2014 IL App (1st) 130583-U

FIRST DIVISION
August 11, 2014

No. 1-13-0583

IN THE
APPELLATE COURT OF ILLINOIS
FIRST JUDICIAL DISTRICT

ENTERPRISE LEASING COMPANY OF CHICAGO, doing business as ENTERPRISE RENT-A-CAR, Plaintiff-Appellant, v. ROBERT JENKINS, Defendant. FOUNDERS INSURANCE COMPANY, Third Party Citation Respondent-Appellee.	)	Appeal from the Circuit Court of Cook County. No. 05 M1 19462 Honorable Patrick Sherlock, Judge Presiding.

JUSTICE DELORT delivered the judgment of the court.
Presiding Justice Connors and Justice Hoffman concurred in the judgment.

ORDER

¶ 1 ***Held:*** When an SR-22 insurance policy excludes unlicensed drivers from coverage, the insurer is not liable to pay a judgment resulting from an accident involving an unlicensed driver, even if: (1) the unlicensed driver is the primary insured party on the policy; and (2) the insurer belatedly asserted the exclusion long after it had initially issued a reservation of rights letter to the insured.

¶ 2 This dispute involves whether an insurance company must pay a judgment rendered against its insured. The company denied coverage and disclaimed responsibility to pay the judgment because its policyholder, who drove the vehicle at fault, was not licensed to drive at the time of the subject accident. The court below held that the insurer could justifiably refuse to indemnify the unlicensed driver. We agree and therefore affirm.

¶ 3 BACKGROUND

¶ 4 Plaintiff Enterprise Leasing Company of Chicago, doing business as Enterprise Rent-a-Car (Enterprise), sued defendant Robert Jenkins after a car driven by Jenkins collided with an automobile Enterprise owned. Third party citation respondent Founders Insurance Company (Founders) had issued Jenkins a financial responsibility automobile insurance policy, commonly known as an "SR-22" policy, apparently without verifying whether Jenkins could legally drive in Illinois.[1] About two months after the accident, Founders sent Jenkins a letter rescinding the policy because he failed to disclose his lack of a valid license on his policy application. Founders refunded Jenkins's premium to his insurance agent. The sole basis stated in the rescission letter and in Founders' later communications to Jenkins was the material misrepresentation he made on the policy application. Notwithstanding the rescission, Founders defended Jenkins in the underlying accident lawsuit subject to a "complete" reservation of rights. The reservation of rights letter stated, among other things, that Founders reserved the right to withdraw its defense any time and/or deny him indemnification at any time.

[1] An SR-22 policy "monitors the insurance of problem drivers and authorizes the Secretary of State's office to suspend [the driver's license] upon cancellation or expiration. Financial Responsibility Insurance is required in Illinois for individuals with safety responsibility suspensions, unsatisfied judgment suspensions, mandatory insurance supervisions and individuals who receive three or more convictions for mandatory insurance violations." Illinois Secretary of State, "Financial Responsibility (SR-22) Insurance," *available at* http://www.cyberdriveillinois.com/departments/drivesr/drivers_licenses/SR-22_uninsured_crashes/finressr22.html (last visited August 1, 2014).

¶ 5 At trial on the accident case, the court found Jenkins at fault and awarded Enterprise $4,535.00. Neither Jenkins nor his insurer, Founders, paid the judgment. Enterprise initiated collection efforts and filed a citation to discover assets against Founders to collect the judgment.

¶ 6 In the citation proceedings, Founders admitted that it had issued an insurance policy to Jenkins, but alleged two affirmative defenses: (1) it had rescinded the policy; and (2) exclusion P of the policy excluded unlicensed drivers from coverage. The citation proceeded to an evidentiary hearing. Before the evidentiary hearing began, Founders withdrew its defense of rescission, apparently because it was questionable whether the SR-22 policy could be rescinded after the accident. See 625 ILCS 5/7-317(f)(2) (West 2004) (providing that an SR-22 policy cannot be "cancelled or annulled as respects any loss or damage, by any agreement between the carrier and the insured after the insured has become responsible for such loss or damage"). Enterprise did not contest this withdrawal. Founders relied, however, on its second basis to deny Jenkins coverage, namely that exclusion P in the policy excluded unlicensed drivers from coverage. Founders had never previously notified Jenkins or Enterprise of this new basis to deny coverage.

¶ 7 Founders presented testimony from a representative of the Illinois Secretary of State's office that Jenkins's driver's license had been suspended at the time of the accident. In fact, the license was subject to several different cancellations and suspensions dating back to 2003, two years before the 2005 accident, and had never been reinstated.

¶ 8 The trial court found that Founders was required to notify Jenkins that it intended to deny coverage based on exclusion P. However, the court determined that failure was not fatal to Founders' rights. It found that an insurer may assert a previously undisclosed exclusion unless the insured detrimentally relied upon the insurer's failure to assert that particular defense.

Accordingly, the court held that Founders was not required to indemnify Jenkins and dismissed the citation. This appeal followed.

¶ 9 ANALYSIS

¶ 10 Enterprise's primary argument in its appeal is that Founders' initial rescission of the SR-22 policy was invalid. However, Founders withdrew its rescission defense below, and Enterprise did not object to that withdrawal. Accordingly, that issue is moot and we will limit our analysis to whether exclusion P provides relief to Founders. Our review of the issues presented is *de novo*. *Solon v. Midwest Medical Records Ass'n, Inc.*, 236 Ill. 2d 433, 439 (2010) (statutory construction); *Virginia Surety Co. v. Northern Insurance Co. of New York*, 224 Ill. 2d 550, 556 (2007) (insurance policy construction).

¶ 11 Exclusion P bars coverage for "bodily injury or property damage arising out of the use by any person of a vehicle without a reasonable belief that the person is entitled to do so." In *Founders Insurance Co. v. Munoz*, 237 Ill. 2d 424 (2010), our supreme court held that exclusion P did not violate public policy, and that insurance companies "may limit their risk by excluding insureds and permissive users alike who lack the most basic requirement for driving in this state: a valid license." *Id.* at 445. Section 7-317(f)(1) of the Illinois Motor Vehicle Code (625 ILCS 5/7-317(f)(1) (West 2004)), provides that the "liability of the insurance carrier under [an SR-22] policy shall become absolute whenever loss or damage *covered by the policy* occurs." (Emphasis added.) Founders argues that because Jenkins could not have possessed any reasonable belief that he was a licensed driver, exclusion P was triggered and Founders' indemnification obligation was nullified.

¶ 12 Enterprise counters that Founders is estopped from invoking exclusion P because it did not notify Jenkins or Enterprise about it sooner. Enterprise claimed that Founders had "five

years to get it right and never did." Its argument is essentially based on the "mend the hold" doctrine which prevents bait-and-switch defenses. Over a century ago, our supreme court described the doctrine in the following terms:

> "Where a party gives a reason for his conduct and decision touching anything involved in a controversy, he cannot, after litigation has begun, change his ground, and put his conduct upon another and different consideration. He is not permitted thus to amend his hold. He is estopped from doing it by a settled principle of law." *County of Schuyler v. Missouri Bridge & Iron Co.*, 256 Ill. 348, 353 (1912); accord *Trossman v. Philipsborn*, 373 Ill. App. 3d 1020, 1042 (2007).

The doctrine is grounded in the general contractual principle of good faith and precludes "[a] party who hokes up a phony defense to the performance of his contractual duties" from "[trying] on another defense for size." *Harbor Insurance Co. v. Continental Bank Corp.*, 922 F.2d 357, 363 (7th Cir. 1990).

¶ 13 A variation of the doctrine is applicable in Illinois insurance cases. Our supreme court has held that insurers who believe that a lawsuit is not covered under a policy have only two options: (1) they may defend the suit under a reservation of rights or (2) seek a declaratory judgment that there is no coverage. *Employers Insurance of Wausau v. Ehlco Liquidating Trust*, 186 Ill. 2d 127, 150 (1999). Insurers who walk away from their insured and do neither, and are later found to have wrongfully denied coverage, are estopped from raising policy defenses to coverage. *Id*. at 150-51. The *Employers Insurance* court noted that this doctrine had "deep roots in Illinois jurisprudence" and recognizes 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 contract." *Id*. at 151 (citing *Kinnan v. Charles B. Hurst Co.,* 317 Ill. 251, 257 (1925)).

¶ 14 This estoppel doctrine applies, however, only where an insurer has breached its duty to defend. If, as here, an insurer issues a reservation of rights letter, the insurer defends the underlying lawsuit, and the insured accepts defense counsel provided by the insurer, the insurer is not estopped from asserting policy defenses. *Stoneridge Development Co. v. Essex Insurance Co.*, 382 Ill. App. 3d 731, 741 (2008). Accordingly, this doctrine does not itself prevent Founders from raising exclusion P during the course of the collection proceedings.

¶ 15 Similarly, if an insurer defends its insured without disclosing a potential conflict of interest in its reservation of rights, the insurer is estopped from raising coverage defenses. *Id*. at 742. An example of that situation is when the issue in the underlying tort claim and reason for denial of coverage are the same, therefore creating a potential conflict of interest between the insurer and insured. *Royal Insurance Co. v. Process Design Associates, Inc.*, 221 Ill. App. 3d 966 (1991). The reason for the *Royal Insurance* doctrine is that "only when the insured is adequately informed of the potential policy defense that he can intelligently choose between retaining his own counsel or accepting the tender of defense counsel from the insurer." *Id*. at 973 (quoting *Cowan v. Insurance Co. of North America*, 22 Ill. App. 3d 883, 896 (1974)). No such potential conflict was present here because there was no factual connection between the negligence which caused Jenkins's car to hit Enterprise's car and Jenkins's lack of a valid driver's license, Jenkins's and Founders' interests were aligned.

¶ 16 We also note that our supreme court has recently held that when an "insurer adequately informs the insured that it is proceeding under a reservation of rights, identifying the policy

provisions that may preclude coverage, and the insured accepts defense counsel provided by the insurer, then the insurer is not estopped from asserting policy defenses." *Standard Mutual Insurance Co. v. Lay*, 2013 IL 114617, ¶ 20.

¶ 17 In the end, this case hinges on detrimental reliance. While an insurer is not required to assert all of its defenses to liability in a reservation of rights letter (*Tobi Engineering v. Nationwide Mutual Insurance Co.*, 214 Ill. App. 3d 692, 696 (1991)), an insurer may be estopped from asserting a defense of noncoverage if it undertakes the defense of an action and that undertaking results in some prejudice to the insured. *Western Casualty & Surety Co. v. Brochu*, 105 Ill. 2d 486, 499-500 (1985). Prejudice can be found "if the insurer's assumption of the defense induces the insured to surrender her right to control her own defense" by retaining independent counsel at the insurer's expense. *Standard Mutual Insurance Co.*, 2013 IL 114617, ¶ 19.

¶ 18 We do not see how Jenkins would be prejudiced by Founders' belated invocation of exclusion P. Both the exclusion and the rescission letter are based on the same operative fact that Jenkins was not licensed. Accordingly, Jenkins could not have detrimentally relied on Founders' failure to promptly invoke exclusion P. In these circumstances, Founders was not prevented from asserting exclusion P as a "new" reason for denial of coverage. *Jones v. Universal Casualty Co.*, 257 Ill. App. 3d 842, 852 (1994) (stating "[w]e believe that the better rule is that insureds must show that they relied to their detriment upon the insurer's failure to assert a particular defense").

¶ 19 CONCLUSION

¶ 20 The trial court correctly dismissed the citation on the basis that Founders was not responsible to indemnify Jenkins. Because we find that Founders properly denied

indemnification to Jenkins, we must also reject Enterprise's final claim that Founders is responsible for vexatious delay damages under section 155 of the Illinois Insurance Code 215 ILCS 5/155 (West 2010).

¶ 21 Affirmed.