

Virginia Surety v. Northern Insurance Co. of New York
Case Update

By Dean Barakat

The Illinois Supreme Court has changed the law regarding insurance coverage of employers sued in contribution when a Kotecki waiver has occurred. Prior to the Illinois Supreme Court's decision in Virginia Surety v. Northern Insurance Co. of New York, (Jan. 19, 2007), workers' compensation policies did not provide coverage to employers beyond the amounts paid out in workers' compensation benefits. Conversely, general liability policies covered any liability above and beyond the Kotecki cap where a waiver by contract has occurred. As a result of the Virginia Surety decision, there will potentially be coverage under workers' compensation policies up to the policy limits and no coverage under general liability policies in contribution actions with a Kotecki waiver. This ruling overturns the cases of Michael Nicholas, Inc. v. Royal Insurance Co. of America, 321 Ill. App. 909 (2nd Dist. 2001) and Christy-Foltz Inc. v. Safety Mutual Insurance Casualty Corp., 309 Ill. App. 3d 686 (4th District 2000).

The Supreme Court's decision in Virginia Surety has turned the state of the law on its head and has practical implications. As a result of the Virginia Surety decision general liability carriers will not have to provide coverage for any liability above the Kotecki cap when an employer is sued for contribution. Additionally coverage by workers' compensation carriers for employers' contribution actions is no longer limited to the amounts paid out in workers' compensation benefits, but potentially to their policy limits. So, general liability carriers will no longer have to deal with Kotecki waiver situations and workers' compensation carriers will have to evaluate their insured employers' actual liability in these cases.

This decision is applicable to a common but specific circumstance where an employee is injured and receives workers' compensation benefits. The injured employee then commences litigation against potentially liable third parties. Those defendants then file a contribution action against the employer. Under Illinois law, the employer is liable only up to those amounts that were paid out in workers' compensation benefits unless that right was waived by contract (commonly known as the Kotecki cap). The Illinois courts began grappling with insurance coverage of both general liability carriers and workers' compensation carriers for that remaining portion of liability above and beyond the Kotecki cap.

The state of the law prior to the Supreme Court's Decision in Virginia Surety

Prior to the Virginia Surety decision, there was a split with regard to general liability carriers. In Hankins v. Pekin Insurance Co. 305 Ill. App. 3d 1088(5th Dist. 1999). The Fifth District found that an "indemnity provision" in a contract essentially waiving Kotecki did not constitute an "insured contract" which would have provided coverage under the general liability policy of insurance.

The exact opposite conclusion was reached by the Second District in Michael Nicholas, Inc. v. Royal Insurance Co. of America, 321 Ill. App. 909 (2nd Dist. 2001). That court found that the employer was assuming another party's tort liability by contract and constituted an "insured contract" falling within the insured content exception and covered by the general liability policy. The Michael Nicholas decision seems to be the much more widely followed precedent exposing general liability carriers to defense and indemnity claims in Kotecki waiver scenarios.

In a related issue, the Illinois Appellate Court in Christy-Foltz Inc. v. Safety Mutual Insurance Casualty Corp., 309 Ill. App. 3d 686 (4th District 2000) provided guidance with regard to coverage by a workers' compensation carrier where a Kotecki waiver is present. The Christy-Foltz court construed a workers' compensation and employer's liability policy where there was a contractual Kotecki waiver. In reviewing the matter the Christy-Foltz court construed the contractual Kotecki waiver as "voluntarily assumed liability." Given this analysis there would be no coverage under the workers' compensation policy for any liability above the Kotecki cap as that was voluntarily assumed liability excluded by the policy.

The state of the law as a result of the Supreme Court's Ruling

The Illinois Supreme Court has overturned Michael Nicholas and Christy-Foltz. In Virginia Surety, the Supreme Court rejected the notion that a Kotecki waiver is "voluntary assumed liability" or the liability of another assumed by contract. The Supreme Court noted that an employer has contribution liability pursuant to the Illinois Contribution Act. The employer is liable for their pro rata share of contribution under the law. The Kotecki decision allows an employer to assert the Illinois Workers' Compensation Act as an affirmative defense to limit its liability in the contribution action. The Court reasoned, an employer faces its full share of liability until it elects to raise the Kotecki affirmative defense. Likewise, it may bargain away the right to raise the affirmative defense in anticipation of litigation. Based on this interpretation there is no voluntarily assumed liability, the employer always had the liability, but had the right to raise an affirmative defense to a contribution action. Additionally, there is no liability assumed by contract under the terms of a general liability policy.

Therefore, a Kotecki waiver in a contract does not fall into the insured contract exception of any employer's general liability policy. There is no coverage under an employer's general liability policy for liability as the result of a Kotecki waiver.

Additionally, the Court found a Kotecki waiver is not voluntarily assumed liability and does not fall within the coverage exceptions of a workers' compensation and employer's liability policy. There is now coverage for an employer's contribution liability up to the policy limits for employer's liability when there is a Kotecki waiver. This is essentially reverting back to the law prior to Christy-Foltz and Michael Nicholas. As a practical matter, contribution actions against employers will not be covered under their general liability policies and workers' compensation carriers will have to evaluate the levels of liability of the employer where there is a Kotecki waiver. In these instances there is the possibility of additional exposure under the employer's liability portion of a workers' compensation policy beyond those sums paid out in workers' compensation benefits.

Finally, this is currently the law in Illinois and affects all currently pending actions. In other words, all contribution actions against employers that have been filed and have not been tried or resolved are subject to this interpretation by the Illinois Supreme Court.