

**UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF ILLINOIS**

ST. PAUL MERCURY INSURANCE)	
COMPANY,)	
)	
Plaintiff,)	
)	
v.)	Case No. 01-1382
)	
ELLEN D. FOSTER, as Executrix of the)	
Estate of Thomas S. Foster and as Co-)	
Trustee of the Thomas S. Foster Trust)	
executed April 14, 1994, et al.,)	
)	
Defendants.)	

ORDER

This matter is now before the Court on Plaintiff, St. Paul Mercury Insurance Company’s (“St. Paul”), Motion Regarding Remaining Coverage Issues and the responses of the various Defendants in this matter. Based on the assertion that certain claims can now be finally disposed of now that judgment has been entered in the underlying litigation, St. Paul makes essentially five arguments: (1) the Counterclaims by the Foster Defendants and Cole Defendants for Vexatious Delay should be dismissed; (2) the Cole Defendants’ Counterclaim for willful and wanton misconduct should be dismissed; (3) St. Paul had no duty to defend any of the Defendants sued only for restitution in Count IX in the Keach case; (4) St. Paul does not owe any defense or indemnification obligations to the Co-Trustees of the Thomas Foster Trust because they are not “insureds”; and (5) St. Paul is entitled to judgment that there is no coverage for any Defendants because the only available remedy to the underlying claimants was restitution, which is not an insurable “loss”. While St. Paul’s

assertion that each of these claims was somehow made ripe by the entry of judgment in the underlying litigation is incorrect, as some of the arguments could clearly have been raised in the prior summary judgment proceedings, each argument will be addressed in turn because it is not in the interests of justice to try a claim that should not properly be submitted at trial.

DISCUSSION

I. Vexatious Delay Counterclaims

St. Paul first contends that there can be no claim that it vexatiously delayed any indemnification, as the entry of judgment in favor of the insureds in the underlying litigation negates any claim for indemnification. While this may be true in some respects (assuming that the Court's finding of no liability is upheld on appeal), the greater point of contention in this case appears to be the claim that St. Paul vexatiously denied its duty to defend.

St. Paul argues that it cannot be held to have breached its duty to defend where it followed the recommended procedure of bringing a declaratory judgment action. However, while the cases cited by St. Paul, namely Insurance Corporation of Ireland, Ltd. v. Board of Trustees of Southern Illinois University, 937 F.2d 331, 337 (7th Cir. 1991), and Tews Funeral Home, Inc. v. Ohio Casualty Insurance Company, 832 F.2d 1037, 1042 (7th Cir. 1987), do address the three options available to an insurer in Illinois, they do not involve claims of vexatious denial of a defense or stand for the proposition that an insurer that brings a declaratory judgment action can never be found to have vexatiously denied or delayed a duty to defend.

Under Illinois law, an insurer has three options when an insured requests that it defend a third party action which the insurer believes to be outside the scope of the policy in question. The insurer can:

(1) seek a declaratory judgment regarding its obligations before or pending trial of the underlying action, (2) defend the insured under a reservation of rights, or (3) refuse either to defend or to seek a declaratory judgment at the insurer's peril that it might later be found to have breached its duty to defend.

Maneikis v. St. Paul Insurance Co. of Illinois, 655 F.2d 818 (7th Cir. 1981); Tews Funeral Home, 832 F.2d at 1042. As an important benefit of a liability policy is the defense of liability claims that have been filed against the insured, the duty to defend is considerably broader than the duty to indemnify, and an insurer may be obligated to defend actions which are not in fact covered under its policy. Conway v. Country Casualty Ins. Co., 92 Ill.2d 388, 442 N.E.2d 245 (1982); Richardson v. Illinois Power Co., 217 Ill.App.3d 708, 711, 577 N.E.2d 823 (1991). If any of the allegations against an insured in the underlying lawsuit are even potentially within the scope of the policy, an insurer has an obligation to defend that insured even if other theories of recovery are specifically excluded under the policy. National Union Fire Insurance Co. v. Gelnview Park District, 158 Ill.2d 116, 124, 632 N.E.2d 1039 (Ill. 1994); Maryland Casualty Co. v. Peppers, 64 Ill.2d 187, 194, 355 N.E.2d 24 (Ill. 1976); Bedoya v. Illinois Founders Insurance Co., 293 Ill.App.3d 668, 674-75, 688 N.E.2d 757 (1st Dist. 1997); Tews Funeral Home, 832 F.2d at 1042.

When considering a claim for vexatious delay, the Court must consider the totality of the circumstances in determining whether the insurer's position was willful and without reasonable cause. Buais v. Safeway Ins. Co., 275 Ill.App.3d 587, 656 N.E.2d 61 (1st Dist. 1995). See Citizens First State Bank of Princeton v. Cincinnati Insurance Co., 200 F.3d 1102, 1110 (7th Cir. 2000) (noting that generally an insurer's conduct will not be deemed vexatious if there is a bona fide dispute concerning the scope and application of coverage, a legitimate policy defense, a genuine legal or factual issue regarding coverage, or a reasonable legal position on an unsettled issue of law.) While the prompt and proper filing of a declaratory judgment action may effectively serve to

insulate an insurer from subsequent claims for vexatious delay under certain circumstances, the totality of the circumstances reflected in the record in this case are not such that the Court can find as a matter of law prior to trial that St. Paul's conduct fits within this general rule. *See Old Republic Insurance Company v. Chuhak & Tecson, P.C.*, 906 F.Supp. 1177, 1179 (N.D.Ill. 1995).

St. Paul cites Citizens First National Bank of Princeton for the proposition that taking an unsuccessful position in coverage litigation cannot establish vexatious delay. However, the record thus far could permit a reasonable fact finder to conclude that St. Paul's conduct went far beyond merely taking an unsuccessful position, particularly with respect to the circumstances surrounding the issuance of the policy, attempts to obtain a corrected policy, ultimate reformation of the policy, bringing this declaratory judgment action, and some of the coverage defenses asserted, as well as the directive under Illinois law that the duty to defend extends to all claims asserted against an insured even if only one of the claims is potentially covered under the policy. Accordingly, St. Paul's Motion is denied in this respect, and this issue will proceed to trial.¹

II. Willful and Wanton Misconduct

St. Paul seeks the dismissal of the Cole Defendants' Counterclaim for willful and wanton misconduct based on the assertion that such a claim is essentially duplicative of, and is therefore preempted by, the vexatious delay statute, 215 ILCS 5/155. This claim was raised and implicitly rejected in the summary judgment proceedings, where the Court found that since coverage was at least potentially available for the ESOP, summary judgment was inappropriate. Had the Court

¹ St. Paul has submitted the Affidavit of Michele Whitney indicating that she has been in charge of paying the attorneys' fees submitted by counsel for the Cole Defendants in the underlying action since June 2002. While this may be a factor to consider at trial, it is not dispositive of the entire vexatious delay claim as suggested by St. Paul and is another example of an issue that has nothing to do with matters that have become ripe for decision in the wake of the judgment entered in Keach.

accepted St. Paul's preemption argument, the claim would have failed in its entirety regardless of the outcome of the underlying litigation, and summary judgment could have been granted at that time.

Moreover, St. Paul relies on Kush v. American States Insurance Co., 853 F.2d 1380 (7th Cir. 1988), Bagcraft Corp. v. Federal Insurance Co., 848 F.Supp. 115 (N.D. Ill. 1994), and Bageanis v. American Bankers Life Assurance Co., 783 F.Supp. 1141, 1149 (N.D.Ill. 1992), all of which attempted to predict how the Illinois Supreme Court would rule on similar, although not identical, questions. All of these decisions predate the Illinois Supreme Court's decision in Cramer v. Insurance Exchange Agency, 174 Ill.2d 513, 675 N.E.2d 897 (Ill. 1997).

In Cramer, the Illinois Supreme Court specifically mentioned the Kush and Bageanis cases in examining the relationship between the vexatious delay statute and the tort of bad faith and the conflicting approaches that had been taken by courts addressing the issue. Id. at 522. The court noted that a defendant may engage in conduct that both breaches a contract and constitutes a separate and independent tort before going on to note that well-established tort actions, such as common law fraud, require proof of different elements and remedy a different harm than that addressed by the vexatious delay statute by "address[ing] insurer misconduct that is not merely vexatious and unreasonable." Id. at 523. After finding that the vexatious delay statute provides the insured with an extra-contractual remedy for insurer misconduct that does not rise to the level of a well-established tort, the Illinois Supreme Court reaffirmed that allegations of more than mere bad faith or unreasonable and vexatious conduct could form the basis of a separate and independent tort action that could stand along with the breach of contract action. Id. at 526-27. "In cases where a plaintiff actually alleges and proves the elements of a separate tort, a plaintiff may bring an independent tort action . . . for insurer misconduct." Id. at 527.

Here, the Court cannot find as a matter of law that the Cole Defendants' Counterclaim for willful and wanton misconduct is fairly characterized as nothing more than an artfully pleaded bad faith claim, as it involves more than mere allegations of bad faith or unreasonable conduct and goes beyond a claim that the insurer breached its duty of good faith and fair dealing. Rather, the Cole Defendants assert that St. Paul's actions in continuing to ignore evidence of the parties' original intent to provide fiduciary liability coverage for the ESOP, the existence of a mistake, and the voluntary reformation undertaken by its employees were affirmatively carried out for the specific purpose of harming them, which essentially amounts to allegations of intentionally tortious behavior. A showing of willful and wanton misconduct also involves different elements of proof from those required to be established under the vexatious delay statute, as a showing of willful, wanton, or reckless disregard is not required to prevail under § 155. Under the standard set forth in Cramer, the Court cannot find that this aspect of the Cole Defendants' Counterclaim is necessarily preempted, and St. Paul's Motion seeking a contrary finding is therefore denied.

III. Duty to Defend Defendants Sued Only in Count IX

In two paragraphs, St. Paul next contends that because the Court has found that it had no duty to indemnify any of the Defendants sued only for restitution in Count IX of the underlying complaint, it also had no duty to defend them. In support of this argument, St. Paul cites Crum & Forster Managers Corp. v. Resolution Trust Co., 620 N.E.2d 1073 (Ill. 1993). St. Paul argues that unlike other Defendants against whom claims other than the purely restitutional claim in Count IX were asserted, the sole claim asserted against the Defendants named only in Count IX was clearly outside the scope of coverage and did not trigger any duty to defend.

The Defendants contend that the policy requires only that a claim be made against an insured for any act connected with any breach of fiduciary duty. Noting the well-settled principle that the

duty to defend is broader than the duty to indemnify, they then assert that as the policy provides coverage for any loss, including defense costs, for which the insureds shall become obligated to pay on account of any claim made against the insureds for any act in connection with any breach of fiduciary duty, the policy applies to the Count IX Defendants for purposes of defense costs.

Defendants also point to language in Crum & Forster indicating that “[i]f the facts alleged in the underlying complaint fall within, or potentially within, the policy’s coverage provisions, then the insurer has a duty to defend the insured in the underlying action.” Id. at 393. In this respect, the present situation is distinguishable from Crum & Forster, where the insured sought a defense under their real estate agents and brokers professional liability policy for claims that did not arise or result because of their performance of real estate services. Id. at 393-94.

St. Paul fails to recognize any difference between a claim that does not fall within the policy’s substantive coverage provisions and an element of damages that is deemed uninsurable as a matter of public policy. The Court cannot conclude that any claim for defense costs by the Count IX Defendants would not be “potentially within” the coverage provisions of the policy despite the fact that St. Paul would have had no duty to indemnify them for any judgment that could have been entered against them on that claim. St. Paul’s Motion is therefore denied in this respect.

IV. Duty to Defend or Indemnify the Co-Trustees

In another argument that is in no way made ripe for resolution by the entry of judgment in the underlying litigation, St. Paul seeks a declaration that it does not owe any defense or indemnity obligations to the Co-Trustees of the Thomas Foster Trust because they are not insureds. Initially, the Court notes that it has already determined on summary judgment that St. Paul would have no duty to indemnify the Co-Trustees because they were named Defendants only with respect to the restitution claim asserted in Count IX, and the Court had already determined that no viable claim

remained for damages against the closed estate. That being said, the question of whether St. Paul owes the Co-Trustees a duty to defend remains.

The Co-Trustees respond that they qualify as “insureds” under the policy because they are the only remaining legal representatives of Thomas Foster, who would unquestionably have been an insured under the policy. They also note that the terms of the Foster Trust identify them as the successor legal representatives of the Foster Estate and that they clearly stood in the place and represented the interests of Foster in the Keach litigation.

The policy at issue defines “insured” to include:

any natural person who was or now is or may hereafter be a director, officer or employee of the Parent Company, Plan Sponsor or of any Plan and, in addition, the estate, heirs or legal representatives of any such natural person who is deceased or incompetent.

The term “legal representatives” is not further defined in the policy, and any doubts related to the interpretation of undefined or ambiguous contractual terms are generally to be resolved in favor of the insured. Outboard Marine Corp. v. Liberty Mutual Insurance Co., 154 Ill.2d 90, 607 N.E.2d 1204 (Ill. 1992). Moreover, the Co-Trustees cite non-binding authority indicating that a legal representative includes persons other than an executor or administrator of an estate who stand in place of and represent the interests of an individual. As St. Paul has cited no binding or persuasive precedent establishing that the Co-Trustees of the Foster Trust do not qualify as Foster’s legal representative under the policy, its Motion must fail.

V. Insurable Loss

Apparently dissatisfied with the Court's previous ruling that the underlying complaint contains allegations giving rise to an "insurable loss" under the terms of the policy, St. Paul once again attempts to obtain a ruling that there is no coverage for any Defendant as a matter of law because the only available remedy was restitution. This argument has nothing to do with and was not made ripe by the entry of judgment in the underlying litigation. As the Court does not know how its prior findings to the contrary (i.e., that the relief sought by the plaintiffs in the Keach case included more than just restitution of purportedly ill-gotten gains) could have been any clearer, what amounts to yet another attempt to seek reconsideration on this issue merits no further discussion and is summarily denied.

CONCLUSION

For the reasons set forth above, St. Paul's Motion Regarding Remaining Coverage Issues [#265] is DENIED. This matter remains set for final pretrial conference at 10:00 a.m. on Wednesday, April 14, 2004, in person in Peoria.

ENTERED this 7th day of April, 2004.

(Signature on Clerk's Original)

Michael M. Mihm
United States District Judge