The Illinois Supreme Court Gives Policyholders a Break from the Two-Front War

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I. INTRODUCTION

It has always seemed strange to me that in Illinois an insurer could "honor" its duty to defend a policyholder (i.e. protect it from incurring defense costs) by refusing to defend and then suing the policyholder for a declaration that there is no duty to defend – thus imposing on the policyholder a two-front war. Far from getting protection from litigation costs, the policyholder must pay out of its own pocket to defend two lawsuits.

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Yet, this is precisely the impression an insurer might have from reading the often-stated rule that, "[w]hen a complaint against the insured alleges facts within or potentially within the scope of the policy coverage, the insurer taking the position that the complaint is not covered by the policy must defend the suit under a reservation of rights or seek a declaratory judgment that there is no coverage." Insurers reason that as long as they take one of these options (i.e. sue their insured), they have followed Illinois law and cannot get into trouble. What insurers are missing, however, is that the above-stated options relate only to the question of whether they will be estopped from raising policy defenses to coverage. The options noted above are part of a rule that – completely stated – finishes with the sentence: "If the insurer fails to take either of these actions, it will be estopped from later raising policy defenses to coverage."2

These options have nothing to do with whether an insurer must pay the policyholder’s defense costs while the insurer prosecutes its declaratory judgment action. That issue turns on an entirely different rule – the rule governing what triggers an insurer’s duty to defend and when that duty is triggered. That rule states: "‘An insurer may not justifiably refuse to defend an action against its insured unless it is clear from the face of the underlying complaints that the allegations fail to state facts which bring the case within, or potentially within, the policy’s coverage.’"3 "‘Whereas the duty to indemnify can arise only after damages are fixed in their amount, the duty to defend may arise as soon as damages are sought in some amount.’"4 “[T]he duty to defend flows in the first instance from the allegations in the underlying complaint; this is the concern at the initial stage of the proceedings when an insurance company encounters the primary decision of whether to defend its insured.”5 Hence, the key question is: What does it mean for the allegations of an underlying complaint to come potentially within policy coverage at the time an insurance company must determine whether to defend its policyholder?

Surprisingly, until quite recently, the Illinois Supreme Court has said very little about this important topic. On March 24, 2005, however, the

2. Id. at 1231 (citing Clemmons, 430 N.E.2d at 1107).
Illinois Supreme Court broke its silence and brought much needed clarity to this area of insurance law. As discussed below, in *General Agents Insurance Co. v. Midwest Sporting Goods Co.* (“Midwest Sporting Goods”), the Illinois Supreme Court held that an insurer cannot determine whether a complaint against its policyholder is potentially within coverage retroactively by reference to the result of a declaratory judgment action. Rather, that determination must be made by the insurer at the time it reviews the complaint and makes a decision to defend or not to defend its policyholder.

This critical ruling clarifies that under Illinois law insurers may not impose a two-front war on their policyholders and takes away the unfair leverage that the two-front war tactic provides insurers in settling claims. Rather, as explained below, the necessary implication of *Midwest Sporting Goods* is that, upon receiving a complaint against its policyholder, if the insurer has doubts about coverage, it must: (i) defend its policyholder under a reservation of rights; (ii) file a declaratory judgment action seeking a judgment that it has no duty to defend AND pay the policyholder’s defense costs until a judgment is obtained; or (iii) refuse to defend and take its chances that it will be estopped from raising policy defenses to any judgment or settlement if it is wrong.

II. WHEN DOES THE DUTY TO DEFEND ARISE? (AND WHEN DOES IT END?)

The duty to defend “may arise as soon as damages are sought [against the policyholder] in some amount,” and “at the initial stage of the proceedings when an insurance company encounters the primary decision of whether to defend its insured.” Hence, an insurer’s duty to defend exists (or not) long before any court has a chance to consider whether that duty exists. Consequently, if an insurer files a declaratory judgment action and the judge declares that there is a duty to defend, it is clear at that point that there has always been a duty to defend from the time the underlying complaint was filed against the policyholder. The insurer must pay for defense costs incurred by the policyholder from the inception of the underlying suit. The opposite, however, is not true. If the judge in the declaratory action determines that there is no duty to defend, it does not necessarily follow that there has never been a duty to defend.

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7. See id.
8. Id.
9. *Cent. Ill. Light Co.*, 821 N.E.2d at 216 (quoting *Certain Underwriters*, 16 P.3d at 102 (Cal. 2001)).
Long before *Midwest Sporting Goods*, Illinois courts recognized circumstances in which an underlying complaint filed against a policyholder came "potentially within" coverage – thus triggering the insurer’s duty to defend – but that the duty to defend could be cut-off by a judicial declaration that eliminated the potential for coverage raised by the underlying complaint. This is demonstrated by the rules that have developed concerning the circumstance where an insurer wishes to deny a defense on the basis of facts not alleged within the four corners of the underlying complaint.

In *Clemmons v. Travelers Insurance Co.*,11 the Illinois Supreme Court found that an insurer was required to defend a putative insured even though the insurer possessed evidence that the putative insured was not an insured under the policy. Anthony Clemmons sued Dennis Reed for negligently injuring Clemmons in an automobile accident.12 Reed was a blood distributor for the Red Cross and was driving a car owned by the Red Cross when the accident occurred.13 Travelers insured the car and covered persons driving the car with permission of the Red Cross.14 Clemmons’ complaint said nothing about whether Reed was driving with permission and, in fact, no issue in Clemmons’ case turned on whether Reed had permission.15 Travelers obtained an accident report indicating that Reed was not driving with permission at the time of the accident and refused to defend.16 The court held that Travelers had wrongfully refused to defend17 because the complaint stated facts creating a potential for coverage under the policy (i.e. Reed might have had permission).18 The court further held that "the duty to defend must be determined solely from the language of the complaint and the policy."19 In addition, the court noted that "[i]f Travelers wanted to preserve its right to later contest permission, it had the choice of defending under a reservation of rights or seeking a declaratory judgment of no coverage."20

Similarly, in *Chandler v. Doherty*,21 the insurer possessed strong evidence that the putative insured’s car was not covered by the insurance policy. Otis Doherty owned one car insured by American Fire & Casualty

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12. *Id.* at 1106.
13. *Id.*
14. *Id.*
15. *Id.* at 1107.
17. *Id.* at 1111.
18. *Id.* at 1108.
19. *Id.*
20. *Id.* at 1109.
Company ("American Fire") but received another car as a gift. American Fire did not insure the gift car until three months after Doherty got in an accident with Verna Chandler. Chandler’s complaint, however, stated only that Doherty was driving "his motor vehicle." American Fire refused to defend because the gift car was not an insured vehicle at the time of the accident. The appellate court held that "American Fire had unjustifiably refused to defend." It found that Chandler’s complaint created the potential for coverage (i.e. "his motor vehicle" could have referred to the covered car). The court further held that:

It is the law of this state that in determining whether it has a duty to defend a suit, and insurer is limited to comparing the bare allegations of the complaint with the face of the policy of insurance... The duty to defend is not annulled by the knowledge on the part of the insurer the allegations are untrue or incorrect or the true facts will ultimately exclude coverage.

As in Clemmons, the Chandler court noted that American Fire could have defended under a reservation of rights or filed a declaratory judgment action to preserve its right to argue that the gift car was not insured under the policy.

The insurers in both Clemmons and Chandler failed to follow Illinois law and paid the price. They were both held to have breached the duty to defend and had to pay the insured’s defense costs and the judgment against the insured up to policy limits. The lesson of these cases is that where a complaint against the insured, on its face, raises the potential for indemnity coverage, an insurer must defend its insured because the duty to defend is broader than the duty to indemnify. If the insurer wishes to cut-off that duty to defend based on facts extrinsic to the underlying complaint, it must file a declaratory judgment action and prove up those facts. Only upon a judicial determination that the extrinsic facts eliminate the potential for

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22. Id. at 636.
23. Id.
24. Id.
25. Id. at 638.
27. Id. at 638.
28. Id.
29. Id. at 640.
30. Clemmons, 430 N.E.2d 1104; Chandler, 702 N.E.2d 634.
31. See Clemmons, 430 N.E.2d 1104; Chandler, 702 N.E.2d 634.
32. Id.
indemnity coverage (e.g., by proving that an exclusion applies), is the insurer excused from continuing to defend its insured.\footnote{Id.}

The facts in \textit{Fidelity & Cas. Co. of N.Y. v. Envirodyne Eng.} ("Envirodyne")\footnote{461 N.E.2d 471 (Ill. App. Ct. 1983).} demonstrate how an insurer can correctly follow Illinois law. In \textit{Envirodyne}, the insured, Envirodyne, was engaged as a consulting engineer at a construction site.\footnote{Id. at 472.} Ben Guzman, who was working at the site, alleged that he was injured due to violations of the Structural Work Act and negligence attributable to Envirodyne.\footnote{Id.} The complaint did not say anything about the capacity in which Envirodyne was participating at the site. The policy issued by Fidelity & Casualty Company of New York ("Fidelity") contained an exclusion, which would apply if Envirodyne’s work at the site consisted solely of "supervisory, inspection or engineering services."\footnote{Id. at 473.} Although the complaint was silent, Fidelity believed that Envirodyne was acting solely to provide "supervisory, inspection or engineering services."\footnote{Id. at 474.} This exclusion would have to be proved, however, by reference to facts extrinsic to the underlying complaint.\footnote{Id. at 474.} Consequently, Fidelity defended Envirodyne under a reservation of rights and promptly filed a declaratory judgment action.\footnote{Envirodyne Eng’g., 461 N.E.2d at 472.} The Illinois Appellate Court allowed Fidelity to prove its exclusion while the underlying action was still pending and cut-off its duty to defend.\footnote{Id. at 476.} Importantly, the court held that no conflict was presented with the underlying case in allowing Fidelity to prove facts relevant to its exclusion in the declaratory judgment action because the facts pertinent to Envirodyne’s capacity at the site were not at issue in the underlying liability case.\footnote{Id. at 476.} The judicial determination that the exclusion applied ended the potential for indemnity coverage and therefore cut-off – but did not retroactively eliminate – Fidelity’s duty to defend.\footnote{Id. at 476.}

The reason for the cut-off rule discussed above has been well-explained by the Illinois Supreme Court in \textit{Zurich Ins. Co. v. Raymark}

\footnote{There is no indication that Fidelity attempted to seek reimbursement of the defense costs it already paid. Nor, of course, would any attempt have been successful since the complaint allegations triggered Fidelity’s duty to defend, which continued until the judicial determination that there was no longer a potential for indemnity coverage. See also Millers Mut. Ins. Ass’n of Ill. v. Ainsworth Seed Co. Inc., 552 N.E.2d 254 (Ill. App. Ct. 1990) (holding that upon proof of facts establishing an exclusion, insurer was “released” from its duty to defend).}
Indus. In deciding that an insurer could cut-off its duty to defend some asbestos claims by exhausting its indemnity policy limits through payment of other asbestos claims, the court brought clarity to the difference between the duty to defend and the duty to indemnify and why the duty to defend is considered to be broader than the duty to indemnify:

[A]n insurer’s duty to defend and its duty to indemnify are separate and distinct and . . . the former duty is broader than the latter . . . The duty to indemnify arises only when the insured becomes legally obligated to pay damages in the underlying action that gives rise to a claim under the policy. The duty to defend an action brought against the insured, on the other hand, is determined solely by reference to the allegations of the complaint. If the complaint alleges facts which bring the claim within the potential indemnity coverage of the policy, the insurer is obligated to defend the action . . . Thus, the insurer must defend an action even though it may not ultimately be obligated to indemnify the insured. Where the insurer has exhausted its indemnity limits, however, the insurer cannot ultimately be obligated to indemnify the insured. Thus, the duty to defend is broader than the duty to indemnify only when the insurer has the potential obligation to indemnify. But, where, as here, the insurer has no potential obligation to indemnify it has no duty to defend.

In Associated Indem. v. Ins. Co. of N. Am., the Illinois Appellate Court applied the cut-off rule even in the somewhat harsh circumstance where the insurer was prevented from obtaining a declaration cutting off its duty to defend because the coverage issue it wanted to prove would have caused a conflict with the underlying case by establishing liability facts not yet addressed in the underlying case. In Associated Indemnity, the insured struck a pedestrian with an automobile. The insured was either an agent or an independent contractor of a business that transported vehicles long distance. The policy excluded coverage if he had an independent contractor relationship with the owner of the vehicle. The pedestrian’s

44. 514 N.E.2d 150 (Ill. 1987).
45. Zurich, 514 N.E.2d at 163.
47. Id.
48. Id. at 532.
49. Id.
50. Id. at 534.
complaint did not address the independent contractor issue and otherwise came potentially within coverage.\textsuperscript{51} A declaratory judgment action was brought before resolution of the underlying case, and the insurer sought to demonstrate that the insured was in fact an independent contractor.\textsuperscript{52} The court held that the independent contractor issue had to be decided in the underlying case because the issue of whether the insured was an independent contractor was contested in the underlying case.\textsuperscript{53} Hence, the complaint came potentially within coverage and the insurer was prevented from proving an exclusion to cut-off its duty to defend until the underlying case was finally resolved.\textsuperscript{54} The court described its application of the cut-off rule as follows:

\begin{quote}
We direct that IN\textsuperscript{A} [the insurer] reimburse Associated [the insured's subrogee] for the defense costs Associated has incurred in defending Blond [the insured] to date; the amount of these expenses is to be determined by the trial court below upon remand. We note that this obligation of IN\textsuperscript{A}'s is in no way dependent upon whether it is ultimately found that IN\textsuperscript{A}'s policy affords Blond coverage, and, more particularly, whether it is determined that Blond was acting as an agent or independent contractor at the time of the accident.

We find that at the present time the underlying complaint against Blond is still potentially within the coverage of IN\textsuperscript{A}'s insurance policy. Therefore, IN\textsuperscript{A} remains Blond's primary insurer and is obligated to reimburse Blond for future costs of his defense. If and when it is determined with finality, in the underlying suit, that Blond was acting as an independent contractor at the time of the accident, Blond will be denied coverage under IN\textsuperscript{A}'s policy, and correspondingly, IN\textsuperscript{A}'s duty to reimburse Blond for the costs of his defense will end.\textsuperscript{55}
\end{quote}

In \textit{Insurance Co. of Illinois v. Markogiannakis},\textsuperscript{56} the Illinois Appellate Court reaffirmed the cut-off rule in a case where – like \textit{Associated Indemnity} and \textit{Envirodyne} – the facts pertinent to the insurer's defense did

\begin{flushleft}
\textsuperscript{51} \textit{Id.}
\textsuperscript{52} \textit{Associated Indem.}, 386 N.E.2d at 535.
\textsuperscript{53} \textit{Id.} at 544-45.
\textsuperscript{54} \textit{Id.}
\textsuperscript{55} \textit{Id.}
\end{flushleft}
A BREAK FROM THE TWO-FRONT WAR

not appear on the face of the underlying complaint. In Markogiannakis, the insured, Stellios Markogiannakis, went to a condominium unit he owned to collect rent from John Mason, who had been renting the unit from him for three years.\(^{57}\) When leaving the apartment, Markogiannakis was called into the condominium unit owned by Julia Crawley, an officer of the condominium association.\(^{58}\) Markogiannakis and Crawley argued over association fees owed by Markogiannakis, and at some point Crawley was injured when she was knocked down either directly by Markogiannakis or by a door that he pushed.\(^{59}\) Crawley filed a complaint against Markogiannakis alleging that he either negligently or intentionally injured her.\(^{60}\) The complaint said nothing about why Markogiannakis was in her unit at the time of the injury or what they were discussing.\(^{61}\) The insurer, Insurance Company of Illinois ("ICI") refused to defend because it learned from some source other than Crawley's complaint that Markogiannakis was at the condominium to collect rent and, subsequently, to discuss association fees with Crawley. ICI claimed that a business pursuits exclusion applied.\(^{62}\) ICI filed a declaratory judgment action promptly but did not move for summary judgment until after the underlying case was over and it had been determined that Markogiannakis was liable on the basis of negligence but not intentionally harmful conduct.\(^{63}\) Since the underlying case was concluded, there was no question as to whether the court could consider facts extrinsic to the underlying complaint in determining coverage. The court considered the facts concerning why Markogiannakis was at the condominium and determined that the business pursuits exclusion applied.\(^{64}\) This ruling relieved ICI from paying the judgment against Markogiannakis, but it did not relieve ICI from paying his defense costs. The court stated:

[W]e must look to Julia Crawley's complaint in the underlying personal injury action to determine whether her claim was potentially covered by the insured's homeowner's policy at the time ICI was requested to tender a defense. If the allegations of the complaint indicated potential coverage, and no allegation clearly indicated non-coverage, ICI had a duty to defend, which must be satisfied by reimbursing the insured for his costs in defending the

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57. Id. at 1083.
58. Id.
59. Id.
60. Id. at 1083-84.
61. Id. at 1084.
63. Id.
64. Id. at 1090.
Crawley lawsuit. Count I of the Crawley complaint alleged negligent conduct potentially covered under the policy. As we have observed, nowhere in the complaint is there an allegation or even a suggestion that Markogiannakis' conduct took place in a business context or that the encounter between the two parties was in any way related to a business or rental activity of the insured. While it is clear from the statements in ICI's denial letter that it had knowledge, from another source, of the business context of the altercation, this knowledge is of no consequence in determining whether a duty to defend existed based on the allegations of the complaint.  

 Accordingly, the court held that ICI had to reimburse Markogiannakis for his defense costs incurred in the underlying action.

The above discussion demonstrates that Illinois courts, prior to the Illinois Supreme Court decision in Midwest Sporting Goods, have already clarified several points concerning when the duty to defend arises and when it ends: (1) the duty to defend arises as soon as the potential for indemnity coverage exists (i.e. when a complaint against the insured comes potentially within coverage of the policy); (2) the duty to defend is not negated by the insurer's or the insured's knowledge of facts that prove non-coverage or trigger an exclusion; (3) an insurer must secure a judicial determination that such facts eliminate the potential for indemnity coverage to cut-off its duty to defend; (4) the duty to defend continues from the time of the filing of the lawsuit until the insurer obtains a judicial determination eliminating the potential for indemnity coverage; and (5) a judicial determination that facts extrinsic to the underlying complaint eliminate the potential for indemnity coverage does not retroactively eliminate the duty to defend.

III. CAN THE DUTY TO DEFEND BE ELIMINATED RETROACTIVELY IN AN EIGHT-CORNERS CASE?

What about an eight-corners case? An eight-corners case is one where the sole question is whether the allegations of the complaint against the

65. Id. at 1094.
66. Id. at 1095.
68. Clemmons, 430 N.E.2d at 1108.
69. Chandler, 702 N.E.2d at 638.
70. Clemmons, 430 N.E.2d at 1109.
72. Id. at 639.
insured come potentially within the coverage of the insurance policy. It is a case where there is no question of whether facts extrinsic to the underlying complaint prove non-coverage or trigger an exclusion. The insurer and insured merely disagree as to whether the complaint allegations create a potential for indemnity coverage. In this circumstance, the only information at issue in determining whether there is a duty to defend is: (i) the allegations found within the four-corners of the underlying complaint, and (ii) the terms and conditions found within the four-corners of the insurance policy.

As noted above, the insurer must decide at the outset whether the allegations of a complaint against its insured create a potential for indemnity coverage and trigger its duty to defend. If the insurer has doubts, it can file a declaratory judgment action and see if the court agrees that there is no potential for indemnity coverage. But, what if the declaratory judge does agree? Illinois law instructs the declaratory judge as follows: "In order to determine whether the insurer’s duty to defend has arisen, the court must compare the allegations in the underlying complaint to the policy language." If the underlying complaint alleges facts within or potentially within policy coverage, an insurer is obligated to defend its insured even if the allegations are groundless, false or fraudulent. "The allegations in the underlying complaint must be liberally construed in favor of the insured." This is the process for making a judicial determination as to whether a duty to defend exists in an eight-corners case.

When a declaratory judge applies this process in an eight-corners case and determines that there is no duty to defend, does that mean that there never was a duty to defend, or in other words, that there never was a potential for indemnity coverage? Most insurers would probably argue that this is the case – that when they obtain a declaration in a four-corners case that there is no duty to defend, the declaration means that there never was any potential for coverage, and consequently, that they had no obligation to pay defense costs between the time the underlying complaint was filed against their insured and the time when the declaratory court issued a

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73. The concept of the eight-corners case is often utilized by Illinois courts in describing a process for determining whether there is a duty to defend in the context of a declaratory judgment action. Although some courts call it the “four-corners” case (or rule), reference to the “eight-corners” case is more appropriate because courts consider the corners of both the insurance policy and the underlying complaint. See Pekin Ins. Co. v. Fid. & Guar. Ins. Co., 830 N.E.2d 10, 14 (Ill. App. Ct. 2005).
75. Clemmons, 430 N.E.2d at 1108.
77. Wilkin, 578 N.E.2d at 930.
78. Outboard Marine, 607 N.E.2d at 1220 (citing Wilkin, 578 N.E.2d at 930).
judgment. This view endorses the idea that, in an eight-corners case, the question of whether an insurer has a duty to defend at the time a complaint is filed against its insured can be determined retroactively by referencing the result of a declaratory judgment action.

The best argument in favor of the retroactive view is that the declaratory judge is merely following the same process that an insurer is supposed to follow at the outset in determining whether a duty to defend exists. Hence, if the declaratory judge agrees with the insurer, it is ratifying the insurer's initial determination that no duty to defend ever existed. However, the retroactive view is incorrect. It has never been held by an Illinois court to be the law. It ignores the fact that construction and application of insurance policy terms is a judicial function, the result of which is continually in doubt until a court actually rules, and it leads to the absurd result that an insurer can "honor" its duty to defend by subjecting its insured to a two-front war.

The better view, and the one adopted by Midwest Sporting Goods as the law of Illinois, is that when an insurer is in doubt enough about coverage to file a declaratory judgment action, even in an eight-corners case, a potential for indemnity coverage - and hence a duty to defend - exists. Moreover, that duty to defend cannot be extinguished retroactively based on the result of the declaratory judgment action. In an eight-corners case, the duty to defend is triggered when the underlying complaint is filed against the insured and the insurer has a question about whether the policy coverage applies to the factual allegations contained in the complaint. The function of the declaratory judgment action is to obtain a judicial construction of the insurance policy terms as applied to the factual allegations to eliminate or affirm the potential for coverage that exists due to the possibility that the judicial construction issue could be decided in favor of coverage. The result is the same as in the extrinsic fact cases. The judicial act of issuing a declaration concerning policy construction and application resolves the uncertainty existing before the declaration and either eliminates or affirms the potential for coverage. If coverage is affirmed, it is clear that there always was a potential for coverage, and hence, a duty to defend. If the declaration eliminates the potential for coverage, then the insurer's duty to defend is cut off - it is not retroactively eliminated.

80. Id. at 1104.
81. Id. at 1098.
82. Id.
83. Id. at 1104.
The adoption of this view in *Midwest Sporting Goods* was foreshadowed in the *Markogiannakis* case. As noted above, *Markogiannakis* was an extrinsic facts case, which held that the insurer's proof of facts extrinsic to the underlying complaint merely cut off — but did not retroactively eliminate — the insurer's duty to defend. However, the *Markogiannakis* court also clearly indicated that it believed the result would be the same even if the coverage-defeating facts appeared on the face of the underlying complaint:

> [E]VEN IF MARKOGIANNAKIS' PURPOSE IN GOING TO CRAWLEY'S BUILDING IN ORDER TO COLLECT RENT AND/OR CRAWLEY'S INQUIRIES ABOUT THE CONDOMINIUM ASSOCIATION FEES HAD BEEN STATED OR INDICATED ON THE FACE OF THE COMPLAINT, THE WELL-RECOGNIZED AMBIGUITY OF THE "ORDINARILY INCIDENT TO NON-BUSINESS PURSUITS" CLAUSE IN HOMEOWNER'S POLICIES WOULD HAVE HAD TO BE CONSIDERED IN DETERMINING WHETHER IT WAS CLEARLY APPARENT THAT HER PERSONAL INJURY CLAIM WAS BEYOND POLICY COVERAGE. BECAUSE OF THE NECESSITY FOR A JUDICIAL CONSTRUCTION OF THIS CLAUSE, IN THIS AND SIMILAR CASES, THE APPLICABILITY OF THE "BUSINESS PURSUITS" EXCLUSION WOULD NOT HAVE BEEN CLEAR AND FREE FROM DOUBT AT THE TIME ICI WAS REQUESTED TO DEFEND THE CASE.

Hence, the *Markogiannakis* court rejected the retroactivity rule in the eight-corners context. It stated, albeit in *dicta*, that the need for a judicial construction of policy language creates enough uncertainty as to whether the policy terms will apply to the factual allegations against the insured that the potential for indemnity coverage, and thus the duty to defend, exists until a coverage-defeating judicial construction is obtained by the insurer.

**IV. MIDWEST SPORTING GOODS**

This brings us to the *Midwest Sporting Goods* case. *Midwest Sporting Goods* was an eight-corners case. There was never a question as to whether facts extrinsic to the underlying complaint could prove non-coverage or trigger an exclusion. The sole duty to defend question was

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85. *Id.* at 1094 (emphasis added).
86. *Id.*
whether the factual allegations in the complaint created the potential for indemnity coverage under the insurance policy. 

The facts of the underlying case are an important part of Chicago history. As part of Mayer Daley's campaign to reduce gun violence in Chicago, the City of Chicago and Cook County brought suit against a number of gun manufacturers and distributors, including Midwest Sporting Goods ("Midwest"), seeking damages for injuries to citizens due to gun violence in Chicago and seeking injunctions to stop the alleged dangerous conduct of the defendants. The complaint alleged that Midwest and others negligently entrusted guns to suspect purchasers and created a public nuisance by such actions.

A sample of the alleged conduct involved follows:

The city and the county alleged in the complaint that during 1998 undercover police officers went to Midwest's store in Cook County to test the measures Midwest took to prevent guns from getting into criminal hands. One officer purchased a[n] Uzi. According to the complaint: "The sales clerk said that since they could not legally deliver the Uzi to him in Cook County, they would have to write up the purchase order on the forms of the Midwest Sporting Goods' Downers Grove store, and he would have to pick up the firearm at the Downers Grove store. The sales clerk used a blank purchase order with the Downers Grove masthead, and he called the Downers Grove store and asked them to call in his FOID [firearm owners identification card] number. When Officer 1 said that he wanted to purchase a pistol barrel for the Uzi, the sales clerk told him that since it was illegal to put the pistol barrel on the Uzi, he should write up the pistol barrel as a separate purchase from Midwest's Lyons store (the one he was in at the time) rather than the Downers Grove store from which he was technically buying the Uzi. The sales clerk also advised Officer 1 that he should have all of the purchases written up on separate orders so as to avoid ATF [United States Bureau of Alcohol Tobacco and Firearms] scrutiny." When the officer picked up the Uzi in Downers

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89. The appellate court described the relief sought as follows: "The city and the county seek injunctions and damages, including costs of emergency medical services and the 'Bureau of Health's costs to treat victims of firearms violence,' estimated to exceed $50,000,000 for the period from 1994 through 1998." Id. at 1155.
Grove, a Midwest employee advised him “to put the Uzi in his trunk, because he would be arrested if caught with it in Cook County.” The same officer purchased six other guns at Midwest between September 30 and October 24, 1998.\(^91\)

The insurance policies at issue agreed to defend Midwest against claims for bodily injury caused by an “occurrence,” defined as “an accident, including continuous or repeated exposure to substantially the same harmful conditions.”\(^92\) The policies also included an expected or intended injury exclusion.\(^93\) After construing the policy terms and reviewing the facts necessary to prove causes of action for negligent entrustment and public nuisance, the court determined that the expected or intended injury exclusion did not apply, but the pattern of alleged conduct and the conduct necessary to prove the identified causes of action could not fairly be described as “accidents.”\(^94\) Consequently, the court held that there was no duty to defend.\(^95\)

Thus, in an eight-corners case, the court compared the allegations of the underlying complaint to the insurance policy terms and made a judicial determination that the insurer did not have a duty to defend.\(^96\) An important question remained, however. The insurer, General Agents Ins. Co. of America, Inc. (“General Agents”), had agreed to defend Midwest under a reservation of rights while General Agents pursued its declaratory judgment action seeking a declaration that it had no duty to defend.\(^97\) The reservation of rights letter included a reservation to seek reimbursement of any defense costs paid in the event a court determined that it did not have a duty to defend.\(^98\) Up to the point in time where the appellate court affirmed that it had no duty to defend, General Agents had paid approximately $40,000 towards Midwest’s defense.\(^99\) On the theory that the appellate court’s ruling meant that it never had a duty to defend, General Agents filed a motion in the trial court seeking reimbursement of the $40,000.\(^100\) The trial court agreed.\(^101\) Midwest then appealed that decision.\(^102\)

\(^{91}\) Id.
\(^{92}\) Id. at 1155.
\(^{93}\) Id.
\(^{94}\) Id. at 1159.
\(^{95}\) Midwest Sporting Goods Co., 765 N.E.2d at 1160.
\(^{96}\) Id.
\(^{98}\) Id. at 1094.
\(^{99}\) Id. at 1095.
\(^{100}\) Id.
\(^{101}\) Id.
\(^{102}\) Id.
The appellate court fundamentally agreed with General Agents and adopted the retrospective rule. General Agents argued before the appellate court that because its prior opinion determined that there was no duty to defend, then there never was a duty to defend and Midwest would be unjustly enriched if it were allowed to retain the $40,000. Midwest argued before the appellate court that General Agents’ defense costs payments were made pursuant to the insurance contracts and that since the insurance contracts governed their relationship—and did not include a provision allowing for reimbursement of defense costs—the theory of unjust enrichment was inapplicable. The appellate court held as follows:

Contrary to Midwest’s central assertion, we find that Gainsco [General Agents] did not make the payments to Midwest’s counsel pursuant to the insurance contract. Instead, Gainsco made these payments as an accommodation pending litigation to determine whether Gainsco owed Midwest, under the insurance contract, a defense to the City of Chicago’s lawsuit. Midwest accepted the conditions Gainsco placed on the accommodation by accepting the checks it received. Just as our supreme court enforced the terms of the accommodation the parties made in *McKechney*, we find the accommodation here enforceable. The trial court properly enforced the accommodation by ordering Midwest to reimburse Gainsco the amount Gainsco paid for defense against claims not covered by Gainsco’s policy.

Consequently, because the appellate court adopted the retrospective rule, it believed that there was no applicable contract governing General Agents’ payment of defense costs or whether General Agents was entitled to seek reimbursement of those defense costs. Given that view, the appellate court supplied a rule of decision based on fairness. General Agents was basically doing a favor for Midwest by funding its defense until the declaratory judgment action ran its course, and, because General Agents offered that accommodation on the condition that it would be entitled to be reimbursed if it won the declaratory judgment action, it was only fair that the court enforce the condition.

104. *Id.*
105. *Id.*
106. *Id.* at 624.
107. *Id.*
108. *See id.*
The Illinois Supreme Court disagreed with the fundamental premise of the retrospective rule and reversed the appellate court, holding that in fact General Agents' defense costs payment were made pursuant to its duty to defend under the insurance contracts. The Illinois Supreme Court set out the parties' arguments in detail, and specifically noted that the key difference between the parties was whether General Agents' payment of defense costs and alleged right to reimbursement were governed by a contract (i.e. the insurance policy) or not.

The court then stated as follows:

Gainsco argues that we need not look to the insurance contract between the parties to determine whether Gainsco had a right to reimbursement because the circuit and appellate courts have already determined that Gainsco owed no duty to defend. Gainsco maintains that because it had no duty to defend, it follows that there is no contract governing the relationship between the parties. The problem with this argument is that Gainsco is attempting to define its duty to defend based upon the outcome of the declaratory judgment action. Although an insurer's duty to indemnify arises only after damages are fixed, the duty to defend arises as soon as damages are sought.

Hence, the Illinois Supreme Court clearly rejected the retrospective rule in this eight-corners case. The court focused on the fact that General Agents had some uncertainty about whether it had a duty to defend. That uncertainty related to whether the policy provisions covered alleged conduct that could be characterized as intentional or willful – precisely the issue on which the appellate court's decision concerning General Agents' duty to defend later turned. General Agents' duty to defend therefore arose at the time the city and county filed their suit against Midwest because the complaint against Midwest alleged facts that might or might not have been covered, depending on how a court would ultimately construe certain policy terms and apply them to the alleged facts. Thus, the court accepted the dicta in Markogiannakis that, in an eight-corners case, a complaint can come potentially within indemnity coverage because

110. Id. at 1097.
111. Id. at 1103 (emphasis added).
112. Id.
113. Id. at 1104.
114. See id. at 1095-96.
116. Markogiannakis, 544 N.E.2d at 1094.
there is uncertainty about how the policy provisions will be construed and applied to the alleged facts by a court.117

The Illinois Supreme Court was also clear about giving guidance to lower courts as to what an insurance company should do when it is uncertain as its duty to defend.118 Quoting a Wyoming Federal District Court with approval, the court stated:

The question as to whether there is a duty to defend an insured is a difficult one, but because that is the business of an insurance carrier, it is the insurance carrier's duty to make that decision. If an insurance carrier believes that no coverage exists, then it should deny its insured a defense at the beginning instead of defending and later attempting to recoup from its insured the costs of defending the underlying action. Where the insurance carrier is uncertain over insurance coverage for the underlying claim, the proper course is for the insurance carrier to tender a defense and seek a declaratory judgment as to coverage under the policy. However, to allow the insurer to force the insured into choosing between seeking a defense under the policy, and run the potential risk of having to pay for this defense if it is subsequently determined that no duty to defend existed, or giving up all meritorious claims that a duty to defend exists, places the insured in the position of making a Hobson's choice.119

Notably, the Illinois Supreme Court does not suggest that it is an option for the insurer to refuse to defend the insured and drag the insured into court as a proper way to honor its duty to defend.120 If the insurer is uncertain enough about coverage to file a declaratory judgment action, its duty to defend has been triggered and it should pay the insured's defense costs while the declaratory court sorts out the uncertainty.121

Having rejected the retrospective rule, the Illinois Supreme Court adopted the cut-off rule. That is, where the insurer is uncertain enough as to its duty to defend to file a declaratory judgment action, its duty to defend

118. Id. at 1102.
120. Id.
121. Id. at 1104.
arises and continues until the declaratory judge issues a decision finding that there is no coverage.\textsuperscript{122} The court applied the cut-off rule as follows:

Although Gainsco implies that it has always maintained that it did not owe Midwest a defense in the underlying matter, we note that Gainsco's reservation of rights letter reveals some uncertainty concerning coverage. With regard to allegations in the underlying claim that Midwest was liable to the plaintiffs for various acts of intentional and/or willful conduct, Gainsco's reservation of rights letter stated that "the claim \textit{may not be} covered under the Policy." Given this uncertainty, Gainsco correctly agreed to pay Midwest's defense costs in the underlying action and sought a declaratory judgment that it did not owe Midwest a defense. Gainsco thus \textit{remained obligated to defend} Midwest as long as any questions remained concerning whether the underlying claims were covered by the policies. Because Gainsco's obligation to defend continued until the trial court found that Gainsco did not owe Midwest a defense, Gainsco is not entitled to reimbursement of defense costs paid pending the trial court's order in the declaratory judgment action. The fact that the trial court ultimately found that the underlying claims against Midwest were not covered by the Gainsco policies does not entitle Gainsco to reimbursement of its defense costs.\textsuperscript{123}

To summarize, the Illinois Supreme Court's decision in \textit{Midwest Sporting Goods} brings clarity to the following issues in an eight-corners case: (1) the supreme court rejected the retrospective rule and held that an insurer must make a decision as to whether it will defend or not at the time it is presented with a complaint against the insured;\textsuperscript{124} (2) any uncertainty, even as to how policy terms will be construed and applied to alleged facts, creates a potential for coverage and triggers the duty to defend;\textsuperscript{125} (3) if the insurer files a declaratory judgment action to eliminate the uncertainty, it must pay the insured's defense costs while the declaratory judge sorts out the coverage issues;\textsuperscript{126} (4) if the insurer obtains a declaration in its favor, it

\textsuperscript{122}. \textit{Id.}
\textsuperscript{123}. \textit{Midwest Sporting Goods Co.}, 828 N.E.2d at 1104 (second and third emphases added).
\textsuperscript{124}. \textit{See id.}
\textsuperscript{125}. \textit{Id.}
\textsuperscript{126}. \textit{Id.}
will not be entitled to recover defense costs already paid\(^{127}\) as a judgment in the insurer's favor merely cuts off its duty to defend;\(^ {128}\) and (5) the insurer cannot reserve the right to be reimbursed for paying defense costs while a declaratory judgment action is pending because it does not have that right in the first place.\(^ {129}\) It pays defense costs because the policy obligates it to do so.\(^ {130}\)

V. \textit{KEY IMPLICATION OF MIDWEST SPORTING GOODS – THE END OF THE TWO-FRONT WAR}

\textit{Midwest Sporting Goods} puts an end to the two-front war. Now, when an insurer files a declaratory judgment action, it indicates its uncertainty by the very act of seeking judicial guidance.\(^ {131}\) And this is true regardless of whether the coverage question relates to facts extrinsic to the underlying complaint (an extrinsic facts case) or the need to obtain a judicial construction and application of policy terms to alleged facts (an eight-corners case).\(^ {132}\) Consequently, the insurer must pay the insured's defense costs while it pursues a declaration of non-coverage.\(^ {133}\) This eliminates the two-front war because the insured never has to fight two lawsuits with its own money. Even if the insurer wins its declaratory judgment action, the insured will have paid only one set of attorneys at each point in time. During the declaratory judgment action, the insurer pays the attorneys defending the underlying action and the insured pays only its coverage attorneys. If the insurer wins, the insured picks up paying for defense of the underlying case, but the coverage action is over.

Permitting a two-front war allows for abuse. If an insurer is permitted to refuse to defend and file a declaratory judgment action against its insured, it could do so in every case, regardless of whether it is uncertain about its obligations. Thus, even in cases where there is clearly potential coverage and the insurer has a duty to defend, it could refuse to defend and file a declaratory judgment action. If the insured has enough money to fight the declaratory judgment suit and obtains good counsel, some day (maybe years later), the court will rule in its favor and make the insurer pay past defense costs. However, in many cases, either the insured will not have sufficient financial resources to fight the two-front war (keep in mind that the insured has to defend itself while fighting its insurer) or the insured will

\(^{127}\) Id.
\(^{128}\) Id.
\(^{129}\) Midwest Sporting Goods Co., 828 N.E.2d at 1104.
\(^{130}\) Id.
\(^{131}\) Id.
\(^{132}\) See id.
\(^{133}\) Id.
settle cheaply because the cost of the two-front war outweighs the benefit of winning it (e.g. in relatively small underlying cases, it is often more cost effective to forget about insurance since it is so expensive to enforce coverage in a two-front war circumstance).

The *Midwest Sporting Goods* rule creates a strong set of incentives for an insurer to act in good faith towards its insured. First, since bringing a declaratory judgment action against an insured automatically means that the insurer will have to pay defense costs in the underlying case, insurers will think twice about suing their insureds except in cases where their coverage defenses are strong. Second, insurers’ incentive to drag out expensive declaratory judgment actions will be reduced because they have to keep paying underlying defense costs until they obtain a favorable resolution. And third, the option of using the two-front war as an economic hammer to force insureds to settle claims cheaply will be eliminated. Hence, the incidence of weak declaratory judgment suits will be reduced, such actions will be decided more quickly and efficiently, and claims will be settled more fairly.

VI. IS THERE STILL ROOM AFTER *MIDWEST* TO ARGUE FOR THE TWO-FRONT WAR?

I do not think so, but one can anticipate the sorts of arguments insurers will make to try to save the two-front war tactic.

A. FLATLY DENYING ALL CLAIMS WILL NOT WORK

Insurers may focus on the Illinois Supreme Court’s discussion concerning General Agents’ uncertainty about coverage and try to read it narrowly. The court focused on the fact that General Agents in its reservation of rights letters said only that the alleged intentional or willful conduct of Midwest “may” not be covered by the policy. Interestingly, while the court focused on General Agents’ uncertainty (use of the word “may”) with respect to intentional or willful conduct, it earlier quoted General Agents’ reservation of rights letter that indicated no uncertainty as to lack of coverage because the city and county complaint sought only economic damages: “The policy only applies to damages because of property damage or bodily injury caused by an occurrence. The First Amended Complaint does not seek damages because of property damages or bodily injury. As such, the claim is not covered under the Policy.”

134. See id.
136. Id.
137. Interestingly, while the court focused on General Agents’ uncertainty (use of the word “may”) with respect to intentional or willful conduct, it earlier quoted General Agents’ reservation of rights letter that indicated no uncertainty as to lack of coverage because the city and county complaint sought only economic damages: “The policy only applies to damages because of property damage or bodily injury caused by an occurrence. The First Amended Complaint does not seek damages because of property damages or bodily injury. As such, the claim is not covered under the Policy.” *Id.* at 1094 (emphasis added). This was in fact the basis of the trial court’s ruling (i.e. that the damages sought were solely economic damages and not damages for bodily injury or property damage). *Id.* at 1095. Yet, the court still applied the cut-off rule. The only conclusion is that the fundamental basis of the court’s
may reason that as long as they use stronger denial language, courts will not perceive any uncertainty by them as to coverage. They then will be free to file declaratory judgment actions in every case they choose and not pay defense costs. And, this will work even if insurers are uncertain about coverage – as long as they say they are certain there is no coverage in their letters to insureds.

One objection to this work-around is that it suggests that the Illinois Supreme Court intended to promote dishonest denials of coverage by insurers. That seems unlikely. More fundamentally, however, why would an insurer file a declaratory judgment action if it was certain that it had no duty to defend? Declaratory judgment actions are expensive for insurers too. If an insurer is certain that there is no coverage, it has the option of flatly denying coverage and taking the chance that it is wrong and estopped from raising defenses to indemnity coverage, as in 

Clemmons and Chandler. The fear of estoppel may be an incentive to file a declaratory judgment action when an insurer has the slightest doubt about its coverage position – but the slightest doubt is all it takes to trigger the insurers’ duty to defend! Hence, the fact that an insurer files a declaratory judgment action is dispositive as to the existence of its uncertainty concerning its coverage position. Moreover, making the filing of a declaratory judgment action a bright-line rule as to uncertainty will promote respect for the rules set forth in Midwest Sporting Goods rather than creative work-around tactics.

B. MIDWEST SPORTING GOODS CANNOT BE LIMITED TO REIMBURSEMENT CASES

Midwest Sporting Goods was a reimbursement case. General Agents “correctly” defended under a reservation of rights and promptly brought its coverage action. We know from that case that an insurer who follows that route will not be entitled to reimbursement of the defense costs paid. Or, in other words, the result will be that the insurer pays the defense costs of the insured while the insurers’ declaratory judgment action

finding of uncertainty on the part of General Agents is the fact that General Agents was uncertain enough about its coverage position that it felt compelled to file a declaratory judgment action rather than just flatly deny coverage and take its chances that it would later be estopped to deny indemnity coverage as in Clemmons and Chandler.

139. Chandler, 702 N.E.2d 634.
141. Id. at 1093.
142. Id. at 1094.
143. Id. at 1104.
A BREAK FROM THE TWO-FRONT WAR

is pending.144 And, even if the insurer wins the declaratory judgment action, it will not be entitled to recover the defense costs it paid.145

Can an insurer get around this result by refusing to pay defense costs while its declaratory judgment action is pending? Insurers will argue that the Illinois Supreme Court decided in 1999 that, when faced with uncertainty as to coverage, they had two options: (1) defend under a reservation of rights, or (2) promptly file a declaratory judgment action seeking judicial guidance.146 Moreover, State Farm Fire & Casualty Co. v. Martin, also held that these options are independent alternatives, meaning that insurers can follow Illinois law by choosing either option.147 Insurers will question: how can the rule in Martin be consistent with an interpretation of Midwest Sporting Goods that says insurers must pay defense costs while pursuing a declaratory judgment action?

While this argument has some surface appeal, it is incorrect. The Martin case was dealing solely with the estoppel rule discussed earlier in connection with the Clemmons148 and Chandler149 cases.150 There was no question in Martin as to whether State Farm had to pay the insured’s defense costs because, having been abandoned by State Farm, the insured (who was in jail for arson) allowed the underlying case to proceed to a default judgment.151 There were no defense costs.152 Martin was solely about whether State Farm was estopped from raising defenses to indemnity coverage because it had not “secured” a declaration of non-coverage prior to resolution of the underlying case.153 Martin, in fact, stands for the proposition that by either filing a declaratory judgment action or defending under a reservation of rights, an insurer uncertain about its duty to defend can avoid estoppel, especially in default cases like Martin.154 However, pursuant to Midwest Sporting Goods, once the insurer files its declaratory judgment action, if the insured is defending itself, the insurer will be subject to a motion to pay the insureds defense costs while the declaratory action is pending.155 There is no inconsistency between the rules set forth in Martin and those set forth in Midwest Sporting Goods.

144. Id.
145. Id.
146. Martin, 710 N.E.2d at 1231.
147. Id. at 1232.
149. Chandler, 702 N.E.2d 634.
150. Martin, 710 N.E.2d at 1230.
151. Id.
152. Id.
153. Id. at 1231.
154. Id. at 1232.
In addition, given the result in *Midwest Sporting Goods*, it would be absurd to allow insurers to avoid paying defense costs while their declaratory judgment action is pending. After *Midwest Sporting Goods*, it is unquestionably the law of Illinois that the insurer who defends under a reservation of rights while simultaneously pursuing a declaratory judgment action will not be able to recover those defense expenses.156 Such an insurer has followed a path of good faith in protecting its insured while seeking guidance from the court to clear up uncertainty over coverage issues. Given this state of the law, it hardly makes sense to reward the insurer who acts in bad faith by abandoning its insured while simultaneously suing it. If insurers successfully convince Illinois courts to restrict *Midwest Sporting Goods* to reimbursement cases, there would be no more reimbursement cases because insurers would be strongly discouraged from defending under a reservation of rights while pursuing a declaratory judgment action. Such a rule would promote bad faith denials of coverage by insurers and create incentives to abandon—rather than protect—insureds.

C. RECENT APPLICATION IN THE ILLINOIS APPELLATE COURT – SECOND DISTRICT

Recently, one panel of the Illinois Appellate Court - Second District correctly applied *Midwest Sporting Goods* in determining whether an insurer who lost in the trial court had to advance defense costs while its appeal was pending.157 When the trial court ruled in favor of the insured, it ordered the insurer to post a bond for defense costs already incurred and required the insurer to advance defense costs.158 Relying on *Martin*, the insurer argued that it had fulfilled the requirements of law by filing a declaratory judgment action, and that it need not also pay the insured’s defense costs while that declaratory judgment action proceeded to a conclusion.159 The appellate court disagreed and, citing *Midwest Sporting Goods*, held that the insurer was required to post the bond and advance costs through conclusion of the appeal.160 The appellate court also noted that the insurer would not be able to recover those defense costs if it won the appeal.161

156. *Id.*
158. *Swiderski Electronics*, 834 N.E.2d at 566.
159. *Id.* at 576.
160. *Id.* at 577.
161. *Id.* at 577 n.3.
Another panel of the Illinois Appellate Court - Second District subsequently incorrectly applied Midwest Sporting Goods in a rescission case. Before any claim had been brought, the insurer had filed an action for rescission of an errors and omissions liability policy against the insured brokers asserting that the brokers had made material misrepresentations in securing the policy. While the rescission action was pending, a construction company client sued the brokers for negligence and fraud. The insurer denied coverage and amended its rescission action to include additional bases for refusing to cover the construction company suit. The trial court stayed the amended rescission suit because it involved issues that were also involved in the underlying construction company suit. The brokers then asked the trial court to order the insurer to pay their defense costs in the construction company suit until such time as the rescission case could be decided.

Incorrectly relying on Martin, the appellate court held in Professional Underwriters that the insurer had honored its duty to defend by filing a declaratory judgment action and need not also pay defense costs. Somehow this panel of the appellate court missed the fact that Martin did not involve defense costs and made no ruling whatever about the duty to pay defense costs while a coverage action is pending. The appellate court stated:

Defendants attempt to distinguish the rule in Martin by noting that there the supreme court addressed only the issue of whether the insurer was estopped from later denying coverage to the insured because it had filed a declaration that it owed no coverage instead of defending the insured under a reservation of rights. Defendants correctly recite part of the holding in Martin, but they overlook its holding that an insurer may opt to file a declaratory judgment action instead of defending the insured and thus suspend the duty to defend pending the resolution of the declaratory judgment action.

162. See Prof'l Underwriters Agency, Inc., 848 N.E.2d 597.
163. Id. at 598-99.
164. Id. at 599.
165. Id.
166. Id. at 600.
167. See id.
169. Id. at 601 (emphasis added).
Martin made no such ruling – not even in dicta.\textsuperscript{170} As noted above, Martin (a default judgment case) did not involve defense costs.\textsuperscript{171} Martin stands for the proposition that an insurer can avoid estoppel as to paying any judgment or settlement by filing a prompt declaratory action and not paying defense costs.\textsuperscript{172} The appellate court’s statement in Professional Underwriters that Martin held the filing of a declaratory judgment action “suspects the duty to defend” is simply incorrect. Martin never said any such thing.\textsuperscript{173} And, of course, this conclusion is flatly contrary to the express holding of Midwest Sporting Goods, which did deal with the issue of whether an insurer is obligated to pay defense costs pending resolution of a timely filed declaratory judgment action.\textsuperscript{174} The appellate court curtly dismissed Midwest Sporting Goods as a reimbursement case that had nothing to do with the issue it was facing.\textsuperscript{175}

It may be that the appellate court in Professional Underwriters was motivated by the fact that the insurer had an already pending rescission action prior to the construction company suit being brought.\textsuperscript{176} It may have had in mind that a defense of rescission, which could result in a ruling that the policy was void ab initio, is somehow different from asserting policy defenses or non-coverage and supports a special rule.\textsuperscript{177} It did not, however, take that approach.\textsuperscript{178} Rather, it equated the rescission defense with any other defense and ruled based on its incorrect interpretations of Martin and Midwest Sporting Goods.\textsuperscript{179} Having departed so dramatically from the Illinois Supreme Court’s ruling in Midwest Sporting Goods,\textsuperscript{180} the Second District’s opinion in Professional Underwriters should not be followed in future cases.

VII. CONCLUSION

The Midwest Sporting Goods case brings much needed clarity to the thorny area of law concerning an insurer’s duty to defend. Now, when an insurer is presented with a complaint against its insured and is uncertain about coverage, the rules are simple and straightforward: it must: (i) defend its policyholder under a reservation of rights; (ii) file a declaratory

\textsuperscript{170} See Martin, 710 N.E.2d 1228.
\textsuperscript{171} Id. at 1230.
\textsuperscript{172} Id. at 1232.
\textsuperscript{173} See id.
\textsuperscript{174} Midwest Sporting Goods Co., 828 N.E.2d at 1104.
\textsuperscript{175} Prof’l Underwriters Agency, Inc., 848 N.E.2d at 602.
\textsuperscript{176} Id. at 598-99.
\textsuperscript{177} See id. at 598-99.
\textsuperscript{178} Prof’l Underwriters Agency, Inc., 848 N.E.2d 597.
\textsuperscript{179} See id.
\textsuperscript{180} Midwest Sporting Goods Co., 828 N.E.2d at 1104.
judgment action seeking a judgment that it has no duty defend AND pay the policyholder’s defense costs until a judgment is obtained; or (iii) refuse to defend and take its chances that it will be estopped from raising policy defenses to any judgment or settlement if it is wrong.

In the event an insurer attempts to launch a two-front war, the insured now has a remedy. It can file a motion in the trial court requesting that the insurer pay its defense costs in the underlying case until the coverage issues raised in the declaratory judgment action are resolved. In light of the Illinois Supreme Court’s ruling in *Midwest Sporting Goods*, that motion should be routinely granted.