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When Your Insurance Company Defends You...Will You Be Left with the Bill?

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The typical commercial general liability (CGL) insurance policy requires the insurer to defend any claim made against an insured that alleges facts within or potentially within the policy's coverage. The requirement stands even if the allegations are groundless, false or fraudulent. In addition, if several theories of recovery are alleged in the underlying complaint, the insurer's duty to defend arises even if only *one* of them is within the potential coverage of the policy. Furthermore, Illinois law (and the law of most other states) requires an insurer that takes the position that the complaint is not covered by the policy to defend the lawsuit under a reservation of rights or seek a declaratory judgment that there is no coverage.

Case Law: How Illinois Differs from Most Other States

More than 10 years ago, an insurer in California defended a policyholder under a reservation of rights. Among the rights the insurer reserved was the right to recover defense costs from that insured in the event it *was* ultimately determined that the insurer did not have a duty to defend. When it was ultimately determined that the policyholder was not entitled to a defense, the insurer sought reimbursement of all the money it spent on that insured's defense. That case, *Buss v. Superior Court*, went to the California Supreme Court, which held that the insurer was, in fact, entitled to recover its defense costs. Although many states follow the *Buss* rule, Illinois is not one of them.

When an insurer in Illinois made the same argument in a 2005 case, the Illinois Supreme Court ultimately disagreed with the *Buss* decision. In *General Agents Insurance Company v. Midwest Sporting Goods*, the Illinois Supreme Court held that the CGL insurer was not entitled to reimbursement of defense costs paid before the trial court determined that the insurer did not owe a duty to defend, even though the insurer's reservation of rights letter stated that the insurer would not waive its right to recoup defense costs. The court's reasoning was that (1) the insurance policy did not entitle the insurer to recover defense costs and (2) the insurer could not unilaterally modify its contract, through a reservation of rights letter, to allow for reimbursement.

As the Illinois Supreme Court observed, 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 insurer, it is the insurer's duty to make that decision. If an insurer believes that no coverage exists, then it should deny its policyholder a defense at the beginning instead of defending and later attempting to recoup the defense cots. But

where the insurer is uncertain over coverage, the proper course is to defend and seek a declaratory judgment as to coverage under the policy. Otherwise, the insured is forced to choose between two undesirable options: (1) seek a defense and run the risk of having to pay for that defense if it is ultimately determined that no duty to defend existed, or (2) give up all meritorious claims that a duty to defend exists.

The Illinois Supreme Court also observed that, by defending under a reservation of rights, the insurer avoids the risk that an inept defense of the underlying lawsuit may expose it to greater liability if it is determined that the insured's ultimate liability is covered. Therefore, defending under a reservation of rights is at least as beneficial to the insurer as it is to the insured. If the insurer could recover defense costs, the insured would be required to pay for the insurer's own protection against the risks of not being allowed to deny coverage if it defended without reserving its rights.

The Upshot for Policyholders in Illinois

The *Midwest Sporting Goods* decision has led some insurers to add an endorsement to their policies requiring the insured to repay defense costs if it is finally determined that the policy would not cover the insured. In deference to Illinois Supreme Court's reasoning as to why insurers should not be entitled to seek reimbursement, we recommend that policyholders and their brokers be on the lookout for such endorsements. Not all insurers are requiring them, and those that do may be willing to negotiate. Nevertheless, the decision to accept or reject such an endorsement should be made on a fully informed basis. Accordingly, all policyholders should consult with their insurance brokers and legal advisors before making such a decision.

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