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COZEN O'CONNOR

Court Rewrites Insurance Policy to Create Defense Obligation in Favor of "Implied Coinsured" Tenant

Sheckler v. Auto-Owners Insurance Company, 2021 WL 493226, 2021 Ill. App. LEXIS 593 (Oct. 23, 2021), a decision of the Appellate Court of Illinois, Third Judicial District, concluded that principles of equity justified rewriting the liability coverage in a landlord's insurance policy. The policy specifically identified only the landlord as an "insured" entitled to defense and indemnity but the court determined it should also extend a defense and indemnity obligation to tenants whenever someone other than the landlord "sues the [tenant] to recover for fire damage to the [landlord's] structure." 2021 WL 493226, 2021 Ill. App. LEXIS 593, *19-20. Of the three justices on the *Sheckler* panel, one dissented and another concurred only in the result, meaning that the reasoning of the *Sheckler* decision is only that of a single jurist.

The *Sheckler* case arose in the context of a subrogation claim by Auto-Owners, the landlord's insurer, against a contractor (aptly named Workman) for Workman's alleged role in causing a gas explosion and fire at the insured premises, a single family home leased to Sheckler. The circumstances suggest that Sheckler potentially bore substantial responsibility for the fire. However, Auto-Owners chose not to sue Sheckler directly, acknowledging that the "implied coinsured" doctrine adopted in *Dix Mutual Insurance Co. v. LaFramboise*, 149 Ill. 2nd 314, 597 N.E. 2d 622 (Ill. 1992) protected Sheckler from direct liability to Auto-Owners. Predictably, Workman filed a third-party claim seeking contribution from Sheckler. Sheckler filed a separate declaratory judgment action against Auto-Owners, arguing that Sheckler was entitled to defense and indemnity under Auto-Owners' liability coverage because Sheckler was, ostensibly, a "coinsured" under the Auto-Owners policy.

The trial court in the declaratory judgment action entered summary judgment in favor of Auto-Owners. While the appeal of that ruling was pending, |a jury in the underlying subrogation action returned a verdict in favor of Workman. Thus, all that remained at stake in the appeal of the declaratory judgment action was whether Auto-Owners was obligated to reimburse Sheckler's defense costs. Epitomizing the bromide that "bad cases make bad law," the appellate court's decision reversed the trial court and held that Auto-Owners had been obligated to provide Sheckler with a defense in the underlying subrogation lawsuit.

In reaching its conclusion, the *Sheckler* decision purported to rely upon the "implied coinsured" doctrine as articulated by the Illinois Supreme Court in its 1992 decision in *Dix Mutual*. However, the *Sheckler* decision stretches the implied coinsured doctrine beyond all recognition. The implied coinsured doctrine, when it applies, serves only to immunize the tenant from the landlord's *property* insurer's subrogation claim. It does not logically follow, from the limited scope and purpose of the doctrine, that the landlord's property insurer would also be obligated to absorb the cost of defending the tenant against a third party's claim for contribution. The implied coinsured doctrine has been adopted, in various contexts and varying circumstances, by a number of jurisdictions throughout the country. None, prior to the *Sheckler* decision, have attempted to expand its scope in the way *Sheckler* does.

The *Sheckler* decision is particularly problematic because the property insurance provisions of a landlord's insurance policy do not extend a liability defense benefit to the landlord, much less to the landlord's tenant. Liability defense obligations, when they exist at all, arise under liability coverage, not property coverage. As the dissenting justice stated in *Sheckler*:

> [E]ven if *Dix* had announced a new and different general rule regarding the status of tenants *vis-à-vis* their landlords' insurance policies, the decision expressly limited its application to the equitable right of subrogation. *Dix*, 149 Ill. 2d at 323, 173 Ill.Dec. 648, 597 N.E.2d 622. It offers no authorization to apply such a rule when determining an insurer's duties to defend or

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> to indemnify. Whether Auto-Owners has a duty to defend is the specific issue in the instant case, and it presents a question of law, not equity, to be answered based on the specific language of the insurance contract, not the lease. *Dix* does not apply to inform that decision. In other words, *Dix* has nothing to do with this case.

2021 WL 4932296, 2021 Ill. App. LEXIS 593, *25

Moreover, liability policies typically include a provision excluding coverage for claims involving damage to the insured's (the landlord in this case) *own* property. These exclusions maintain the clear delineation between property coverage and liability coverage — a delineation the author of the *Sheckler* decision failed to grasp, or even acknowledge. The author of the *Sheckler* decision did acknowledge, but was blithely unconcerned by, the fact that the decision's holding directly contradicted the language of the landlord's policy and did not attempt to offer any explanation or justification for engendering this contradiction. 2021 Ill. App. LEXIS 593 *19.

The fundamental misunderstanding of the *Sheckler* decision is further underscored by the reality that it is not at all uncommon for commercial property insurance coverage and liability insurance coverage for the same structure to be placed with different insurers under different policies. This circumstance, which did not happen to exist in the *Sheckler* case, would render unworkable the obligations the *Sheckler* decision attempts to impose, because imposition of such obligations on either insurer would be arbitrary and unsupportable. In the circumstance where different insurers have assumed the property and liability insurance obligations, it would be, if anybody, the property insurer whose policy, of course, contains no defense or indemnity provisions, that would owe the tenant "implied coinsured" status under *Dix Mutual*. So, in the circumstance where a tortfeasor files a third-party claim against the tenant, which of the landlord's insurers would owe the defense and indemnity obligations to the tenant that are envisioned by *Sheckler*? Would it be the liability insurer, which has no relationship at all to the tenant, and almost certainly has an exclusion in its policy for claims involving damage to landlord's own property, or does the Sheckler decision envision inserting defense and indemnity obligations into a property insurance policy that contains none, fashioned entirely upon supposed considerations of "equity"?

There would have been a far less clumsy, and far more intellectually honest, way for the author of the *Sheckler* decision to have reached the practical result the decision apparently sought to achieve without rewriting contract language and conjuring defense and indemnity obligations from thin air. If the Illinois courts believe that tenants should also be immunized from indirect liability for their landlord's insurers' subrogation claims (a view that is not universally accepted *See e.g. Emery Waterhouse Company v. Lea*, 467 A.2d 986,996-997 (Maine 1983); *Fireman's Fund Ins. Co. v. New York Mechanical General*, 712 F.Supp. 312 (W.D.N.Y. 1989); *Franzek v. Calspan*, 434 N.Y.S, 2d 288 (4th Dept. 1980), then that would more properly have been addressed in the underlying subrogation action. That could have been done by dismissing Workman's contribution claim against Sheckler, on the theory that Sheckler, as tenant, can have no liability to Workman for contribution if he has no direct liability to Auto-Owners under *Dix Mutual* (the *Sheckler* decision does not mention whether Sheckler ever sought dismissal of Workman's contribution claim in the underlying case, and the docket entries in that case reveal that no such motion was ever filed). If, hypothetically, Auto-Owners had obtained a favorable verdict against Workman, Auto-Owners and Workman could then have battled it out over whether Sheckler's proportionate share of fault should be taken into account at all, and, if so, whether it should result in the reduction of Auto-Owners' recovery.