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Insurance Coverage for Workplace Injuries: Illinois Employers May Be at Risk

Introduction

When a workplace accident occurs, the injured employee's remedy against his employer is usually limited to the amount available to him under the Workers' Compensation Act. Because this amount is typically much less than he could receive in a negligence action against a third party, it is not uncommon for an injured employee to also find a third party to sue for his injuries. For example, in addition to filing a workers' compensation claim, an employee injured on a construction site may sue the general contractor, alleging it failed to provide a safe place to work.

Until February 5, 1992, when an employee sued a third party for his work-related injuries, the third party could file a contribution action against his employer, seeking contribution for that portion of the third party's liability which arose out of the employer's negligence. For example, the general contractor might file a contribution action against the employer alleging that the employee had been improperly trained. At trial, any judgment obtained by the employee would be apportioned between the general contractor and the employer according to their respective degrees of fault. Thus, it was not uncommon for a judgment to be entered against the employer which greatly exceeded the amount which it had previously paid the employee pursuant to the Workers' Compensation Act. Fortunately, the amounts payable by the employer under the Workers' Compensation Act and any judgment entered against the employer in the contribution action were typically covered under the employer's workers' compensation policy.

Kotecki Decision

On February 5, 1992, the Supreme Court of Illinois issued its opinion in the case of *Kotecki v. Cyclops Welding Corporation*, 146 Ill.2d 155, 585 N.E. 2d 1023 (1992). This case set off a chain reaction which may culminate in a significant uninsured exposure for employers in relation to workplace injuries. In *Kotecki*, the supreme court held that the amount of contribution which can be obtained from an employer by a third party is limited to the amount of the employer's liability under the Workers' Compensation Act. Thus, following *Kotecki*, a third party could still file a contribution action against the injured worker's employer, but the employer's liability would be limited to the amount it had already paid in response to the employee's workers' compensation claim.

Kotecki represented a significant benefit to workers' compensation insurers. Under the Workers' Compensation Act, the employer has a statutory lien on an award which an employee obtains against a third party. Thus, the employer and its insurer are entitled to reimbursement of a portion of their workers' compensation payments out of any award obtained by the employee against a third party. Prior to *Kotecki*, workers' compensation insurers would often waive their lien in order to avoid a contribution action and potential liability in excess of the lien amount. *Kotecki*, however, eliminated the risk to the employer and its insurer of a contribution award in excess of the workers' compensation lien. Thus, post-*Kotecki*, an employer and his insurer had incentive to participate actively in the employee's negligence action in hopes of recovering a portion of the workers' compensation lien. There was no downside risk.

Herington, Liccardi and Braye Decisions

Kotecki's benefit to employers, however, was short lived. In 1994, the Illinois Appellate Court, Fifth District, issued its opinion in *Herington v. J.S. Alberici Construction Co.*, 266 Ill.App.3d 489, 639 N.E.2d 907 (1994). In *Herington*, two employees of painting subcontractor Shield Painting Co. were injured while engaged in work taking place on Lock and Dam 22, which spans the Mississippi River from Missouri to Illinois. They filed workers' compensation claims against Shield and a suit against the general contractor on the project, J.S. Alberici Construction Co. Alberici, in turn, filed a contribution action against Shield.

The court held that the employer had waived its right to rely upon the workers' compensation limits recognized in *Kotecki* as a defense to the contribution claim by agreeing in its subcontract agreement to indemnify Alberici for all liability arising out of Shield's negligence. The court stated, "If an employer is free to

choose whether to raise the workers' compensation defense after suit is filed, we see no reason why an employer may not bargain away that defense as part of a subcontract. Just as an employer may choose not to raise the defense in a direct suit by an employee because it may believe it will prevail, the employer may agree to waive the defense as part of the contract bargaining process." Thus, by agreeing to include a standard indemnity/hold harmless agreement in its contract with the general contractor, the employer unwittingly exposed itself to unlimited liability in the contribution action. The ruling in *Herington* was followed by the First District Appellate Court in *Liccardi v. Stolt Terminals*, 283 Ill.App.3d 141, 669 N.E.2d 1192 (1996), and by the Supreme Court of Illinois in *Braye v. Archer-Daniels-Midland Co.*, 175 Ill.2d 201, 676 N.E.2d 1295 (1997).

By agreeing to include a standard indemnity/hold harmless agreement in its contract with the general contractor, the employer unwittingly exposed itself to unlimited liability in the contribution action.

Following *Herington*, *Liccardi* and *Braye*, it appeared that both employers and their insurers once again faced a significant downside risk in contribution actions, particularly in the construction scenario where indemnity agreements are the norm. Current Illinois law, however, suggests that the only party who faces significant downside risk where the employer's *Kotecki* limits have been waived is the employer itself.

Christy-Foltz Decision

On January 7, 2000, the Illinois Appellate Court, Fourth District, issued its opinion in *Christy-Foltz, Inc. v. Safety Mut. Cas. Corp.*, 309 Ill.App.3d 686, 722 N.E.2d 1206 (2000). In *Christy-Foltz*, an employee of Christy-Foltz was injured on a construction project. He filed a workers' compensation claim against his employer and sued the general contractor on the project. The general contractor, in turn, filed a contribution action against Christy-Foltz. In accordance with *Braye*, the court held that Christy-Foltz had waived its right to rely upon the limitations recognized in *Kotecki* by virtue of an indemnification/hold harmless agreement.

Following the court's ruling, Christy-Foltz's workers' compensation insurer, Safety Mutual, denied coverage for any contribution award against Christy-Foltz in excess of its liability under the Workers' Compensation Act. Safety Mutual asserted that Christy-Foltz was not entitled to coverage because it had

voluntarily assumed liability in excess of its workers' compensation liability under a contract. It relied upon a policy exclusion which stated:

In no event shall the CORPORATION [Safety Mutual] be liable for any [l]oss or [c]laim [e]xpenses voluntarily assumed by the EMPLOYER [Christy-Foltz] under any contract or agreement, express or implied.

The court held that under the unambiguous terms of the policy, the exclusion precluded coverage for amounts in excess of the employer's liability under the Workers' Compensation Act, stating:

In agreeing to waive the right to invoke Kotecki as an affirmative defense, the [insured] voluntarily assumed contribution liability in excess of the liability limitations provided to employers under the Workers' Compensation Act.

Hankins Decision

The *Christy-Foltz* decision is especially hard on employers, because a decision by the Appellate Court, Fifth District, in *Hankins v. Pekin Insurance Co.*, 305 Ill.App.3d 1088, 713 N.E.2d 1244 (1999) sixth months earlier suggests that there also is no coverage under the standard commercial general liability policy for liability in excess of the employer's liability under the Workers' Compensation Act.

In *Hankins*, Hankins operated a trucking terminal in Effingham County. Hankins had entered into an "Independent Cartage Operator Agreement" with a motor freight carrier. Under the terms of the agreement, Hankins agreed to provide a shipping and receiving terminal that the motor carrier was permitted to use to deliver and pick up loads of materials. The agreement also contained a provision whereby Hankins agreed to hold the motor carrier harmless for all liability arising out of the negligence of Hankins. One of Hankins' employees was injured while unloading a truck. He sued the motor carrier, who in turn filed a contribution action against Hankins.

Hankins tendered the defense of the contribution action to its general liability insurer. The insurer denied coverage on the grounds that the policy excluded coverage for liability assumed under a contract. The insurer relied on policy language which stated:

This insurance does not apply to:

b. "Bodily injury" or "property damage" for which the insured is obligated to pay by reason of the assumption of liability in a contract or agreement.

About Vedder Price

Vedder, Price, Kaufman & Kammholz is a national, full-service law firm with approximately 200 attorneys in Chicago, New York City and Livingston, New Jersey.

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This exclusion does not apply to liability for damages:

(1) Assumed in a contract or agreement that is an "insured contract," provided the "bodily injury" or "property damage" occurs subsequent to the execution of the contract or agreement.

The policy defined "insured contract" as:

That part of any other contract or agreement pertaining to your business...under which you assume the tort liability of another to pay damages because of "bodily injury" or "property damage" to a third person or organization. Tort liability means a liability that would be imposed by law in the absence of any contract or agreement...

The court held that the indemnification agreement between Hankins and the motor carrier was not an "insured contract," because under the policy definition, an insured contract is "one that provides for the contracting parties to assume someone else's tort liability, that is, someone else's liability for their own negligence." Hankins, the court held, had not agreed to assume the tort liability of the motor carrier, but rather, had only agreed to indemnify the motor carrier to the extent of Hankins' own negligence. Thus, the court found that the insured was not entitled to coverage for the contribution action against it.

Conclusion

What began in 1992 as an attempt by the courts to limit an employer's liability for injuries to its employees may culminate in a significant uninsured exposure for employers. First, the court ruled in *Kotecki* that an employer's liability in a contribution action is limited to the amounts payable under the Workers' Compensation Act. This holding encouraged creative litigants to convince the courts that standard indemnification or hold harmless agreements customarily contained in construction and other contracts constitute an implied waiver of the *Kotecki* defense. These holdings, in turn, allowed workers' compensation and general liability insurers to convince the courts that there is no coverage, because a *Kotecki* waiver constitutes an excluded voluntary assumption of liability under contract.

What began in 1992 as an attempt by the courts to limit an employer's liability for injuries to its employees may culminate in a significant uninsured exposure for employers.

Because of the uninsured risk to employers, the holdings in *Christy-Foltz* and *Hankins* will undoubtedly be the subject of court room disputes until they are finally resolved by the Supreme Court of Illinois. Clearly, employers (and some insurers) presumed insurance coverage was available for this type of liability under existing policies. Understandably, employers will continue to argue that liability in excess of their *Kotecki* limits is covered under their workers' compensation policy, their general liability policy, or both. Where an employer has different insurance companies for its workers' compensation and general liability coverages, those insurers may point their fingers at each other with the insured caught in the middle. Where the employer has the same insurer for its workers' compensation and general liability coverages, that insurer may take the position that there is no coverage under either policy. Indeed, there are countless legal arguments which can be made to support each side of this dispute.

Until these issues are finally resolved by the Supreme Court of Illinois, employers and insurance companies must be aware of the substantial risks they face. If both *Christy-Foltz* and *Hankins* are upheld, many small to medium sized employers could face potential financial ruin if confronted with a million dollar uninsured judgment. If *Christy-Foltz* is upheld, but *Hankins* is not, many general liability insurers will face liability exposures which they had not previously contemplated. Likewise, if *Christy-Foltz* is overturned, workers' compensation carriers will again have to provide coverage for liability in excess of the employer's *Kotecki* limits.

Needless to say, employers, workers' compensation insurers and general liability insurers each need to carefully analyze the policy language and facts involved in each case prior to taking a position on these important issues. Finally, employers and insurers must carefully consider these issues when negotiating future insurance policies. Certain insurers have begun offering policy endorsements which effectively waive the insurer's right to rely on these coverage defenses, presumably eliminating the employer's uninsured exposure. Of course, both employers and insurers must take great care to ensure that these endorsements, where offered, are properly worded to provide the level of coverage intended by

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