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Illinois Court Addresses Insurer's Duty To Pay For Insured's Affirmative Claim

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In its recent decision in *Great American E&S Insurance. Co. v. Power Cell LLC*, 2018 WL 6696550 (N.D. Ill. Dec. 20, 2018), the United States District Court for the Northern District of Illinois held that Great American Insurance Company had a duty to defend Power Cell, LLC, d/b/a Zeus Battery Products in a lawsuit involving the recall of the claimants' products, and the duty extended to Zeus's affirmative claims.

The origin of the parties' dispute was a product recall initiated by Spring Window Fashions ("SWF"), a business that sells battery-operated window shades. SWF assigned blame for window shade failures to the Zeus batteries the company used. However, Zeus believed the window products' failure was due to a design flaw in SWF's products. Zeus stated that SWF's false recall notices had harmed Zeus's reputation, and it subsequently filed suit against SWF seeking a declaration that its batteries were safe along with recovery for the alleged misrepresentation. In response, SWF counterclaimed, alleging breaches of warranty and negligence and demanding indemnification for the cost of the Zeus batteries, the cost of replacing the batteries in the window products, and damages associated with the recall.

Zeus' insurer, Great American, filed a declaratory judgment action seeking a ruling that it owed no coverage for the losses SWF was seeking to recover from Zeus. Great American cited two reasons for its position: First, Great American argued that the Counterclaim filed against Zeus did not seek compensation for losses "because of" "property damage" caused by "an occurrence" within the meaning of the policy. Second, Great American asserted that Zeus failed to provide Great American with timely notice of the potential claim.

With respect to the first issue, the Great American policy stated that it will "pay those sums that the Insured becomes legally obligated to pay as damages because of 'property damage' caused by an 'occurrence.'" The Policy defines "property damage" as "physical injury to tangible property, including all resulting loss of use of that property."

Although the complaint against Zeus cited certain instances where customers' window shades were alleged damaged as a result of the Zeus batteries, there was no suggestion in the complaint that SWF itself was seeking recovery for that property damage. Great American argued that property damage that is not itself part of the injured party's damage calculation is "tangential" to the relevant claim and not covered under the Policy.

The court rejected that argument, finding that it was not necessary for SWF be seeking recovery for "property damage" it suffered, but rather all it must show is that it is seeking damages "because of" property damage, even if that damage was suffered by a third party. The court concluded that damages sought "because of" property damage include consequential damages precipitated by property damage, including those that do not affect the plaintiff's own tangible property.

Great American also argued that Zeus failed to provide timely notice of SWF's claim. The notice provision in Great American's policy provided that an insured party "must see to it that we [Great American] are notified as soon as practicable of an occurrence which may result in a claim or suit which may involve this policy..." The Illinois Supreme Court has held that "as soon as practicable" means "within a reasonable time," and in assessing the reasonableness of the time for providing notice to an insurer, Illinois courts consider five factors: "(1) the specific language of the policy's notice provision; (2) the insured's sophistication in commerce and insurance matters; (3) the insured's awareness of an event that may trigger insurance coverage; (4) the insured's diligence in ascertaining whether policy coverage is available; and (5) prejudice to the insurer." *West Am. Ins. Co. v. Yorkville Nat. Bank*, 238 Ill.2d 177 (Ill. 2010). Here, the court found that each of the five factors were either neutral or tilted in Zeus's favor and in view of the presumption that the court should construe an insurance policy strictly against the insurer, Zeus was entitled to summary judgment on the issue of notice.

Finally, the court held that Great American's policy also required it to prosecute Zeus's affirmative claim against SWF as that claim included a request for a declaration that Zeus' batteries were not defective. The court recognized that the duty to defend "encompasses all litigation by which the insured could defeat its liability." *Great W. Cas. Co. v. Marathon Oil Co.*, 315 F. Supp. 2d 879, 882-83 (N.D. Ill. 2003). Great American expressly conceded that "any declaration Zeus Batteries were safe would . . . bind SWF and prohibit SWF from collecting its recall costs." As success on its affirmative claim would reduce or eliminate Zeus's liability to SWF, the court concluded that Great American's policy required it to pursue both Zeus's affirmative claim against SWF and defend against SWF's counterclaims.