Using Extrinsic Evidence to Defeat the Duty to Defend in Illinois

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Liability insurance policies promise both indemnification against certain types of liability and a defense against suits asserting such liabilities. Ordinarily, the duty to defend must be determined solely by examining the complaint against the insured in light of the insurance policy’s coverage provisions. As the Illinois Supreme Court has expressed the applicable rule:

Illinois law is well established that where an underlying complaint alleges facts within or potentially within policy coverage, “the insurer is obliged to defend its insured even if the allegations are groundless, false, or fraudulent.” The insurer may not refuse to defend “unless it is clear from the face of the underlying complaint[ ] that the allegations fail to state facts which bring the case within, or potentially within, the policy’s coverage.” (Emphasis in original.) The underlying complaint and the policy must be construed in favor of the insured, with all doubts resolved in the insured’s favor.

There are two exceptions to the requirement that attention be limited to the allegations of the complaint. Even if the underlying complaint does not state facts bringing the claim within the policy’s coverage, “an insurer may also be required to defend if the insurer possesses knowledge of true but unpleaded facts that, when taken together with the allegations in the complaint, indicate that the claim is within or potentially within the policy coverage.” Alternatively, as this article will explain, the duty to defend can sometimes be defeated by reference to evidence outside the underlying complaint (“extrinsic evidence”). The use of true but unpleaded facts to create coverage raises issues somewhat different from use of extrinsic evidence to defeat coverage, and this article addresses only the latter subject. But, before considering that subject, it is necessary to review some of the Illinois rules governing the consequences of breaching the duty to defend and the availability of declaratory judgments to determine whether there is a duty to defend.

The Illinois Estoppel Rule

While existence of a duty to defend is theoretically independent of the consequences attached to its breach, all consideration of the duty to defend in Illinois takes place in the shadow of the special Illinois estoppel rule, shared by only a few other jurisdictions. Under that rule, “an insurer which breaches its duty to defend is estopped from raising policy defenses to coverage.” If a duty to defend has arisen, an insurer can avoid an estoppel in only two ways: “(1) defend the suit under a reservation of rights or (2) seek a declaratory judgment that there is no coverage. If the insurer fails to take either of these steps and is later found to have wrongfully denied coverage, the insurer is estopped from raising policy defenses to coverage.”
But this rule applies “only where an insurer has breached the duty to defend . . . . Application of the estoppel doctrine is not appropriate if the insurer had no duty to defend, or if the insurer’s duty was not properly triggered.”7 In addition to cases where the allegations of the complaint do not allege a claim at least potentially within coverage, circumstances where an estoppel is improper include cases “where the insurer was given no opportunity to defend [or] where there was no insurance policy in existence.”8 But application of the estoppel doctrine is not precluded by the fact that the insured provided late notice of a suit alleging claims within the policy’s coverage.9

Limits on Declaratory Judgment Actions

“[W]hen an insurer is in doubt regarding its duty to defend, it may seek a declaratory judgment as to its obligations and rights ....”10 Such a declaration may be sought even while concurrently defending under reservation of rights.11 But a declaration that there is no duty to defend has limited utility if it cannot be obtained until after the underlying action has gone to judgment. Consequently, it is quite important that Illinois strictly limits what can be adjudicated in a declaratory judgment action while the underlying action remains pending. A declaratory judgment court may not resolve factual issues “of ultimate fact on which recovery is predicated in the [underlying] action.”12 An action seeking to resolve such a fact is said to be “premature”; but the Supreme Court has consistently held that a declaratory judgment action on coverage is not premature if the issue to be determined would not collaterally estop any of the parties on an ultimate issue in the tort action.13 Given the contractual logic of the duty to defend, this limitation has relatively little impact on proper actions to determine existence of a duty to defend. In fact, use of this test often leads courts to conclude, correctly, that they may determine the facts necessary to decide whether there is a duty to defend.14

The Contractual Logic of the Duty To Defend

The duty to defend is a contractual duty, so its scope depends on interpretation of the contract. It is the logic of the contract which dictates that existence of the duty must ordinarily be determined from the allegations of the complaint. But courts often lose sight of both the logic and the contract itself. This can lead them into error in those situations where the logic of the contract not only permits, but demands consideration of facts outside the allegations of the complaint. Specifically, one must distinguish between “liability facts” which will determine the existence or extent of the insured’s liability to the underlying plaintiff) and “nonliability facts” (which bear only on coverage). Under standard policy language, the former must almost always be treated as those facts are alleged in the underlying complaint, while the latter should be treated solely on the basis of actual evidence, with no regard to the allegations of the complaint.15

Courts that refuse to consider (or to allow insurers to consider) evidence of the latter sort seem to have lost sight of the fact that the scope of the duty to defend is a matter of contract. Understandably, they are accustomed to looking to prior cases construing the same standardized contractual provisions rather than analyzing those provisions anew in every case. This process leads to error when the general rules stated in prior cases are applied without understanding the contractual logic that generated those rules. When the wording of the interpretive gloss is substituted for the contractual language, the meaning is inevitably distorted, especially where the court providing the gloss was concerned with a problem different from that before the court seeking to rely on that gloss. In extreme cases, courts may even forget that they are construing a contract, rather than making common law that best suits judicial views of public policy.

Such courts apply the rule that an insurer must defend whenever there is the “potential for coverage” without regard for the roots of that rule in the insurance contract. “The insurer’s duty to defend its insured arises from the undertaking . . . stated in the contract of insurance.”16 While the duty
is broad, that is because the contract makes it broad. But courts must not extend the duty beyond what the contract promises. And certainly they must not create a duty where there is no applicable contract.

The “potential for coverage” rule is rooted in the contract, but in a way imposing limits that courts often fail to grasp. Indeed, courts often show no appreciation for the relevance of the contractual language on duty to defend, failing even to mention that the policy contained such language.

A liability insurance policy ordinarily devotes most of its coverage-defining terms to specifying who is insured and what liabilities an insured will be indemnified against, and on what conditions. The duty to defend is created by language promising to defend any suit against an insured alleging liabilities of the sort insured.

The “potential for coverage” rule derives from this language through a contractual construction explained by Judge Learned Hand in the seminal case of *Lee v. Aetna Cas. & Sur. Co.* Judge Hand reasoned that the insurer, having promised to defend, “has promised to relieve the insured of the burden of satisfying the tribunal where the suit is tried, that the claim as pleaded is ‘groundless.’” Consequently, if the injured party states a claim, which is for an injury “covered” by the policy, . . . it is irrelevant that the insurer may get information from the insured, or from any one else, which indicates, or even demonstrates, that the allegations of a covered basis of liability are false. The duty to defend has not been discharged until the court entertaining those allegations has been convinced that no liability of a type covered by the policy exists.

Judge Hand found doubt about application of the duty to a suit involving allegations of both covered and noncovered grounds for the same purported liability, but he concluded that the doubt should be resolved in favor of the insured. This conclusion established another of the now entrenched doctrines governing the duty to defend with respect to such mixed claims: “if the plaintiff’s complaint against the insured alleged facts which would have supported a recovery covered by the policy, it was the duty of the defendant to undertake the defence, until it could confine the claim to a recovery that the policy did not cover.”

The rule requiring defense of suits asserting mixed claims is supported by strong practical considerations where, as is the norm, the covered and noncovered claims arose out of the same incident. Defense of claims intertwined in that way virtually must be conducted by a single chief counsel. So if the insurer is to defend the covered claims, no one else can be in a position to defend the others.

The same reasoning as in *Lee* is universally applied, not only to mixed claims, but also to those where, due to the relatively unspecific nature of modern pleading, one cannot be sure whether the complaint asserts a covered claim. Taken together, these rules constitute what is commonly described as the “potential for coverage” rule. It combines the express contractual duty with ancillary duties necessary to provide the insured with the full benefit of the express duty. The duty to defend is an express promise to satisfy the court in which the insured is sued (on a claim that would be covered if established) that the claim is groundless. The insured ought not to lose the promised benefit of a full defense of covered claims merely because the plaintiff also includes noncovered ones in the complaint. So, where covered claims are joined with noncovered ones, the insurer must also provide whatever defense is necessary for the noncovered claims while it is disposing of the covered ones. Similarly, given the vagueness of notice pleading, the insured ought not to be deprived of a full defense of a covered claim merely because the complaint was unclear on whether that was one of the claims asserted. Accordingly, ambiguities in the complaint must be construed in favor of coverage until those ambiguities can be resolved.

The insurer is bound, for duty to defend purposes, by the allegations of the complaint, but only those allegations necessary to establish the liability of the insured. Only liability-creating allegations
create the obligation to “satisfy [ ] the tribunal where the [tort] suit is tried that the claim as pleaded is ‘groundless.’” All aspects of policy coverage not dependent on liability-determining allegations should be determined according to the actual facts.24

An example of facts where the insurer had not promised to defend (but was erroneously held to be obliged to do so) is Chandler v. Doherty.25 Otis Doherty had two cars: (1) a Chevrolet and (2) a Volkswagen chassis with a replica of a 1927 Bugatti body (the “replicar”). He had an insurance policy with American Fire on the Chevrolet, but no policy covering the replicar. The Chevrolet policy explicitly excluded any liability coverage for any car owned by Doherty but not insured under the policy. Doherty had an accident in the replicar, injuring Verna Chandler. She sued, without alleging which car was involved. American Fire denied a defense, because it was undisputed that the uninsured replicar was the one in the accident. The Illinois Appellate Court held that American Fire wrongfully denied a defense, because American Fire was required to ignore the undisputed fact that Doherty was driving a car not insured under any contract, with American Fire or anyone else.

The insurer has not promised to defend where, as in Chandler, nonliability facts defeat coverage. Chandler had no occasion to allege which car Doherty was driving when he caused Chandler’s injuries: Doherty would be equally liable regardless. But the undisputed facts, fully developed by American Fire’s investigation, showed that Doherty was driving an uninsured car. Accordingly, there would be no coverage should Doherty’s liability be established in the suit against him. With no “potential for coverage,” American Fire was justified in denying a defense.26 As dissenting Justice McCullough put it in Chandler, “[w]here there is no policy to enforce, there is no duty to defend.”27

Use of Extrinsic Evidence in Declaratory Judgment Actions

Declaratory judgment actions on coverage can use extrinsic evidence to resolve factual issues affecting the duty to defend, so long as those issues concern nonliability facts. A leading example of this point is Fidelity & Casualty Co v. Envirodyne Engineers, Inc.28 Guzman was injured while working on a highway project supervised by Envirodyne; he sued it along with the state. Fidelity defended Envirodyne under reservation of rights while pursuing this DJA based on a professional services exclusion.29 The trial court granted summary judgment for Fidelity, and the appellate court affirmed.

Envirodyne argued that the only facts that could be considered were Guzman’s allegations that Envirodyne and the highway authority “‘erected, constructed, placed or operated, a certain scaffold.’30” This language would leave coverage unclear: if Envirodyne physically constructed the scaffold, there would be coverage, but there would be no coverage if it acted only as a consulting engineer.31 But the contract between Envirodyne and the highway authority made it clear that Envirodyne functioned only in the latter capacity.

The appellate court held that the contract had been properly considered:

It is certainly true that the duty to defend flows in the first instance from the allegations in the underlying complaint; . . . [I]f an insurer opts to file a declaratory proceeding, we believe that it may properly challenge the existence of such a duty by offering evidence to prove that the insured’s actions fell within the limitations of one of the policy’s exclusions. The only time such evidence should not be permitted is when it tends to determine an issue crucial to the determination of the underlying lawsuit, . . . . If a crucial issue will not be determined, we see no reason why the party seeking a declaration of rights should not have the prerogative to present evidence that is accorded generally to a party during a motion for summary judgment in a declaratory proceeding. To require the trial court to look solely to the complaint in the underlying action to determine coverage would make the declaratory proceeding little more than
a useless exercise possessing no attendant benefit and would greatly diminish a declaratory actions’s purpose of settling and fixing the rights of the parties.32

Even liability facts other than those alleged in the underlying complaint can be considered in a declaratory judgment action if doing so will not result in removing a bona fide factual issue from the underlying case. This is shown by *American Family Mutual Insurance Co. v. Savickas.*33 The underlying action was a wrongful death case. Savickas, the insured, stood convicted of first-degree murder of the decedent. When Savickas tendered the defense of the wrongful death action, American Family filed a DJA, arguing that the exclusion for injury “expected or intended by any insured” barred coverage. The circuit court agreed. But the appellate court reversed, because the conviction was only prima facie evidence in civil proceedings, leaving the possibility that the civil jury might find the injury not intentional.34 The Supreme Court reinstated the judgment for American Family. It held that the conviction would collaterally estop Savickas to deny that the injury was intentional, and that the decedent’s family stood in Savickas’s shoes in the coverage action. It never even mentioned the question of whether these liability facts could be considered in the DJA.

Logic supports the propriety of considering those facts. The reason for limiting such consideration in a DJA is to prevent “the order and burden of proof [from being] oriented to and dictated by the declaratory judgment action and not by the primary litigation, the personal injury suit.”35 If the facts are conclusively established by an existing judgment or are simply undisputed, there would be no trial of such facts in the personal injury suit. So there is no reason that the coverage court should not take those facts into account.36

The propriety of considering such undisputed facts is supported by *Mid America Fire & Marine Insurance Co. v. Smith,*37 where the coverage issue was whether the insured intended the injury. Because the insured judicially admitted facts establishing that he had so intended, the appellate court held there was no duty to defend, even though intent was relevant in the still-pending tort action.

The *Mid America* rule has been the subject of dispute in subsequent appellate court dicta. It was approved in *Allstate Ins. Co. v. Carioto,*38 but in dictum, because the admissions left unresolved a factual issue which still entitled the insured to a defense. *Mid America* and *Carioto* were rejected by the appellate court in *American Family Insurance Co. v. Savickas,*39 but that rejection was dictum, because even acceptance of the the *Mid America* rule would have left certain allegations requiring a defense in Savickas.40

The *Savickas* majority in the appellate court thought that the *Mid America* rule could not be reconciled with *Thornton v. Paul,*41 where the insurer was held not required to commence a declaratory judgment action to avoid an estoppel, despite evidence of intent undisputed in the record before the Supreme Court. But the *Thornton* record was only compiled through discovery taken after conclusion of the tort action. The insurer could hardly be obliged to commence such an action in the hope that discovery would produce such evidence, when discovery would normally not be permitted at that stage. *Mid America, Carioto,* and *Savickas* all involve efforts to utilize evidence gathered in ways other than discovery in the declaratory judgment action. *Thornton* simply does not address whether undisputed facts established in that way may be considered in deciding the duty to defend. Moreover, the Supreme Court’s decision in *Savickas* seems to resolve the issue in favor of *Mid America.*

The insurer would have no need to resort to a declaratory judgment action for this purpose if it were conducting the insured’s defense and the coverage-defeating fact was useful to the insured. It could simply bring a motion for summary judgment to establish the undisputed facts in question. But the cases just discussed all involve conflicts of interest that entitle the insured to conduct the defense with independent counsel, not subject to direction by the insurer.42 Independent counsel might well refuse to make such a motion, especially given the potential for loss of further payment of defense costs.43
A declaratory judgment action to which the tort plaintiff is a party would equally bind the plaintiff to the judgment based on the undisputed coverage-defeating fact. This would permit a nonprejudicial use of collateral estoppel to discharge the insurer’s duty “satisfy[] the tribunal where the [tort] suit is tried that the claim as pleaded is ‘groundless,’” insofar as that action depends on the undisputed coverage-defeating fact.

If the coverage-defeating fact is, as in the cases just cited, harmful to the insured, resisting its adjudication should be regarded as within the scope of the defense (conducted by independent counsel) for which the insurer must pay. But if the fact is truly undisputed, the only real prejudice to the insured is loss of a continued defense for an action where undisputed facts show there is no potential for coverage. Prejudice of that sort is not unfair, especially given the ability to use insurer-funded counsel to locate and present any evidence favorable to the insured.

**An Insurer Should Be Able to Consider Nonliability Facts Even Without Filing a Coverage Action**

The *Chandler* court recognized that Illinois cases do permit reliance on evidence of nonliability facts to defeat a duty to defend. But it noted that almost all such cases cited to it involved determination of those facts in declaratory judgment actions brought by the insurer; without explanation, it then asserted that the rule was inapplicable to extrajudicial determinations by the insurer itself. Because American Fire had not sought a declaratory judgment, it could not rely on extrinsic evidence and had breached its duty to defend. Moreover, because the complaint was silent on which car was involved in the accident, that silence created a potential for coverage.

The rule *Chandler* espoused is supported by dicta in *Fidelity & Casualty Co v. Envirodyne Engineers, Inc.* Like *Chandler*, the *Envirodyne* court offered no reason why the bringing of a declaratory judgment action should make a difference in determining whether the insurer had a duty to defend.

As a matter of both contractual logic and public policy, bringing of a declaratory judgment action should not make a difference. Taking the contractual logic first, a declaratory judgment concerning only facts irrelevant to the tort action does not create or extinguish a duty to defend. Rather, it declares whether such a duty exists or does not exist, thereby resolving uncertainty otherwise clouding the rights and obligations of the parties to the suit.

The ability to seek a declaratory judgment has been a protection against estoppel, in case the insurer was mistaken about the absence of a duty to defend, not a precondition to denying coverage where none ever existed. So, if a declaratory judgment court could determine, based on facts irrelevant to tort liability, that no duty to defend had arisen, an insurer willing to bear the risk of a mistake should be entitled to deny a defense and litigate the issue after resolution of the tort action. The estoppel rule makes that a perilous course if there is any doubt about existence of a duty, but there is no estoppel if there never was a duty to defend.

Any different rule would not only increase the burdens on insurers (and so the premiums they must charge), but would also burden the judicial system. Insurers would be forced to file numerous declaratory judgment actions to confirm what they would otherwise find adequately clear from the facts. Currently, even in Illinois and other jurisdictions following the “estoppel” rule, only coverage denials perceived as arguable warrant a declaratory judgment action, to avoid the risk of estoppel if a court should find the denial erroneous. If what are now seen as routine denials require filing suit, the number of coverage actions filed would markedly increase.

Because the filing of a declaratory judgment action ought not to change the propriety of denying coverage, the declaratory judgment cases purportedly distinguished by *Chandler* provide an overwhelming weight of authority contrary to that decision. Those cases are fully consistent with and supported by the Illinois Supreme Court’s decisions that a declaratory judgment action on indemnity
coverage is not premature if the issue to be determined would not collaterally estop any of the parties on an ultimate issue in the tort action. If facts irrelevant to tort liability defeat indemnity coverage, they equally establish that there is no "potential for coverage" that could trigger a duty to defend.

Cases that have refused to consider extrinsic evidence generally involve exactly the situation where the "potential for coverage" rule properly precludes such consideration: where the facts alleged to defeat coverage are also issues in the tort case.\(^5\) Illustrative is Sims v. Illinois Nat’l Ins. Co.,\(^5\) where the coverage defense was based on an exclusion for injuries to employees of the insured entitled to workers compensation. But the same facts, if established, would defeat tort liability. The tort plaintiff could not establish liability, once this defense was pleaded, without a finding that workers compensation immunity would be inapplicable. So the insurer was obliged to try to “satisfy[] the tribunal where the [tort] suit is tried that the claim as pleaded is ‘groundless,’” rather than trying to establish that in a collateral coverage action.

Clemmons v. Travelers Ins. Co.\(^5\) addresses a different problem. It was an auto accident case, and the coverage issue was permissive use. The car’s owner was the driver’s employer, but the owner was not sued in this action, and permission was irrelevant to the driver’s tort liability. But the owner-employer had been sued in another action, and the insurer had obtained summary judgment that there was no respondeat superior liability, because the driver was on a personal frolic, outside the scope of employment.\(^5\) Travelers refused to defend the driver, who suffered a default judgment and brought this action for indemnification. Travelers defended on lack of permission, invoking the summary judgment on respondeat superior. But, as the court pointed out, the Illinois standard for permissive use is much broader than for scope of employment, extending to cases where the car’s owner had granted initial permission for the car to be driven, regardless of any subsequent deviations from the scope of the permitted use.\(^5\) The facts established on the tort summary judgment make a prima facie case of sufficient permission to support coverage under the correct standard. Travelers urged that this was rebutted by an accident report in which the driver admitted lack of permission. The court found the admission inadequate for the purpose, because there was no indication the driver understood the broad legal standard applicable to the issue. The court then affirmed the judgment against Travelers, relying on the “potential for coverage” rule.\(^5\)

This was entirely proper. Between the allegations of the complaint and extrinsic facts known to Travelers, there was a prima facie case of coverage. While the driver’s admissions arguably suggested the possibility that this might be rebutted, Travelers failed to develop any evidence sufficient to create a genuine factual issue. (Presumably this failure resulted from its mistaken reliance on the respondeat superior standard.) An insurer must take account of extrinsic evidence known to it which supports coverage, even if coverage is not apparent from the face of the complaint. In the face of such evidence, an insurer wishing to deny a defense should investigate sufficiently to establish that there is contrary evidence. Because Travelers had not done this, even as late as the coverage action, the refusal to defend was unsupported.

Where, as in Chandler, an insurer establishes clear evidence of facts irrelevant to liability and inconsistent with coverage, it ought to be able to refuse to defend without filing a declaratory judgment action, subject only to liability (and possible estoppel) should that evidence later be rebutted in a coverage action.

Not only is the Chandler rule unsound as a matter of contractual logic, it is also contrary to the interests of the insurance-buying public. The point is well illustrated by the facts of Chandler, in which the insured was held entitled to a defense of an action arising out of use of an uninsured car.

Insurance premiums are based primarily on the projected costs of providing the insurance. For liability insurance, those costs are largely those of (1) defending insureds against claims and (2) paying claims that are proven or settled. Both depend primarily on the projected frequency of claims
against the insured. Households with more than one car tend to do more driving than households with only one, so they have more frequent claims. Consequently, insurance for multiple cars costs more than insurance for only one.

Auto insurance policies provide coverage to named insureds for almost all driving they do. But such policies uniformly exclude all coverage for autos owned (or available for regular use) by insured persons, if those autos are not themselves covered by the policy. After all, no premium has been paid for the extra risk posed by any additional car(s).

Insureds who comply with the law by insuring all of their cars will pay a premium reflecting the accident frequency indicated by that many cars. Those, like Otis Doherty, who insure only some of their cars will pay a lower premium, based on the lower frequency indicated by the number of cars insured. If the exclusion for uninsured cars is not given full effect, the costs associated with the population of uninsured cars in insured households will be spread over all insured cars, requiring the owners of insured cars to pay for risks associated with the uninsured cars.

The appellate court’s decision in Chandler would require insurers to defend (though not to pay) claims involving uninsured cars, partially nullifying the exclusion of coverage for those cars. The costs of that defense will be borne by insurers in the first instance, but those costs will necessarily be taken into account in computing future premiums. So those who insure all their own cars will pay, not only the projected costs of defending claims against themselves, but also a share of the costs of defending those who insure only some of their cars.

In mandating insurance for all cars, the Illinois General Assembly has provided a source of compensation for accident victims. But driving is a necessity, even for the poor, so the required insurance must not be too expensive. The General Assembly balanced these concerns in determining the amount of insurance required. The appellate court’s decision in Chandler upsets that balance by increasing premiums for those who buy insurance, with little increase in compensation to accident victims. Rather, almost all of the extra expenses imposed will go for defense of claims involving uninsured cars, rather than to pay victims.57

Moreover, the legal standards applied by the appellate court in imposing this specific rule will similarly inflate the cost of all forms of liability insurance, by requiring defense of claims that, independently of any facts bearing on liability, are demonstrably outside policy coverage. For example, insureds with businesses present greater liability risks than those with no businesses. The latter do not wish to pay higher premiums to protect the former from risks they do not share. So homeowners and personal umbrella policies uniformly exclude liability arising from the insured’s business pursuits.58 Yet the business nature of such liabilities is often not discernible from the complaint against the insured, and plaintiffs may even take pains to avoid making it evident. So application of the rule stated in Chandler would force insureds without businesses to subsidize those who have them.

While perhaps less pernicious than inflating the cost of legally required auto insurance for the benefit of scofflaws who fail to insure all their own cars, such forced subsidies are undesirable. Unless standard insurance contracts clearly require them, courts ought not to impose such requirements.

**Conclusion**

An insurer ought to be able to deny a defense whenever extrinsic evidence of nonliability facts precludes coverage or when coverage-defeating liability facts can be established beyond dispute. But the present state of Illinois law renders such a denial, without filing a declaratory judgment action, very dangerous. Indeed, a few cases even suggest that an insurer that files such an action may still be held in breach of the duty to defend if it does not simultaneously defend under reservation of rights. But when the issue does arise in litigation, counsel should urge and courts should hold that an insurer
which correctly concludes that coverage is precluded need not file a declaratory judgement action to prevent a nonexistent duty to defend from arising.

Endnotes
1. This is sometimes expressed as requiring coverage to be determined within the “four corners” of the complaint or the “eight corners” of the complaint and the insurance policy.
3. *National Union Fire Ins. Co. v. R. Olson Constr. Contractors, Inc.*, 329 Ill. App. 3d 228, 247, 750 N.E.2d 1253, 1256 (2001) (“knowledge” of true but unpleaded facts refers only to facts ascertained or confirmed by insurer, not to unconfirmed allegations of insured; facts alleged here would not have created coverage, even if true); *LaRotunda v. Royal Globe Ins. Co.*, 323 Ill. App. 3d 228, 308 N.E.2d 529, 536-37 (1979) (true but unpleaded fact, disclosed by insurer’s investigation, that part of relevant property was not used as junkyard, and so was outside business property exclusion, established potential for coverage); *Associated Indem. Co. v. Insurance Co of N. Amer.*, 68 Ill. App. 3d 301, 304, 401 N.E.2d 471, 473 (1983). (No duty to defend if facts extrinsic to liability claim defeat coverage).
4. See discussion at notes 29-33, supra.
6. Id. at 150-51, 708 N.E.2d at 1135.
7. Id. at 151, 708 N.E.2d at 1135.
8. Id.
9. Id. at 153-54, 708 N.E.2d at 1136.
11. Id.
13. *Murphy v. Urso*, 88 Ill. 2d 444, 455, 430 N.E.2d 1079, 1084 (1981) (declaratory judgment action permissible where coverage issues separable from ones in tort suit and adjudication in collateral proceeding prejudices no party); *Thornton v. Paul*, 74 Ill. 2d 132, 159, 384 N.E.2d 335, 346 (1978) (declaratory judgment court cannot first determine issues crucial to insured’s liability in the underlying tort action because “the order and burden of proof would be oriented to and dictated by the declaratory judgment action and not by the primary litigation, the personal injury suit”); *Maryland Cas. Co. v. Peppers*, 64 Ill. 2d 187, 197, 355 N.E.2d 24, 30 (1976) (holding trial court’s determination in declaratory judgment action of whether injury was inflicted intentionally or negligently was improper while underlying tort action was pending).
14. See discussion at notes 29-33, supra.
16. Id. at 48-53, 514 N.E.2d at 161-64.

19 178 F.2d at 752.

20 Id. at 751. An alternate statement of this point is that “an insurer cannot avoid the duty to defend merely by concluding, based on its own investigation, that the insured has done no wrong. The duty to defend does not evaporate simply because the insurer has decided that the insured will ultimately be exonerated . . . .” A-H Plating, Inc. v. American Nat'l Fire Ins. Co., 57 Cal. App. 4th 427, 442, 67 Cal. Rptr. 2d 113, 121 (1997).

21 178 F.2d at 753.

22 ALLAN D. WINDT, supra note 5, § 4:2, at 265-67.

23 Some courts allow insurers that have defended noncovered claims along with covered ones to recover the extra costs incurred on account of the noncovered claims. E.g., Buss v. Superior Court, 65 Cal. Rptr. 2d 366, 939 P.2d 766 (Cal. 1997); see William T. Barker, Arch-Angel Insurance Company v. Walter Raleigh: A Hypothetical Case on Recoupment Defense Costs, Appellant’s Brief, 19 INS. LITIG. RPTR. 536 (1997); Reply Brief, 19 INS. LITIG. RPTR. 639 (1997).

24 This rule is supported by all leading commentators who have addressed it. See note 16, supra. Accord Burd v. Sussex Mutual Ins. Co., 267 A.2d 7, 9-10 (N.J. 1970) (“when coverage, i.e., the duty to pay, depends on a factual issue which will not be resolved by the trial of the third party’s suit against the insured, the duty to defend may depend on actual facts and not upon the allegations in the complaint”).

25 299 Ill. App. 3d 797, 702 N.E.2d 634 (1998), leave to appeal denied, 182 Ill. 2d 548, 707 N.E.2d 1238 (1999). Much of this article derives from a proposed amicus brief in support of the petition for leave to appeal. The motion for leave to file that brief at the petition stage was denied.

26 See, Rowell v. Hodges, 434 F.2d 926 (5th Cir. 1970) (reaching that result, under Florida law, on facts parallel to those in Chandler).

27 299 Ill. App. 3d at 808, 702 N.E.2d at 641.


29 Id. at 302-03, 461 N.E.2d at 849. The exclusion provided that “the insurance does not apply to bodily injury or property damage arising out of the rendering of or the failure to render any professional services by or for the named insured including . . . supervisory, inspection, or engineering services.” Id. at 302, 461 N.E.2d at 849.

30 Id. at 303, 461 N.E.2d at 850.

31 Id.

32 Id. at 304-05, 461 N.E.2d at 733-74. Other cases have consistently agreed: State Farm Ins. Co. v. American Serv. Ins. Co., 2002 WL 136887 (Ill. App. Ct. June 24, 2002) (extrinsic evidence showed policy validly rescinded before accident); Fremont Compensation Ins. Co. v. Ace Chicago Great Dane Corp., 304 Ill. App. 3d 734, 742-43, 710 N.E.2d 132, 138-39 (1999) (extrinsic evidence showed that alleged spoliation of evidence occurred after expiration of policy, a fact with no bearing on underlying action; no duty to defend); Atlantic Mutual Ins. Co v. American Academy of Orthopadic Surgeons, 315 Ill. App.3d 552, 567, 734 N.E.2d 50, 62 (2000) (“extrinsic facts, gathered through the discovery process, may be considered in determining whether a duty to defend is shown as long as they do not bear upon issues in the underlying litigation”); dictum, as lack of coverage appeared from allegations of complaint); American Family Mut. Ins. Co. v. Savickas, 304 Ill. App. 3d 614, 711 N.E.2d 1 (1998) (in determining duty to defend, extrinsic evidence may be considered on matters ancillary to tort action, but issues in that case—intent to injure and causation of injury—went to heart of tort action); rev’d on other grounds, 193 Ill. 2d 378, 739 N.E.2d 445 (2000); Transcontinental Ins. Co. v. National Union Fire Ins. Co., 278 Ill. App. 3d 357, 662 N.E.2d 500 (1996) (where status of tort defendant as additional insured depended on whether named insured had contracted to provide insurance to tort defendant, court may examine contract between those parties to determine whether there is a duty to defend; here, named insured had not so contracted); Oakley Transp., Inc. v. Zurich Ins. Co., 271 Ill. App. 3d 716, 721 n.2, 648 N.E.2d 1099, 1102 n.2 (1995) (extrinsic facts may be considered if they do not bear on tort liability, but such consideration unnecessary where absence of duty to defend evident from face of complaint); United States Fidelity & Guar. Co. v. Jiffy Cab Co., 265 Ill. App. 3d 533, 537, 637 N.E.2d 1167, 1169 (1994) (in coverage action under auto policy for injuries suffered in altercation commenced during taxi ride, declaratory judgment action permissible, because issue whether injuries arose out of use of the cab separable from liability issues); Bituminous Cas. Corp. v. Fulkerson, 212 Ill. App. 3d 556, 562, 571 N.E.2d 256, 261 (1991) (in determining duty to defend, proper to look to extrinsic evidence of facts “ancillary” to tort action, such as payment of premiums, but coverage issues before court overlapped with tort action); Millers Mut. Ins. Ass’n v. Ainsworth Seed Co., 194 Ill. App. 3d 888, 552 N.E.2d 254 (1989) (no duty to defend under policy with completed operations exclusion, where extrinsic evidence showed that operations concluded before the injuries complained of); State Farm Fire & Cas. Co. v. Shelton, 176 Ill. App. 3d 858, 867, 531
N.E.2d 913, 919 (1988), appeal denied, 125 Ill. 2d 574, 537 N.E.2d 818 (1989) (in determining duty to defend, proper to look to extrinsic evidence of facts “ancillary” to tort action, such as payment of premiums, but that rule inapplicable because coverage issues before court overlapped with tort action); Tapp v. Wrightsman-Musso Ins. Agency, 109 Ill. App. 3d 928, 441 N.E.2d 145 (1982) (finding no duty to defend based on extrinsic evidence that insured’s injury-causing conduct did not arise from insured premises, an issue irrelevant to tort liability); Graman v. Continental Cas. Co., 87 Ill. App. 3d 896, 899-900, 409 N.E.2d 387, 390 (1980) (under claims-made policy, proper to consider extrinsic evidence that no claim made before policy expired); Avenco Ins. Co. v. Acer Enters., Inc., 796 F. Supp. 343, 346 (N.D. Ill. 1992) (same); National Union Fire Ins. Co. v. Thomas M. Madden & Co., 813 F. Supp. 1349, 1351-52 (N.D. Ill. 1993) (proper to look to extrinsic evidence to determine issues ancillary to tort action; determining one such issue and finding others not ancillary); Old Republic Ins. Co. v. Chuhak & Tecson, P.C., 84 F.3d 998, 1002 (7th Cir. 1996) (where issue is status of tort defendant as insured, court may look to extrinsic evidence to determine whether defendant is stranger to the policy, even if complaint alleges facts that would make defendant an insured, so long as those facts will not estop tort plaintiff).

33 193 Ill. 2d 378, 739 N.E.2d 445 (2000).
36 This point is implicitly supported by the description of the applicable rules in National Union Fire Ins. Co. v. R. Olson Constr. Contractors, Inc., 329 Ill. App. 3d 228, 234, 769 N.E.2d 977 (2000).
39 304 Ill. App. 3d 617-18, 711 N.E.2d at 3.
40 Id. But see id. at 623-24, 711 N.E.2d at 7 (Rakowski, J., concurring) (approving Mid America rule).
41 74 Ill. 2d 132, 384 N.E.2d 335 (1978).
43 Refusal to move for the purpose of forcing continued payment might well constitute a breach of the insured’s obligation of good faith and fair dealing, by needlessly increasing the cost of performing the insurer’s obligations. But counsel might have other reasons, real or ostensible, for such a refusal, so that enforcement of that duty would be problematic.
44 178 F.2d at 752.
46 Insofar as Chandler relied on the complaint’s silence about a nonliability fact to create a potential for coverage, it conflicts with Federal Ins. Co. v. Economy Fire & Cas. Co., 189 Ill. App. 3d 732, 545 N.E.2d 541 (1989) (umbrella insurer, which did not seek declaratory judgment, had no duty to defend because complaint did not allege that car involved in accident was not available for regular use by the putative insured—and it apparently was available for such use; even had there been duty to defend, it would not have attached until applicable primary insurance exhausted). Because Federal Insurance regarded silence as failing to show potential coverage, it had no occasion to consider the use of extrinsic evidence. This point is also inconsistent with the Chandler court’s distinction of Tapp v. Wrightsman-Musso Ins. Agency, 109 Ill. App. 3d 928, 441 N.E.2d 145 (1982), on the ground that the underlying complaint did not allege whether the claim arose out of an insured premises, as required for coverage. In that respect, Tapp is like Chandler, where the underlying complaint did not allege which car was involved. Like Chandler, Tapp did not involve a DJA prior to resolution of the underlying action.

On the other hand, Chandler is supported on this point by Insurance Co. v. Markogiannis, 188 Ill. App. 3d 643, 544 N.E.2d 1082 (1989) (even though indemnity coverage barred by fact that injuries at issue inflicted in connection with insured’s business pursuits, insurer had breached duty to defend, because facts relevant to that exclusion not alleged in complaint against insured).
48 Sims v. Illinois Nat’l Ins. Co., 43 Ill. App. 2d 184, 195-99, 193 N.E.2d 123, 128-30 (1963) (insurer that breaches duty to defend will be estopped to assert coverage defenses to indemnification unless it has sought a declaratory
judgment); Thornton v. Paul, 74 Ill. 2d 132, 145-59, 384 N.E.2d 335, 340-46 (1978) (adopting Sims rule, but recognizing an exception for cases where the insurer had a conflict of interests barring it from assuming insured’s defense and declaratory judgment could not be adjudicated before conclusion of tort action); Employers Ins. Co v. Ehlco Liquidating Trust, 186 Ill. 2d 127, 708 N.E.2d 1122 (1999) (construing and applying rule).

But see American Std. Ins. Co. v. Gnowjeski, 319 Ill. App. 3d 970, 797-78 (2001) (where insurer has neither defended under reservation of rights nor brought DJA, factual and legal questions regarding validity of preaccident cancellation created potential for coverage, so that duty to defend was breached before insurer sought summary judgment on that duty); LaGrange Mem. Hosp. v. St. Paul Ins. Co., 317 Ill. App. 3d 863, 869-70, 740 N.E.2d 21, 27-28 (2000) (where defendant’s status as an additional insured depended on whether contract with named insured required provision of insurance, unresolved questions as to whether contract did so require created potential for coverage, so duty to defend was breached and insurer estopped to raise coverage defense after claim was resolved). These cases are doubly unsound, because they treat unresolved legal questions bearing on coverage as themselves creating a duty to defend. The “potential for coverage” rule protects the insured against uncertainty about what type of claim is being asserted. There is no reason why it should broaden the scope of coverage, as that scope would be determined under a proper view of the law.

Insurance Co. v. Markogiannakis, 188 Ill. App. 3d 643, 544 N.E.2d 1082 (1st Dist. 1989), found a breach of the duty to defend, even though indemnity coverage was barred by the business pursuits exclusion, because facts relevant to that exclusion not alleged in complaint against insured. Because the court agreed that extrinsic evidence of nonliability facts could properly be used to defeat coverage, the implication seems to be that an insurer must defend until the absence of coverage is adjudicated. This, too, misconceives the meaning of “potential for coverage.”

Ehlco 186 Ill. 2d at 151, 708 N.E.2d at 1135.


Outboard Marine Corp. v. Liberty Mut. Ins. Co., 154 Ill. 2d 90, 126, 607 N.E.2d 1204, 1220 (1992), appeal denied, 169 Ill. 2d 257, 675 N.E.2d 634 (1996) reversed a grant of summary judgment that a pollution exclusion eliminated any duty to defend. Even if the decision were read to direct entry of summary judgment that the duty to defend existed, based solely on the face of the complaints, it can still be reconciled with the rule advanced here. The court did not discuss whether the coverage issue might overlap with some liability issue. More importantly, the insurers appear to have staked their entire case on an interpretation of the contract rejected by the court, without any attempt to offer evidence satisfying the alternate interpretation advanced by the insured and ultimately adopted by the court. Id. at 244-50, 570 N.E.2d at 1162-66 (describing insurer’s arguments and evidence). This would appear to be a waiver, precluding any attempt to present additional facts on remand.


Id. at 473, 430 N.E.2d at 1106.

Id. at 476, 430 N.E.2d at 1108.

Id.

By giving such claims a nuisance value, the decision would result in some settlement payments to injured parties. But such payments would likely be only a small fraction of the total costs of dealing with such claims.

Those with businesses can protect themselves with business policies or endorsements to their personal liability policies.

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