

Insurer Found to Be Reasonable in Disclaiming Coverage Even Though Illinois Appeals Court Found Coverage for UIM Benefits

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Summary: Automobile insurer brought a declaratory judgment action against insureds and automobile rental company seeking to disclaim liability for underinsured motorist (UIM) benefits arising out of a collision between the insureds' vehicle and a rental vehicle. Insureds filed counterclaims for breach of insurance policy and vexatious refusal to pay and the rental company filed counterclaims including request for declaration that it did not provide liability insurance arising out of the collision. After partial summary judgment was granted to the insurer by the trial court, the insureds appealed. The appellate court held the insureds were not required to exhaust the minimum financial responsibility amounts required to be provided by rental companies before they could collect UIM benefits and the insurer's conduct was not vexatious and unreasonable.

The insureds were involved in an automobile accident with a vehicle owned by the rental company and driven by Carlos Velez. At the time of the accident, both the insureds and Velez had insurance. The insureds had a policy through Safeway, which included UIM coverage with limits of \$100,000.00 per person and \$300,000.00 per occurrence. When he rented the vehicle from the rental company, Velez declined a liability insurance supplement and instead chose to rely on his own insurance policy through his own insurer, which had limits of \$20,000.00 per person and \$40,000.00 per occurrence. At the time of the accident, the rental company was in compliance with the Illinois statute requiring proof of financial responsibility and was therefore authorized to do business in the State of Illinois. The financial responsibility statute requires the rental company to insure "the operator of the rented motor vehicle against liability upon such insured to a minimum amount of \$50,000.00 because of bodily injury to, or death of any one person or damage to property and \$100,000.00 because of bodily injury to, or death of two or more persons in any one motor vehicle accident."

As a result of the accident, the insureds recovered \$40,000.00 (the policy limits) from Velez's insurer. Because that amount did not cover the insureds' injuries and because they had paid for underinsured motorist coverage, the insureds claimed UIM coverage and demanded arbitration of their claims pursuant to their policy with Safeway. Safeway disputed coverage because it believed it was not obligated to pay under its UIM coverage until after the limits of liability under all applicable bodily injury policies had been exhausted by payment of judgments or settlements and the rental company had not been exhausted. After several months of exchanging letters between the insureds and Safeway, Safeway filed a declaratory judgment action against its insureds and the rental company. Safeway asked the court to declare that its policy did not provide coverage for the UIM claims and that Safeway was not obligated to pay, settle or arbitrate the UIM claims. The insureds filed a counterclaim asserting breach of insurance contract based upon Safeway's failure to arbitrate their UIM claims and for unreasonable and vexatious conduct based on Safeway's handling of the insureds' claims.

The insureds and Safeway then filed cross-motions for summary judgment. The insureds argued that the rental company did not provide liability coverage in this matter because they offered primary insurance and Velez declined to purchase it. In so declining, Velez and the rental company agreed as stated in the rental agreement that any insurance that provides coverage to Velez shall be primary and such primary insurance shall be responsible for the payment of all personal injury and/or property damage claims up to the limits of that primary insurance. The insureds argued that based upon the provisions in the rental agreement, they exhausted all applicable coverage as required under the Safeway UIM provision in the policy, and therefore, Safeway had an obligation to arbitrate their claims.

Safeway argued that both Velez's personal policy and the rental company's liability as owner of the rented vehicle must be exhausted before Safeway's UIM coverage was triggered and that the rental company was not absolved of liability when its customer's personal policy is less than the statutory required minimum for owners of rental vehicles under the financial responsibility statute. Furthermore, Safeway contended its conduct was not vexatious and unreasonable under the Illinois Insurance Code because there was a *bona fide* issue of coverage in this case.

The appellate court found that Safeway owed its insureds UIM benefits based upon the policy the insureds had purchased. The appellate court found that if the rental company were forced to pay for the insureds' shortfall, the outcome would insulate Safeway and would not at all protect the insureds or injured insureds like them. The appellate court reasoned that the insureds were in a much better position to reflect on the terms of the Safeway policy than Velez would have been in signing the rental car agreement. Therefore, Safeway should provide primary insurance coverage.

However, the appellate court acknowledged Safeway was obligated to comply with the process for handling the UIM claims set out in its policy, including arbitrating those claims. Under Illinois law, the insureds were entitled to recover relief including attorneys' fees if Safeway was found to be unreasonable and vexatious in its refusal to arbitrate or cover the UIM claims. The appellate court found that there were factors indicating the rental company's priority, including that the statutorily mandated minimum for a motor vehicle's insurance policy is less than the statutorily mandated financial responsibility liability for a rental company. Because of this factor and the scarcity of case law addressing the issue, the appellate court found Safeway's conduct was not vexatious or unreasonable. Safeway's interpretation of its policy was a viable one, but with the facts in the case, its interpretation contravened public policy. Ultimately, the appellate court found that the trial court did not abuse its discretion in not awarding the insureds their attorneys' fees.

This case again illustrates a situation in a first party context where an insurer is ultimately found to have coverage under its policy or to have misinterpreted its own policy may still not be liable for extra contractual damages because it acted reasonably in its handling of the claim. If the law in Illinois had been more clear-cut with more Illinois case law addressing this issue, the appellate court may not have given the insurer the benefit of the doubt in this case. Thus, it is very important to understand the jurisdiction you are in to determine how much leeway courts will give in awarding extra-contractual damages when coverage has been found and whether in that jurisdiction the coverage position was "fairly debatable" based on the law at the time the coverage decision was made.