Docket Nos. 12-1988, 12-2091

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

TKK USA INC.,
f/k/a The Thermos Company,

Plaintiff-Appellee/Cross-Appellant,

v.

SAFETY NATIONAL CASUALTY CORPORATION,

Defendant-Appellant/Cross-Appellee.

On Appeal from the United States District Court for the Northern District of Illinois, Eastern Division

No.: 1:10-cv-08146

The Honorable James B. Zagel,
Judge Presiding

COMBINED RESPONSE AND REPLY BRIEF OF DEFENDANT-APPELLANT/ CROSS-APPELLEE SAFETY NATIONAL CASUALTY CORPORATION

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JURISDICTIONAL STATEMENT

The jurisdictional statement set forth in the combined principal and response brief of plaintiff-appellee/cross-appellant TKK USA Inc., formerly known as The Thermos Company ("TKK"), is complete and correct.

STATEMENT OF THE ISSUES

Whether amounts paid in settlement of a common law negligence action brought directly against the insured by a former employee to recover damages as a result of asbestos exposure constitutes liability imposed upon the insured by "Workers' Compensation or Employers' Liability Laws" under an excess indemnity policy where the action was barred by the exclusive remedy provisions of the Illinois Workers Occupational Diseases Act ("Occupational Disease Act"), 820 ILCS 310/5(a), 310/11.

Whether Safety National owed an obligation to indemnify the insured for "Claims Expenses" as defined under the Safety National policy for amounts paid in defense of a common law negligence action barred by the exclusive remedy provisions of the Occupational Disease Act.

Whether the district court abused its discretion in finding that Safety National's filing of a motion for reconsideration of a non-final order or, alternatively, a Rule 54(b) finding, was "vexatious and unreasonable" under section 155 of the Illinois Insurance Code, 215 ILCS 5/155.

Whether the district court properly granted summary judgment in favor of Safety National on count IV of TKK's complaint brought under section 155 of the Illinois Insurance Code.

STATEMENT OF THE CASE

Safety National incorporates its statement of the case from its appellant's brief and states that TKK's statement of the case is generally correct with the following exceptions. TKK states that Safety National argued in its motion for reconsideration of the district court's June 29, 2011 order that it was entitled to an evidentiary hearing on the reasonableness of TKK's defense costs. Appellee's Brief ("Brief") at 4, citing R.29 at 9-10. In the motion cited, Safety National did not request an evidentiary hearing but stated that it was entitled to review legal bills submitted by TKK's counsel to determine whether those costs were, in fact, reasonable (R.29 at 9-10). In the district court's order of December 2, 2011, the district court did not order Safety National to file a motion challenging the reasonableness of TKK's defense costs but gave Safety National fourteen days to file such a motion after TKK submitted a list of its defense costs (App. at 11-12).

STATEMENT OF THE FACTS

Safety National incorporates its statement of the case from its appellant's brief and states that TKK's statement of the case is generally correct subject to the exceptions noted above.

SUMMARY OF THE ARGUMENT

It is undisputed that the Safety National policy is an excess indemnity workers' compensation and employers' liability insurance policy—excess, meaning the policy does not pay dollar one but only after exhaustion of a predetermined self-insured retention—and indemnity—meaning the policy contains no duty to defend. Under the insuring agreement, the policy indemnifies only for "Loss" sustained by the insured employer because of liability imposed upon the employer by the Workers' Compensation or Employers' Liability Laws of the applicable state. "Loss" includes "actual payments" made by the insured in satisfaction of settlements and judgments, and includes "Claim Expenses," defined to include defense costs even for claims or suits that prove to be "wholly groundless, false, or fraudulent." Once the employer has liability imposed upon it for a claim within the coverage of the policy, Safety National must indemnify the employer for the payments it has made, including associated defense costs.

In its response brief, TKK asks this Court to read the Safety National policy backwards, beginning with payment of defense costs. TKK goes to great lengths to attempt to equate a duty to reimburse defense costs for covered claims with a duty to defend, a duty expressly disclaimed in the policy. TKK also tries to minimize the significance of the issue of Safety National's duty to indemnify TKK for the underlying settlement of $15,000. This is understandable, not only because its defense counsel billed almost a half a million dollars to achieve this result, but also because TKK relies on the Illinois estoppel doctrine in an attempt to avoid the policy language

and case authority from other jurisdictions finding no coverage under similar circumstances. As the estoppel doctrine is applied in Illinois, however, there could be no estoppel because Safety National had no duty to defend.

TKK cross appeals from the judgment entered in favor of Safety National with respect to count IV of its complaint, in which TKK sought attorney fees under section 155 of the Illinois Insurance Code based on Safety National's denial of coverage. Because there was a *bona fide* dispute as to coverage, Safety National's denial was not vexatious and unreasonable, as the district court correctly found. TKK nevertheless relies on additional allegations of wrongful litigation conduct on the part of Safety National, not found in count IV, as a basis for challenging the district court's denial of attorney fees it incurred in this action beyond those awarded in connection with Safety National's motion for reconsideration. Not only are the allegations unfounded, the district court's alleged error is not properly before this Court. Finally, TKK's request for Rule 38 sanctions should be denied as Safety National's appeal is neither frivolous nor wholly without merit but well supported by the case law and the facts.

ARGUMENT

I. The District Court Erred in Granting Summary Judgment in Favor of TKK on Count II Where Safety National Owed No Duty to Indemnify TKK for Amounts Paid in Settlement of a Negligence Action That Could Not Constitute Liability Imposed upon TKK under Illinois' Workers' Compensation or Employers' Liability Laws

A. The Negligence Claim in the Underlying Action Was Not Covered under the Safety National Policy

Insurance policies are contracts and should be interpreted as such. *Horning Wire Corp. v. Home Indem. Co.*, 8 F.3d 587, 589 (7th Cir. 1993). In construing an insurance policy, the primary function of the court is to ascertain and enforce the intentions of the parties as expressed in the agreement. *Crum & Forster Managers Corp. v. Resolution Trust Corp.*, 156 Ill. 2d 384,

391, 620 N.E.2d 1073 (1993). This requires the court to construe the policy as a whole, taking into account the type of insurance for which the parties have contracted, the risks undertaken and purchased, the subject matter that is insured and the purposes of the entire contract. *Id.*

Here, the Safety National policy is an excess workers' compensation and employers' liability indemnity agreement (App. at 19). The coverage, by its terms, applies only to (1) "Loss," (2) imposed on the employer, (3) under the Workers' Compensation and Employers' Liability Laws of the applicable state (App. at 19). "Loss" means actual payments made by the employer to its employees and their dependents and "Claim Expenses," which includes costs of defense (App. at 19). The policy language is consistent with the purpose of a workers' compensation and employers' liability policy, *i.e.*, "to insure an employer primarily for liability under workers' compensation laws," but secondarily, to fill "gaps in workers' compensation law that sometimes allow an employee to sue his employer in tort, bypassing the limits on workers' compensation relief." *Hayes Lemmerz Int'l, Inc. v. ACE American Ins. Co.*, 619 F.3d 777, 778-79 (7th Cir. 2010).

In Illinois, the only manner in which liability can be "imposed upon" an employer in its capacity as an employer for accidental workplace injuries to its employee is under the Workers' Compensation Act, 820 ILCS 305/1, *et seq*. or the Occupational Disease Act. Each statute provides that it is the exclusive remedy for either workplace injuries or occupational disease claims by an employee against an employer. 820 ILCS 305/5(a); 820 ILCS 310/5(a) and 11. As a result, as the Safety National policy applies in Illinois, there are no "gaps" for the policy to fill in cases brought by the employee against his or her employer.

Notably, in its 42 page brief, TKK cannot point to any other statute or common law theory under which an employee can recover directly against his or her employer in its capacity

as an employer in Illinois. For a "gap," it simply states for the first time on appeal that a statutory exclusivity bar can be raised as an affirmative defense and that the employer can held liable in negligence if the employer fails to do so (Brief at 19-20, citing *Geise v. Phoenix Co. of Chicago, Inc.*, 159 Ill. 2d 507, 639 N.E.2d 1273 (1994)). If TKK was being sued as an employer and it chose to reject the protection of the workers' compensation law by failing to assert the exclusivity provision as a defense and allowing the claim against it to proceed in negligence, there is no coverage under the Safety National policy. The Safety National policy specifically excludes from the definition of "Loss" any amounts required to be paid by TKK because of "[r]ejection by [TKK] of any Workers' Compensation Law" (App. at 19-20 at ¶ D(3)(f)(4)).[1] Moreover, TKK does not dispute that the exclusively bar of the Occupational Disease Act, 820 ILCS 310/5(a), 310/11, was raised and precluded any potential recovery by Perkins against TKK in the underlying case.

TKK disingenuously asserts that Safety National waived its argument, as one brought for the first time on appeal, that coverage was barred because the exclusivity provision of the Occupational Disease Act barred Perkins' recovery. Brief at 24-25. Not only does TKK acknowledge that Safety National raised the issue (in its reply in support of its cross-motion for summary judgment) in the district court, but Safety National also clearly made this argument in response to TKK's cross-motion for summary judgment (R.22 at 5-7). In addition, Safety National raised as an affirmative defense the fact that it had no duty to indemnify or reimburse defense costs because there would not be any "Loss" imposed upon TKK by the Workers'

[1] The Safety National policy specifically assigns defense obligations to TKK. With that, control of the defense also devolves upon TKK. Under these circumstances, it would be surprising were Safety National to allow TKK to decide to rely on or waive the protections of the Workers' Compensation or Occupational Disease Law at its discretion if the applicability of the Safety National coverage were dependent upon it without the protection afforded by this language.

Compensation or Employer's Liability Laws of Illinois (R.11 at 15). Safety National's reliance on the exclusive remedy provision as the basis for liability not being imposed on TKK cannot be deemed waived where the issue was both raised by TKK in the district court and the district court specifically addressed the issue in its opinion granting TKK summary judgment (App. at 5-6).

The district court here determined that Safety National owed a duty to indemnify TKK for the underlying settlement because it had first found, incorrectly, a duty to reimburse defense costs and concluded that the policy "also" covers settlement costs (App. at 11, citing paragraph (D)(1)). Paragraph D(1) of the Safety National policy is the definition of "Loss," not the policy's insuring agreement (App. at 19). The Safety National policy does not cover just any "Loss," but only "Loss" sustained by the insured because of liability imposed by the workers' compensation or employers' liability laws of the relevant state. When the policy is read as a whole, it is clear that Safety National's duty to pay settlement costs depends upon those settlement costs being paid because of liability imposed by the workers' compensation or employers' liability laws. *See, e.g., Continental Casualty Co. v. Duckson*, 826 F. Supp. 2d 1086, 1102 (N.D. Ill. 2011) (insured was not entitled to recover defense costs as "claim expenses" where underlying complaint did not seek relief covered by the policy). *See also Farmers Auto. Ins. Ass'n v. St. Paul Mercury Ins. Co.*, No. 05-1331, 2006 WL 1686087 at *7 (C.D. Ill. Jun. 19, 2006), *aff'd*, 482 F.3d 976 (7th Cir. 2007) (where court concluded that even though defense expenses were included in policy's definition of "Loss," insurer owed no duty to reimburse defense costs because underlying claims were not covered under policy).

Further, the duty to indemnify cannot be determined simply on the basis of whether the factual allegations of the underlying complaint potentially state a claim against the insurer.

Waste Management, Inc. v. International Surplus Lines Ins. Co., 144 Ill. 2d 178, 203, 579 N.E.2d 322 (1991). Rather, "it is a necessary prerequisite to recovery upon a policy for the insured to show a claim within the coverage provided by the policy." *Waste Management*, 144 Ill. 2d at 204. Where, as here, the insured seeks indemnity for an underlying settlement, an insurer must reimburse an insured for its settlement expenses when the settlement was made in reasonable anticipation of liability for damage covered by the insurer's policy and the settlement's primary focus was a claim covered under the policy. *Santa's Best Craft, LLC v. St. Paul Fire & Marine Ins. Co.*, 611 F.3d 339, 351-52 (7th Cir. 2010). If it is possible that none of the settlement was attributable to the dismissal of claims for damage covered by the insurer's policy, the insured has the burden of establishing that the "primary focus" of the claims that were settled was a potentially covered loss. *Id.* at 352. If the insurer can establish that the claims were not even potentially covered, the insurer is not required to reimburse the settlement. *Id.*

TKK misstates the standard under Illinois law as "an insurer is required to indemnify the settlement of a 'potentially' covered claim when it is 'reasonable in view of the size of possible recovery and degree of probability of claimant's success against the [insured].'" Brief at 28 (citing *United States Gypsum Co. v. Admiral Ins. Co.*, 268 Ill. App. 3d 598, 625-26, 643 N.E.2d 1226 (1st Dist. 1994)). It is clear from a review of cited language in *U.S. Gypsum* that the proper focus is not a "potentially" covered claim but a potential *liability* that the insured has that is covered under the policy. 268 Ill. App. 3d at 625-26 (in order to recover a settlement, "the insured need not establish actual liability to the party with whom it has settled" so long as a potential liability on the facts known to the insured is shown to exist) (quoting *Luria Bros. & Co. v. Alliance Assur. Co.*, 780 F.2d 1082, 1091 (2d Cir. 1986)); *see also Federal Ins. Co. v. Binney & Smith, Inc.*, 393 Ill. App. 3d 277, 288, 913 N.E.2d 43 (1st Dist. 2009) (citing *U.S. Gypsum*, the

court stated that the insured was not required to prove it was "actually liable" in the underlying action to justify the settlement).

Here, there was no claim against TKK for which TKK was potentially liable as the employer under Illinois workers' compensation or employers' liability laws and for which there would be coverage under the Safety National policy. TKK may have believed that a $15,000 settlement of an uncovered, meritless claim was reasonable (particularly after paying its counsel over $475,000 to achieve that result). This does not mean that the claim was covered where the *Perkins* Lawsuit did not seek to impose any liability upon TKK cognizable under any Illinois workers' compensation or employers' liability laws not otherwise excluded under the policy.

TKK's weak attempt to distinguish the cases cited by Safety National based on the estoppel doctrine fails because, as discussed below, the estoppel doctrine does not apply and Safety National's duty to indemnify must be considered based on the actual policy language. *Waste Management*, 144 Ill. 2d at 204; *Santa's Best*, 611 F.3d at 352. *Wake County Hospital System, Inc. v. Safety National Casualty Corp.*, 127 N.C. App. 33, 487 S.E.2d 789 (N.C. Ct. App. 1997), which involves the identical language in a policy issued by Safety National and an underlying settlement, is indistinguishable.

In *Wake County*, as here, the negligence claim asserted was barred by the applicable exclusivity provision in the state workers' compensation act such that the insured's liability could not arise under "Employers' Liability Laws" for the purpose of the insurer's duty to indemnify. Illinois law similarly requires an otherwise covered loss for the purposes of the duty to indemnify, even if the insured's obligation arises out of a settlement. *U.S. Gypsum*, 268 Ill. App. 3d at 625. Like the negligent hiring claim at issue in *Wake County*, the negligence claim against Perkins was not only groundless because it was barred, it was groundless and not covered

under the Safety National excess workers' compensation insurance policy. As in *Bond Builders, Inc. v. Commercial Union Ins. Co.*, 670 A.2d 1388 (Me. 1996), and *Hames Contracting, Inc. v. Georgia Ins Co.*, 211 Ga. App. 852, 440 S.E.2d 738 (Ga. Ct. App. 1994), the negligence claim was barred under the applicable state law workers' compensation or employers' liability laws and therefore not within the scope of coverage.

In this case, TKK was not liable to Perkins in its capacity as her husband's employer because the negligence claim was barred by the exclusivity provision of the Occupational Disease Act *and* the claim could not be covered under the policy because there must be "liability imposed upon the insured by the Workers' Compensation or Employers' Liability laws of [Illinois]." In Illinois, there are only two ways for that to be accomplished, its Workers' Compensation Act or the Occupational Disease Act. Safety National therefore did not owe a duty to indemnify TKK for the underlying settlement, even if the settlement was a reasonable option for TKK to put an end to the significant legal fees incurred in defending against an uncovered, meritless claim. The district court erred in holding otherwise.

B. The Estoppel Doctrine Has No Applicability Where the Policy Contains No Duty to Defend

Although the district court ruled in TKK's favor on the duty to indemnify, TKK takes issue with the district court's failure to address its estoppel argument. Should this Court determine that there is actual coverage for the underlying settlement based on the policy language, this Court also need not reach the issue. If, however, it agrees that the underlying settlement is not the result of liability imposed upon the insured by the workers' compensation or employer's liability laws of Illinois, the estoppel doctrine does not serve as an alternative basis for finding a duty to indemnify.

It is well-established under Illinois law that the estoppel doctrine does not apply where an

insurer does not have a duty to defend. *See Employers Insurance of Wausau v. Ehlco Liquidating Trust*, 186 Ill. 2d 127, 151, 708 N.E.2d 1122 (1999). In *Ehlco*, the Illinois Supreme Court explained that the estoppel doctrine arose out of the recognition that an insurer's duty to defend under a liability insurance policy is so fundamental an obligation that a breach of that duty constitutes a repudiation of the contact. Accordingly:

> Th[e] estoppel doctrine applies only where an insurer has breached its duty to defend. Thus, a court inquires whether the insurer had a duty to defend and whether it breached that duty. *See Clemmons*, 88 Ill. 2d at 475-78 (determining first that the insurer had a duty to defend, and then finding that the insurer had renounced that duty). Application of the estoppel doctrine is not appropriate if the insurer had no duty to defend, or if the insurer's duty to defend was not properly triggered.

186 Ill. 2d at 151. Here, it is undisputed that the Safety National policy does not include a defense obligation. The Safety National policy expressly provides:

> [Safety National] *shall not be obliged to assume charge of the investigation, defense, appeal or settlement of any claim*, suit, or proceeding brought against [TKK], but [Safety National] shall be given the right and opportunity to investigate, defend, or participate with [TKK] in the investigation and defense of any claim….

(App. at 21) (emphasis added). Where, as here, an excess insurer has no duty to defend, the estoppel doctrine is inapplicable. *Household Int'l, Inc. v. Liberty Mut. Ins. Co.*, 321 Ill. App. 3d 859, 876-77, 749 N.E.2d 1 (1st Dist. 2001) (estoppel did not apply where excess policy provided that insurer had no duty to defend, only a right and opportunity to associate in the insured's defense). Further, having no duty to defend, Safety National was not required to provide coverage under a reservation of rights or file a declaratory judgment action seeking a declaration of no coverage. *See Ehlco*, 186 Ill. 2d at 150-51 ("an insurer which takes the position that a complaint potentially alleging coverage is not covered *under a policy that includes a duty to*

defend…has two options: (1) defend the suit under a reservation of rights or (2) seek a declaratory judgment that there is no coverage….") (emphasis added).

Two federal court decisions cited by TKK, *Rothschild Investment Corp. v. Travelers Cas. & Sur. Co. of America*, No. 05 C 3041, 2006 WL 1236148 (N.D. Ill. May 4, 2006), and *Solo Cup Co. v. Federal Ins. Co.*, 619 F.2d 1178, 1182 (7th Cir. 1980), do not support a departure from established Illinois estoppel principles. In *Rothschild*, the insurer issued a fidelity bond to an investment firm that included separate insuring agreements for various losses such as those resulting from employees' dishonest acts, robberies and forgeries. 2006 WL 1236148 *1. The bond also included a provision for reimbursement of certain court costs and attorney fees "whether or not fully litigated on the merits and whether or not settled." 2006 WL 1236148 *1-2. After the insured provided notice that certain assets were missing from a client's profit sharing plan, the insurer declined to reimburse the insured for its attorney fees, arguing that the claimed loss was excluded as a loss resulting from transactions in a customer's account or that it did not result "directly from" one of the identified events. The court held that the insurer had breached a duty to defend because it was not clear and free from doubt that the exclusion applied and there was a sufficient causal link between the forgery alleged and the insured's loss to implicate potential coverage. Here, unlike the bond at issue in *Rothschild*, the Safety National policy does not require the insurer to indemnify defense costs "whether or not fully litigated on the merits and whether or not settled." Safety National also expressly disclaimed any duty to defend in its policy (App. at 21), preventing a finding that there is an implicit duty to defend that can be breached.

Solo Cup did not involve an excess policy with no duty to defend, as TKK erroneously suggests, but rather an umbrella liability policy[2] with an endorsement that imposed a "separate and distinct defense obligation" upon the insurer:

> It is agreed that, with respect to any occurrence not covered by the underlying policies…but covered by the terms and conditions of this policy…*the company shall*:
>
> > (A) *Defend any suit* against the insured alleging such injury…and seeking damages on account thereof, even if such suit is groundless, false or fraudulent….

619 F.2d at 1182 (emphasis added). Because the insurer refused to assume the defense of the underlying action, the court analyzed whether that refusal was a breach of the duty of defense obligation contained in the endorsement. 619 F.2d at 1184. No such defense obligation is at issue here.

Courts applying Illinois law also have recognized that even where an insurer may have a duty to reimburse or indemnify the insured for defense costs, the estoppel doctrine does not apply. *See Alliant Credit Union v. CUMIS Ins. Soc., Inc.*, 10 C 0737, 2011 WL 941257 at *8-9 (N.D. Ill. Mar. 10, 2011) (insurer not estopped where it had option to defend or to pay defense costs but not the duty to defend); *International Ins. Co. v. City of Chicago Heights*, 268 Ill. App. 3d 289, 301-02, 643 N.E.2d 1305 (1st Dist. 1994) (reversing award of attorney fees in declaratory judgment action where insurer only had a duty to indemnify against "loss," including defense costs, and had no duty to defend that could be breached).

Further, if there were a duty to reimburse defense costs as they were incurred by TKK, any alleged obligation to file a declaratory judgment action or pay defense costs under a

[2]An umbrella policy is a type of policy that acts both as an excess insurance policy and, in certain circumstances, as a primary insurance policy by providing coverage for those incidents left uncovered by other insurance policies, filling gaps in underlying insurance. *Premcor USA, Inc. v. American Home Assurance Co.*, 400 F.3d 523, 525 (7th Cir. 2005).

reservation of rights would not arise until TKK exhausted the $275,000 retention: "[Safety National] agrees to reimburse [TKK] only for such Loss in excess of such Self-Insured Retention…" (App. at 19, ¶ B). In a letter dated May 11, 2010, TKK's counsel stated that "Thermos is nearing the exhaustion of the SIR" (R.15-3 at Exhibit F). TKK states that it had incurred defense costs in excess of $275,000 at the time it filed its complaint for declaratory judgment on December 22, 2010. Brief at 8 (citing R.1 at ¶ 20). The timely filing of a declaratory judgment action, even by the policyholder, thwarts the application of estoppel. *J.A. Jones Construction Co. v. Hartford Fire Ins. Co.*, 269 Ill. App. 3d 148, 152-53, 645 N.E.2d 980 (1st Dist. 1995); *Sportmart, Inc. v. Daisy Mfg Co.*, 268 Ill. App. 3d 974, 979-80, 645 N.E.2d 360 (1st Dist. 1994). Here, TKK has not shown that an unreasonable amount of time passed from the time it allegedly exhausted its SIR to the time that the declaratory judgment action was filed. Accordingly, the district court could not have concluded that the declaratory judgment action was untimely.

II. The District Court Erred in Granting Summary Judgment in Favor of TKK on Count I and Requiring Safety National to Reimburse Defense Costs Incurred in Defending against a Claim Not Actually Covered under the Safety National Policy

TKK's argument and the district court's opinion are premised on a fundamental misapprehension of the coverage provided by the Safety National excess policy. What TKK wants, but did not purchase, is an insurance policy with a duty to reimburse it on an ongoing basis for the cost of counsel it selects in defense of a common law negligence claim that can never be covered under the policy because liability would never be imposed upon TKK under the workers' compensation or employers' liability laws of Illinois. Other states, such as Indiana and California, may have "gaps" that are filled by the coverage provided under the Safety National policy for actions brought by employees directly against their employers. Illinois is not one of

them.

Safety National did not deny coverage because the claims were "wholly groundless, false or fraudulent" or meritless. It denied coverage because it would never be called upon to indemnify TKK for "Loss" arising out of the negligence counts in the *Perkins* complaint when those common law claims are barred by the exclusivity provision in the Occupational Diseases Act, in addition to the remaining claims falling within the scope of the intentional acts exclusion (R.15-3 at 42-43 of 50). Contrary to TKK's assertion, there are circumstances under which Safety National would be required to reimburse defense costs for a groundless, false or fraudulent claim. For example, if TKK made a reasonable settlement to compromise a meritless workers' compensation claim asserted in the Illinois Industrial Commission for which TKK was potentially liable, TKK would be entitled to reimbursement of the settlement amount and related claim expenses. The *Perkins* Lawsuit filed in state court is not such a case. Where a suit is "groundless, false or fraudulent," an insurer owes no duty to the insured if the suit is predicated on a ground of liability not covered by the policy. *Brodek v. Indemnity Ins. Co. of North America*, 292 Ill. App. 363, 383-84, 11 N.E.2d 228 (1st Dist. 1937) (holding that insurer owed no duty to defend lawsuit brought under Occupational Disease Act where policy only covered liability under Workers' Compensation Law).

TKK creates five elements that it contends are the requirements for coverage under the policy (Brief at 23-24), but importantly omits the requirement that there be "liability imposed" upon the insured. As the insuring agreement provides: "This Agreement applies only to Loss sustained by the EMPLOYER because of Liability imposed upon the EMPLOYER by the Workers' Compensation or Employers' Liability Laws of [Illinois]…" (App. at 19). It goes without saying that there cannot be "Loss," defined to include "Claim Expenses," because of

"liability imposed" upon TKK unless there is "liability imposed" upon TKK by settlement, judgment or statutory benefits. TKK's interpretation of the Safety National policy, adopted by the district court, writes this language out of the policy—contrary to the rules of contract interpretation. *Employers Ins. of Wausau v. Bodi-Wachs Aviation Ins. Agency, Inc.*, 846 F. Supp. 677, 684 (N.D. Ill. 1994), *aff'd,* 39 F.3d 138 (7th Cir. 1994) ("no policy language should be rendered meaningless surplusage—instead all of the language must be read in accordance with its plain and ordinary meaning").

If TKK desired broader coverage, it was free to purchase primary coverage with a duty to defend. It did not. Instead, it purchased an indemnity policy under which the duty to reimburse does not arise until liability is imposed upon the Employer (App. at 19, ¶ A) *and* the Employer pays the Loss incurred in excess of the self-insured retention (App. at 20, ¶ E). Requiring Safety National to pay TKK's defense costs before TKK has liability imposed upon it under the workers' compensation or employers' liability laws, as the district court ordered, is contrary to the plain language of the policy's insuring agreement in ¶ A.

Asserting that Safety National has miscast a duty to reimburse defense costs as a duty indemnify defense costs, TKK takes the opposite and unsupported approach that a duty to reimburse defense costs is the same as a duty to defend. TKK repeatedly draws generalizations from cases involving different policy language and different types of risks than the Safety National policy was designed to cover. Citing *Rothschild*, 2006 WL 1236148, and *Farmers Auto. Ins. Ass'n v. St. Paul Mercury Ins. Co.*, No. 05-1331, 2006 WL 168087 (C.D. Ill. Jun. 19, 2006), *aff'd*, 482 F.3d 976 (7th Cir. 2007), throughout its brief, TKK states that courts of this circuit have held that there is little distinction between the duty to defend and the duty to reimburse defense costs "other than who selects defense counsel and directs the defense." The

cases cited do not even mention the selection or control of defense counsel, nor was the distinction between the two duties specifically addressed.

The fidelity bond at issue in *Rothschild*, discussed above in section I.B., specifically provided that for reimbursement of certain court costs and attorney fees "whether or not fully litigated on the merits and whether or not settled." 2006 WL 1236148 at *1-2. The Safety National policy, on the other hand, "applies only to Loss [including Claim Expenses] sustained by [TKK] because of liability imposed upon [TKK]…" (App. at 19). Also unlike the Safety National policy here, there is nothing to suggest that the fidelity bond disclaimed the duty to defend. The Safety National policy expressly states: [Safety National] shall not be obliged to assume charge for the investigation, defense, appeal or settlement of any claim, suit, or proceeding brought against [TKK]" (App. at 21). In light of this language, it makes no sense to impose a duty defend under the guise of a "duty to reimburse" directly contrary to the policy language.

TKK's citation to Iowa law notwithstanding,[3] the obligation to reimburse defense costs typically does not arise until coverage is established. *See, e.g., In re Celotex Corp.*, 152 B.R. 661, 666 (Bankr. M.D. Fla. 1993) ("If [the policyholder] is not liable on the underlying claim, there has been no occurrence covered under the policy and, thus, the excess insurer is under no obligation to indemnify [the policyholder] for anything, including defense costs associated with defending the underlying claim."); *In re Kenai Corp.*, 136 B.R. 59, 64 (S.D.N.Y. 1992) ("Unlike duty to defend policies, which require the insurer to defend claims even if they are only *arguably* entitled to coverage, policies requiring the insurer to reimburse damages and defense costs related to wrongful acts entitle the insured to costs only when the underlying claims *are* covered

[3] *Liberty Mutual Ins. Co. v. Pella Corp.*, 650 F.3d 1161 (8th Cir. 2011) (Iowa law); *McCuen v. American Cas. Co.*, 946 F.2d 1401 (8th Cir. 1991) (Iowa law).

by the policy.") (emphasis in original). In the remaining cases relied upon by TKK, the insurer specifically agreed to advance defense costs, *Hurley v. Columbia Cas. Co.*, 976 F. Supp. 268, 274-75 (D. Del. 1997) (Michigan law) ("the Insurer on behalf of [the insureds] shall advance prior to the final disposition of such Claim all such Defense Costs"), or agreed to pay amounts the insured was obligated to pay as respects his legal liability "whether actual or asserted," *F.D.I.C. v. Booth*, 824 F. Supp. 76, 80-81 (M.D. La. 1993) (Louisiana law). Safety National made no similar undertaking here.

Courts applying Illinois law have recognized that excess policies require the insurer to indemnify the insured for defense costs at the conclusion of the underlying lawsuit as part of the loss against which the policy insures. *See Zaborac v. American Cas. Co.*, 663 F. Supp. 330, 331-32 (C.D. Ill. 1987) (the insurer's obligation to pay the insured for covered "loss," defined to include defense costs, did not accrue until the loss suffered by the insured could be ultimately determined, "which is at the time the underlying claims are adjudicated or settled"); *Liberty Mutual Ins. Co. v. American Home Assurance Co.*, 348 F. Supp. 2d 940, 953 (N.D. Ill. 2004) (recognizing that "[r]ather than providing a duty to defend, most excess policies require the excess insurer to indemnify the insured for the costs of the defense as part of the 'ultimate net loss' against which the policy insures"); *American States Ins. Co. v. Liberty Mutual Ins. Co.*, 291 Ill. App. 3d 336, 339, 683 N.E.2d 510 (1st Dist. 1997) ("Insurers that issue excess policies . . . are not liable to pay defense costs before the conclusion of the underlying suit."). The Safety National excess policy is no different. Because Safety National's duty to reimburse defense costs did not arise until TKK paid a "Loss" for which TKK could be held liable and that could be covered under the policy (which the underlying settlement later reached was not), the district court erred in granting summary judgment in favor of TKK on count I.

III. The District Court Abused Its Discretion in Awarding Attorney Fees in Connection with Safety National's Motion for Reconsideration

A. Standard of Review - Abuse of Discretion

TKK agrees that an abuse of discretion standard applies for a section 155 ruling other than one decided on a motion for summary judgment, which here includes its claims that it is entitled to attorney fees for alleged conduct not at issue in count IV of its complaint. Brief at 30.

B. The District Court's Misapprehension of the Law on the Duty to Indemnify Versus the Duty to Defend Was a Proper Basis for Requesting Reconsideration

TKK relies on *Peerless Enterprise, Inc. v. Kruse*, 317 Ill. App. 3d 133, 738 N.E.2d 988 (2d Dist. 2000), and *Myrda v. Coronet Ins. Co.*, 221 Ill. App. 3d 482, 582 N.E.2d 274 (2d Dist. 1991), and asserts that Safety National's conduct in moving for reconsideration of the district court's June 29, 2011 order entering summary judgment in favor TKK or a Rule 54(b) finding that the order was final and appealable was vexatious and unreasonable under section 155 of the Illinois Insurance Code. These cases are inapposite. In *Peerless*, the court upheld an award of attorney fees and a statutory penalty and further awarded attorney fees on appeal where the court found no *bona fide* dispute as to coverage. 317 Ill. App. 3d at 147-49. In *Myrda*, the court also had found that the insurer did not have a *bona fide* defense to liability, and distinguished case law where the court had denied attorney fees where the insurer had raised a *bona fide* defense to coverage. 221 Ill. App. 3d at 489-90 (citing *Marvel Eng. Co. v. Commercial Union Ins. Co.*, 118 Ill. App. 3d 844, 455 N.E.2d 545 (2d Dist. 1983)). Here, as the district court recognized, there was a *bona fide* dispute as to coverage (App. at 7-8).

Safety National's motion for reconsideration was based on the district court's misapplication of a duty to defend standard for potentially covered claims in determining whether Safety National owed a duty to reimburse defense costs for claims actually covered by

the policy (R.29). As set forth in in Safety National's motion and above in section II, this represents a clear error and misapprehension of law of the duty to reimburse defense costs under an excess indemnity policy. It was an abuse of discretion for the district court to sanction Safety National merely for asking it to correct this error of law or asking the court at least to allow it to appeal immediately to this Court. When the motion to allow for immediate appeal was made on July 26, 2011, the district court had decided that Safety National owed a duty to reimburse TKK's defense costs but did not indicate when or how much was to be paid (App. at 6; R.29 at 9-10). TKK filed its submission on defense costs over four months later on December 7, 2011 (R.45). Safety National could not have known how long it would take to resolve the outstanding defense cost issues or the indemnity portion of the case. Moreover, no motions were pending with regard to TKK's count III for breach of contract, which was not resolved until it was dismissed nine months later on April 10, 1012 (App. at 14-15).[4]

If Safety National's motion to reconsider was so obviously meritless and its request for intermediate appeal was "doomed to fail," as TKK asserts, TKK did not need to respond to it. Instead, it deemed Safety National's motion of sufficient concern for it to incur $11,970.50 in attorney fees to oppose it (App. at 14). Where, as here, there was a *bona fide* dispute as to coverage and a good faith basis for Safety National to ask the district court to reconsider its ruling on defense costs, the district court abused its discretion in sanctioning Safety National under section 155 of the Illinois Insurance Code.

C. The District Court Did Not Abuse Its Discretion in Denying TKK's Request for Attorney Fees in Connection with Safety National's Alleged Litigation Conduct

In response to Safety National's motion for reconsideration, but in no motion or pleading,

[4] TKK agreed at that time that count III was moot and does not cross-appeal its dismissal (App. at 14).

TKK asserted that the district court should "reconsider" its June 29, 2011 order denying it attorney fees under section 155 of the Illinois Insurance Code based on Safety National's alleged "subsequent litigation activity" in (1) filing a motion for reconsideration; (2) requesting an interlocutory appeal in the same motion; (3) requesting an evidentiary hearing on the reasonableness of TKK's claimed defense costs and (4) "forcing" TKK to file a summary judgment motion on the duty to indemnify (R.35 at 9-11). In response to this request, the district court awarded attorney fees incurred by TKK in responding to Safety National's motion for reconsideration (App. at 11).

TKK did not reference the June 29, 2011 order in its notice of cross-appeal and it cannot be said that the denial of its "motion" for attorney fees was an order leading up to the order of April 10, 2012 denying its motion for summary judgment on count IV based on Safety National's denial of coverage. Should this Court consider TKK's request for additional attorney fees based on Safety National's alleged conduct in requesting an evidentiary hearing and preparing a motion for summary judgment on the duty to indemnify during the course of this litigation, the district court clearly did not abuse its discretion in failing to award it additional attorney fees.

As to Safety National's alleged request for an evidentiary hearing, TKK cites to Safety National's motion for reconsideration, in which Safety National simply asked that it be allowed to challenge the reasonableness of the $490,000 in defense costs submitted by TKK, without reference to an evidentiary hearing. The entirety of the argument on defense costs was as follows:

> In the event that the Court declines to reconsider its prior ruling, Safety National would only be required to reimburse Thermos for reasonable defense costs. At a minimum, Safety National is entitled to review the legal bill submitted by Thermos' counsel for defending the *Perkins* Lawsuit to determine whether those

> costs are, in fact, reasonable. *See, Great W. Cas. Co. v. Marathon Oil Co.*, 2003 U.S. Dist. LEXIS 2721 at *21 (N.D. Ill. Feb. 25, 2003) ("In the context of calculating attorney's fees in an insurance dispute, the market rate is the rate that lawyers of similar ability and experience in the community normally charged their paying clients for the type of work in question"). This issue remains unresolved.

(R. 29 at 9-10). To the extent an evidentiary hearing was requested, the district court noted in its order of December 2, 2011 that TKK had not submitted a list of its defense expenses to the court or opposing counsel and provided that TKK should do so by December 7, 2011, with Safety National having fourteen days thereafter to file a motion challenging the reasonableness of these costs (App. at 11-12). The district court was then to determine whether a hearing was necessary (App. at 12). TKK does not appeal this order or contend that the district court erred in requiring it to submit its claimed defense costs before they were reimbursed. If this Court even considers the issue, TKK's reliance on *Taco Bell Corp. v. Continental Cas. Co.*, 388 F.3d 1069 (7th Cir. 2004), is clearly misplaced. There, the court denied an insurer an evidentiary hearing where it had breached a duty to defend and the insured had provided detailed billing statements, neither of which is the case here. TKK instead complains that after Safety National received TKK's cost submission, Safety National failed to challenge these costs. Had it done so, no doubt TKK would point to the challenge as yet another example of Safety National's "vexatious" conduct.

As to Safety National's refusal to concede that it owed a duty to indemnify the underlying settlement after the district court held that it owed a duty to reimburse defense costs, TKK argues that Safety National was "bound to indemnify the Perkins settlement under the straightforward application of the Illinois estoppel rule." Brief at 39-40. As set forth above, the estoppel doctrine does not apply where an excess insurer does not have a duty to defend. In light of this well-settled precedent, the district court did not abuse its discretion in denying TKK attorney fees for preparing its summary judgment motion.

D. Safety National's Appeal Bond Is Not at Issue

TKK further asserts that it was required to incur unnecessary fees as a result of Safety National's requests in the district court for leave to proceed without an appeal bond and for approval of an appeal bond that it, as a surety company, issued. Because TKK did not request any relief from the district court with respect to these alleged fees or Safety National's alleged wrongful conduct, there is no ruling for this Court to review. In addition, the issue has been waived. *United States v. Torres*, 142 F.3d 962, 968-69 (7th Cir. 1998) (issues not raised in the district court are deemed waived). Further, Safety National did not request that the appeal bond requirement be waived; it asked that the district court fix an appeal bond in the sum of $300,000 with the bond to be posted within 28 days of the entry of an order approving the bond and staying enforcement of the judgment (R.51). Its later request for approval of an appeal bond issued by Safety National was not in bad faith where proof by the losing party of its ability to pay a judgment is a recognized exception to the Rule 62(d) bond requirement and it was within the district court's discretion to waive the bond requirement. *Dillon v. City of Chicago*, 866 F.2d 902, 904-05 (7th Cir. 1998). TKK admits that Safety National procured an appeal bond that TKK considered valid. Brief at 40, citing R.71.

IV. The District Court Properly Granted Summary Judgment in Favor of Safety National on Count IV of TKK's Complaint

A. Standard of Review – *De Novo*

Safety National agrees that the district court's denial of TKK's motion for summary judgment is subject to a *de novo* standard of review. The Court's review of the denial of TKK's motion for summary judgment, however, should not include consideration of Safety National's alleged litigation conduct that was not pled in count IV or contained in TKK's motion for partial summary judgment or reply brief, which TKK now attempts to bootstrap into its argument for

reversal of summary judgment on count IV (R.1 at 9-10; R.16, R.17, R.19). Safety National's alleged litigation conduct raised by TKK in its cross-appeal brief with regard to the district court proceedings is discussed above in section III. TKK's request for attorney fees under Rule 38 of the Federal Rules of Appellate Procedure in connection with this appeal is addressed in section V, below.

B. There Was a *Bona Fide* Dispute as to Coverage under the Safety National Policy

Section 155 of the Illinois Insurance Code provides an extracontractual remedy where an insurer's refusal to recognize liability and pay a claim is vexatious and unreasonable. *Cramer v. Ins. Exch. Agency*, 174 Ill. 2d 513, 519, 675 N.E.2d 897 (1996); 215 ILCS 5/155. An insurer's conduct is *not* vexatious and unreasonable if: (1) there is a *bona fide* dispute concerning the scope and application of insurance coverage; (2) the insurer asserts a legitimate policy defense; (3) the claim presents a genuine legal or factual issue regarding coverage; or (4) the insurer takes a reasonable legal position on an unsettled issue of law. *Citizens First Nat'l Bank v. Cincinnati Ins. Co.*, 200 F.3d 1102, 1110 (7th Cir. 2000). An insurer will not be liable for attorney fees and costs under section 155 merely because it litigated and lost the issue of insurance coverage. *American States Ins. Co. v. CFM Constr. Co.*, 398 Ill. App. 3d 994, 1003, 923 N.E.2d 299 (2d Dist. 2010).

A *bona fide* dispute regarding coverage means one that is "real, actual, genuine and not feigned." *American States*, 398 Ill. App. 3d at 1003 (quoting BLACK'S LAW DICTIONARY, p. 177 (6th ed. 1990)). A *bona fide* dispute can exist where the issue has not been addressed by Illinois courts (*American Alliance Ins. Co. v. 1212 Restaurant Group, L.L.C.*, 342 Ill. App. 3d 500, 511, 794 N.E.2d 892 (1st Dist. 2003)), where the issue is novel and the insurer presents legitimate arguments favoring its interpretation (*General Star Indem. Co. v. Lake Bluff School Dist. No. 65*,

354 Ill. App. 3d 118, 128-29, 819 N.E.2d 784 (2d Dist. 2004)), and where the policy language is ambiguous with no clear answer to the issue disputed by the parties (*Baxter Int'l, Inc. v. American Guarantee & Liability Ins. Co.*, 369 Ill. App. 3d 700, 710, 861 N.E.2d 263 (1st Dist. 2006)).

Here, the district court correctly determined that there was a *bona fide* dispute as to coverage with the parties disagreeing as to the interpretation of the coverage provided. App. 8. In particular, the district court did not find the argument that "Employers' Liability Laws" means, in Illinois, the Occupational Disease Act and the Workers' Compensation Act exclusively to rise to the level of vexatious or unreasonable conduct (App. at 8). Safety National has consistently argued that there can be no recovery, and therefore no indemnity obligation, for the claims asserted in the *Perkins* Lawsuit under Illinois law. This is unlike other states' laws relied upon by TKK such as Indiana, New Jersey and California, where there is a "gap" in employers liability laws for certain liabilities arising from an employee's accidental workplace injuries such as consequential bodily injury to a family member. *See Hayes*, 619 F.3d at 779 (and cases cited therein). This does not make the coverage provided illusory as the policy's coverage is not limited to cases arising under Illinois law.

TKK asserts that Safety National's position is patently contradicted by "well-established" case law, and for its "uniform rule" that an insurer may not deny its "duty to defend" on the grounds that the underlying claim may be barred by the exclusive remedy provision of a state court relies on two unpublished out-of-state appellate court cases, *Panther Machine, Inc. v. Accident Fund Ins. Co. of America*, No. 264454, 2007 WL 258313 (Mich. Ct. App. Jan. 30, 2007) (unpublished) and *Industrial Door Co., Inc. v. Builders Group*, No. A09-2065, 2010 WL 2900312 (Minn. Ct. App. Jul. 27, 2010) (unpublished), and one New Jersey appellate court case

Danek v. Hommer, 28 N.J. Super. 68, 100 A.2d 198 (N.J. Super Ct. App. Div. 1953). Brief at 20-21, 35. As discussed above, other courts have looked to exclusive remedy provisions as a basis for finding no coverage, including the North Carolina Court of Appeals in *Wake County*, which construed identical language in a Safety National policy. 487 S.E.2d 789. TKK further asserts that the fact that these cases involved a duty to defend rather than a duty to reimburse is simply "irrelevant." Brief at 21. To the contrary, as discussed above in section II, the obligation to reimburse defense costs does not arise until coverage is established, nor does estoppel apply. This distinction can hardly be deemed irrelevant. It instead demonstrates that a *bona fide* dispute as to coverage clearly existed.

TKK's additional allegation that it was "forced to file its own lawsuit" does not warrant reversal of the district court's ruling. It is undisputed that Safety National had no defense obligation. It therefore was not required to file a declaratory judgment action under *Ehlco* and established Illinois case law. *See* Section I, above. Even if the policy included a duty to defend, Illinois law does not require the insurer to be the first party to file a declaratory judgment action. *See J.A. Jones*, 269 Ill. App. 3d at 152-53; *Sportmart*, 268 Ill. App. 3d at 979-80.

Given the lack of clear Illinois precedent establishing the scope of an insurer's obligation to indemnify or reimburse defense costs under an excess indemnity policy for a claim barred by a statutory exclusivity provision, Safety National's denial of coverage cannot be deemed vexatious or unreasonable even if this Court ultimately decides the coverage issues in TKK's favor. Accordingly, the district court properly entered summary judgment in favor of Safety National on count IV.

V. TKK's Request for Sanctions under Rule 38 Should Be Denied

A. Standard of Review

In weighing a request for sanctions under Rule 38, this Court should consider first whether the appeal is indeed frivolous and, if so, whether sanctions are appropriate. *Insurance Co. of the West v. County of McHenry*, 328 F.3d 926, 929 (7th Cir. 2003). Whether to impose sanctions is within this Court's sound discretion. *Id.*

B. Rule 38 Sanctions Are Inappropriate Where Safety National's Appeal Is Well-Supported by the Case Law

Rule 38 allows an appellate court to award sanctions, in the form of costs and money damages, against an appellant who brings a frivolous appeal. Fed. R. App. P. 38. TKK's request for alternative relief in the form of sanctions fails to comply with Rule 38, which requires a sanction request to be presented in a separately filed motion. Fed. R. App. P. 38*; In re Gulevsky*, 362 F.3d 961, 964 (7th Cir. 2004). An appeal is frivolous when the appellant's arguments are utterly meritless and have no conceivable chance of success. *Gulevsky*, 362 F.3d at 964.

The mere fact that the district court entered judgment against Safety National on two of its four counts does not make Safety National's appeal of those counts frivolous. Safety National has presented substantial arguments on appeal supported by significant case authority on all issues. As discussed above in section I, Safety National obtained the opposite result in the North Carolina Court of Appeals under *identical* policy language in the *Wake County* case. It is not unreasonable to expect that an appellate court in another jurisdiction considering the same issue under identical language would arrive at the same result. Safety National was well within its right to deny coverage on a claim that it reasonably believed to be outside the scope of its excess policy, and to contest coverage in the declaratory judgment action filed by TKK within months after Safety National denied coverage.

Given the significant case authority in Safety National's favor, including *Wake County*, it is far from a foregone conclusion that this Court will interpret the Safety National policy in the same way as did the district court. TKK's request for attorney fees under Rule 38 should be denied.

CONCLUSION

For all of the foregoing reasons, defendant-appellant/cross-appellee, Safety National Casualty Corporation, respectfully requests that the April 10, 2012 judgment of the district court on counts I and II be reversed and the case be remanded for entry in judgment in its favor on counts I and II; that summary judgment in its favor on count IV be affirmed; that the award of damages, post-judgment interest and attorney fees in favor of TKK be vacated; and for such further relief as this Court deems just and proper.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I, Michael Resis, attorney for the defendant-appellant, Safety National Casualty Corporation, certify pursuant to Federal Rules of Appellate Procedure 32(a)(7)(B), that this brief complies with the type volume limitation. Specifically, I certify that the brief contains 8,778 words. This number was obtained from the word count of the word processing system, Microsoft Office Word 2010.

Dated: December 21, 2012

/s/ Michael Resis
Attorney for Defendant-Appellant/Cross-Appellee
Safety National Casualty Corporation

CERTIFICATE OF SERVICE

I, Michael Resis, an attorney, certify that I caused the foregoing Combined Response Brief and Reply Brief of Defendant-Appellant/Cross-Appellee to be electronically served upon all parties of record on this 21st day of December 2012.

/s/Michael Resis
Attorney for Defendant-Appellant/Cross-Appellee Safety National Casualty Corporation