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Insurance Law Update

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Recent Illinois Supreme Court Decision Holds That Statute of Limitations Against Insurance Producers Commences When Defective Policy Is Issued

Historically, Illinois appellate courts have held that the two-year statute of limitations that applies to negligent procurement claims against insurance producers (brokers and agents) begins running when insureds learn that they have been wrongfully injured, which typically is when their insurance company denies coverage under a defective insurance policy. See, e.g., *Scottsdale Ins. Co. v. Lakeside Community Committee*, 2016 IL App (1st) 141845, ¶¶ 27-31 (citing cases). In *American Family Mutual Insurance Co. v. Krop*, 2018 IL 122556, however, the Illinois Supreme Court declined to apply the discovery rule followed by *Lakeside Community Committee* and other prior Illinois appellate decisions, holding instead that "when customers have the opportunity to read their insurance policy and can reasonably be expected to understand its terms, the cause of action for negligent failure to procure insurance accrues as soon as the customers receive the policy." *Krop*, 2018 IL 122556, ¶ 2.

In early 2012, Walter and Lisa Krop asked an American Family insurance agent to provide them with a homeowner's insurance policy that provided coverage "equal to the coverages provided by" their existing homeowner's policy. *Id*. ¶ 4.

More than two years after the Krops received their American Family policy, they were sued in an underlying action alleging defamation, invasion of privacy, and emotional distress. *Id*. ¶ 5. American Family refused to defend the underlying action because, unlike the Krops' previous homeowner's insurance policy, the American Family policy did not provide coverage for defamation or invasion of privacy. *Id*. ¶¶ 7-8. American Family filed a declaratory judgment action against the Krops, seeking a ruling that it had no duty to defend or indemnify the Krops.

In response, the Krops brought a third-party complaint against the American Family insurance agent alleging that he had negligently failed to provide them with a policy equal to their prior policy and a counterclaim against American Family alleging that it was vicariously liable for its agent's negligence. *Id*. ¶ 8.

Both the agent and American Family moved to dismiss, alleging that the suit was time-barred pursuant to Section 13-214.4 of the Illinois Code of Civil Procedure, 735 ILCS 5/13-214.4, which creates a two-year statute of limitations for claims against insurance brokers and agents. *Krop*, 2018 IL 122556, ¶ 9. Section 13-214.4 provides, in relevant part, that:

> All causes of action brought by any person . . . under any statute or legal or equitable theory against an insurance producer . . . concerning the sale, placement, procurement, renewal, cancellation of, or failure to procure any policy of insurance shall be brought within 2 years of the date the cause of action accrues.

735 ILCS 5/13-214.4.

The trial court granted American Family and the agent's motions, holding that the statute of limitations expired two years after the Krops received their policy. *Krop*, 2018 IL 122556, ¶ 10. The appellate court reversed, holding that the statute of limitations did not commence until the Krops knew or should have known about their injury, *i.e.*, when American Family denied coverage.

The Illinois Supreme Court disagreed with the appellate court's application of the discovery rule and reinstated the trial court's order dismissing the Krops' negligence claims, finding that the cause of action accrued when the Krops received the deficient insurance policy. In so ruling, the Illinois Supreme Court undertook an analysis of when a cause of action against an insurance producer accrues.

The court noted that "Illinois courts have typically treated allegations of negligence in relation to insurance policies, such as [negligent procurement], as torts arising out of contractual relationships." *Id*. ¶ 18. Thus, according to the court, a cause of action against an insurance agent accrues when the insured receives the policy, as "the earliest date of accrual for torts arising out of contractual relationships is the date of the breach of the duty or contract, not the date of the damages." *Id*. Because the date of the breach was when the agent procured the American Family policy with the coverage missing, which was more than two years before the Krops sued the American Family agent, the Supreme Court concluded that their claims were time-barred.

The Supreme Court rejected the Krops' argument that the appellate court had correctly applied the so-called "discovery rule," that is, the rule that the limitations period does not commence "until the claimant knew or reasonably should have known of the injury and that the injury was wrongfully caused." *Id*. ¶ 21. The Supreme Court's primary reasons for holding that the discovery rule should not apply were: (1) insurance consumers have "an obligation to read their policies and understand the terms" as soon as the policies are purchased (*id*. ¶ 22); and (2) prior Illinois cases applying the discovery rule in negligent procurement cases against insurance brokers were based on the existence of a fiduciary duty that no longer exists under Illinois law. *Id*. ¶¶ 26-29.

In ostensible support of its position that the discovery rule should be inapplicable to insurance agent negligence claims, the Supreme Court made some questionable statements—particularly with regard to unsophisticated consumers like the Krops, who were buying a personal lines policy—including: "[c]ustomers generally know their own goals better than their insurance agent does" and "[e]xpecting customers to read their policies and understand the terms incentivizes them to act in good faith to purchase the policy they actually want, rather than to delay raising an issue until after the insurer has already denied coverage." *Id*. ¶ 29.

The Supreme Court also stated that "we recognize that there will be a narrow set of cases in which the policyholder reasonably could not be expected to learn the extent of coverage simply by reading the policy," like when policies contain "contradictory provisions or fail to define key terms," or when "the circumstances that give rise to the liability may be so unexpected that the typical customer should not be expected to anticipate how the policy applies." *Id*. ¶ 36. However, the court went on to state that the "alleged facts of this case do not present such an exceptional circumstance where a customer should not be expected to understand the terms of the policy" because the policy's definition of "bodily injury" stated that bodily injury only includes emotional or mental injuries that "arise[ ] out of actual bodily harm to the person." *Id*. ¶ 37.

Justice Mary Jane Theis dissented, opining that the majority was wrong in concluding that the claim against the agent sounded in contract rather than tort and, as a result, commencing the statute of limitations at the time of the breach. *Id*. ¶ 46. Justice Theis explained that negligence claims against insurance agents and brokers are authorized by Section 2–2201(d) of the Illinois Code of Civil Procedure, 735 ILCS § 5/2-2201, and claims—like those brought by the Krops—

alleging that an insurance producer negligently failed to procure the correct coverage sound in negligence, which are tort-based claims. *Id*. ¶¶ 47-49. As Justice Theis continued, negligence claims accrue when the underlying plaintiff knows or reasonably should have known that an injury occurred, and the injury in negligent procurement claims is "when the plaintiff sustains a loss for which an insurance claim is not covered but would have been covered if the requested insurance had been properly procured or if the plaintiff had been timely notified of the rejection of the risk." *Id*. ¶ 52. Until the Krops received a coverage denial, their injury was "purely contingent and speculative" and, therefore, Justice Theis determined that the statute of limitations should have commenced when American Family denied the Krops' claim. *Id*. ¶¶ 53-54.

Justice Theis pointed out that the majority's holding that the statute of limitations for a negligent procurement claim commences when the policy is procured could have the consequence of allowing a "cause of action to be barred before any actionable injury resulted." *Id*. ¶ 65. As Justice Theis explained, if the Krops "had brought suit in 2012 when they received the allegedly defective policy, their complaint would not have survived a section 2-615 motion to dismiss because no actual damages had yet occurred." *Id*. As she continued, "[u]nder the majority's view, the cause of action for negligent procurement by an insurance producer under section 2-2201 is essentially a dead letter if the underlying liability claim is not brought within two years from the date the policy was issued." *Id*.

Conclusion

Although the *Krops* decision appears to be a significant win for insurance producers, it could have the unintended effect of increasing the number of lawsuits against producers. Under the majority's holding, since the limitations period commences before the insured is damaged by way of a coverage denial, insureds now have an incentive to sue within two years of receiving a defective policy even if they have not suffered an uninsured loss or claim. Of course, this concern presupposes that insureds, including those buying personal lines policies, will have sufficient knowledge and understanding of policy language and the complex body of Illinois insurance law that will permit them to identify deficiencies in their policies resulting from the negligence of insurance producers or agents.

About the Author

Seth D. Lamden is a litigation partner at *Neal, Gerber & Eisenberg LLP* in Chicago. He concentrates his practice on representing corporate and individual policyholders in coverage disputes with their insurers. In addition to dispute resolution, Mr. Lamden counsels clients on matters relating to insurance and risk management, including maximizing insurance recovery for lawsuits and property damage, policy audits and procurement, and drafting contractual insurance specifications and indemnity agreements. He obtained his B.A. from Brandeis University and his J.D., *magna cum laude*, from The John Marshall Law School.

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