgment. An insurer will not be estopped from denying coverage merely because the underlying case proceeds to judgment before the declaratory judgment action is resolved.

When an insurer is uncertain as to whether it should defend or refuse to defend, the filing of a declaratory judgment action to determine its obligations and rights is not premature. Gibraltar Insurance Co. v. Varkalis, 46 Ill.2d 481, 263 N.E.2d 823, (1970). Apex Mutual Insurance Co. v. Christner, 99 Ill.App.2d 153, 240 N.E.2d 742 (1968), Motor Vehicle Casualty Co. v. GSF, 193 Ill.App.3d 1, 549 N.E.2d 884, 140 Ill.Dec. 233 (1st Dist. 6th Div. 1989). Note, however, that where a duty to defend exists, an insurer's duty to indemnify cannot be determined until the underlying action has been adjudicated. Abrams v. State Farm, 306 Ill.App.3d 545, 714 N.E.2d 92, 239 Ill.Dec. 534 (1st Dist., 4th Div. 1999).

In drafting the reservation of rights letter, the insurer must be aware of the possibility of waiver and estoppel. The insurer cannot take one position in a reservation of rights letter, and then take a contradictory position in a declaratory proceeding. However, a declaratory judgment action can be pursued on non-contradictory grounds not found in the reservation of rights letter. An insurance company is not required to raise all possible defenses in its letter to its insured. The failure to raise all defenses does not result in a waiver of those defenses. Tibbs v. Great Central Insurance Co., 57

Ill.App.3d 866, 373 N.E.2d 492, 15 Ill.Dec. 146 (5th Dist. 1978); Ladd Construction Company v. Insurance Company of North America, 73 Ill.App.3d 43, 391 N.E.2d 568, 29 Ill.Dec. 305 (3rd Dist. 1979).

Given those rulings, the safest decision for the insurer would be to pursue a complaint for declaratory judgment. If that complaint is on file prior to judgment in the underlying case, the insured should be prevented from claiming estoppel, even where the underlying action is resolved prior to the declaratory judgment.

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