State Of Insurance: Q3 Notes From Illinois

By **Matthew Fortin** (October 23, 2025)

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The last two quarters have seen Illinois' appellate courts weigh in on the scope of appraisal and a liability insurer's duty to indemnify based on settlement language.

Meanwhile, the U.S. Court of Appeals for the Seventh Circuit has also been active, affirming the validity of occupancy requirements in commercial auto insurance policies and, of particular significance, certifying a question to the Illinois Supreme Court regarding the applicability of the standard-form pollution exclusion in commercial general liability policies to permitted emissions of industrial pollutants.

The Illinois Appellate Court finally weighs in on the scope of appraisal.

Federal district courts applying Illinois law, especially the U.S. District Court for the Northern District of Illinois, have issued numerous opinions over the last eight years regarding the scope of appraisal under homeowners and commercial property insurance policies. In most of those cases, courts have concluded that disputes regarding causation and the scope of damage from an admittedly covered loss are categorized under "amount of loss," which may be resolved in appraisal, rather than coverage issues reserved for judicial determination.[1]

The Appellate Court of Illinois finally weighed in with its first published decision on the subject on May 12 in Zhao v. State Farm Fire & Casualty Co., holding that a disagreement regarding the scope of covered damage may be resolved through appraisal.[2]

The insured had made a claim for hail damage to her dwelling under her homeowners insurance policy with State Farm. Following its investigation, State Farm issued an actual cash value payment of $12,677.94 based on an estimate that included replacement of gutters, downspouts and aluminum wraps on certain window frames and trim.[3]

The insured, in turn, claimed that the hail damage was extensive enough to require replacement of all the windows in the dwelling at a cost of $133,817.82.[4]

The Lake County Circuit Court granted the insured's motion to compel appraisal over State Farm's objection that the parties' dispute was a coverage issue not appropriate for appraisal.[5]

In the first published Illinois Appellate Court opinion on the issue, the Second District court held that the parties' disagreement regarding the scope of hail damage to the insured's windows was an amount of loss issue appropriately resolved in appraisal and not, as State Farm argued, an issue of coverage that fell outside the terms of the appraisal clause.[6]

In doing so, the court acknowledged that multiple rulings in recent years from federal district courts sitting in diversity and applying Illinois law, particularly the Northern District of Illinois, had reached similar results.[7]

With the Illinois Supreme Court having denied State Farm's petition for leave to appeal, on

Sept. 24, Zhao provides importance guidance for Illinois' trial courts and federal district courts sitting in diversity, as well as for practitioners advising their clients on whether a given dispute is subject to appraisal.[8]

There's no duty to indemnify where the insured assigned rights under a policy in lieu of an obligation to pay the settlement amount.

In 2003, in Guillen v. Potomac Insurance Co. of Illinois, the Illinois Supreme Court held that an insurer that had breached its duty to defend could not avoid an indemnity obligation for a settlement amount even though its insured's obligation to pay was satisfied by an assignment of rights.[9] The court's ruling in that case hinged on a liberal construction of the policy's phrase "legally obligated to pay," which the court said "[f]airness require[d]" since the insurer had breached its duty to defend.[10]

In ISMIE Mutual Insurance Co. v. Pergament, the Appellate Court of Illinois, First District, on June 16 declined to extend the benefit of that same liberal construction to an insured whose insurer had defended it subject to a reservation of rights.[11]

The insured, a medical provider, reached a settlement of a negligence action with the underlying claimants for an undisclosed sum, but the settlement agreement did not obligate the insured to pay any sum of money to anyone. Instead, the settlement agreement provided that the insured's assignment of his rights to the claimants fully and finally discharged the insured from any obligation to pay regardless of whether the claimant was able to collect the settlement amount from ISMIE.[12]

ISMIE denied having an indemnity obligation for the settlement amount because its insured was never "legally obligated to pay" anything, as his only obligation under the settlement agreement was his assignment of rights under the ISMIE policy.[13]

The insured and his assignees argued they were entitled to a liberal construction of the policy's "legally obligated to pay" language under Guillen.[14] The First District distinguished Guillen primarily on the ground that Guillen's liberal construction of the "legally obligated to pay" language was motivated by the insurer's breach of its duty to defend.

In contrast, ISMIE had defended its insured under a reservation of rights. Because ISMIE had not breached its duty to defend the insured, his assignees were not entitled to a liberal construction of the "legally obligated to pay language" and, therefore, ISMIE did not owe indemnity to its insured or its assignee for the settlement amount.[15]

ISMIE serves as a cautionary tale for practitioners negotiating settlements involving an assignment of an insured's rights against his or her liability insurer.

The Illinois Supreme Court is asked to weigh in on applicability of a pollution exclusion to permitted emissions of industrial pollutants.

The most significant recent judicial development in Illinois is the Seventh Circuit's April 11 decision in Griffith Foods International v. National Union Fire Insurance Co., which certified a question of considerable importance to the Illinois Supreme Court regarding the application of the standard form pollution exclusion in commercial general liability policies.[16]

Griffith Foods involved liability coverage for the defense of mass tort litigation against an

insured industrial manufacturer arising out of its emission of ethylene oxide over a 35-year period.[17]

An issue presented to the Seventh Circuit was whether the standard form pollution exclusion applied to the insured's emission of ethylene oxide pursuant to a permit issued by the Illinois Environmental Protection Agency. The court noted that the applicability of the pollution exclusion in those circumstances would be clear under the Illinois Supreme Court's 1997 ruling in American States Insurance Co. v. Koloms if not for the Illinois Appellate Court, Third District's 2011 ruling in Erie Insurance Exchange v. Imperial Marble Corp., which found a pollution exclusion ambiguous as to whether it barred coverage for emissions authorized by regulatory permit.[18]

Rather than attempt to resolve the tension between Koloms and Imperial Marble itself, the Seventh Circuit opted to certify to the Illinois Supreme Court the question of what relevance, if any, a permit or regulation authorizing emissions generally, or at particular levels, plays in assessing the application of a pollution exclusion within a standard-form CGL policy.[19]

As the Seventh Circuit noted in explaining its decision to certify the question, the issue presented in the case before it was likely to recur, and its resolution will have substantial ramifications for insurers and insureds.[20] The Illinois Supreme Court granted review of the certified question.[21]

Occupancy requirements in commercial auto policies are still valid.

In 2023, the Illinois Supreme Court struck down an occupancy requirement for uninsured motorist coverage in a personal automobile insurance policy as against Illinois public policy in Galarza v. Direct Auto Insurance Company.[22] Two years later, in the wake of Galarza, the Seventh Circuit affirmed the continued validity of occupancy requirements in commercial auto policies in Rahimzadeh v. Ace American Insurance Co.[23]

The plaintiff had been denied coverage under his employer's commercial automobile insurance policy because he was not occupying a covered vehicle when he was struck by an underinsured motorist while riding his bicycle.

The occupancy requirement in Ace's policy stated that coverage applied to any person "occupying" a covered vehicle. Because the employee's bicycle was not a covered vehicle, and he was not otherwise occupying a covered vehicle at the time of the accident, he was not entitled to UIM coverage under his employer's policy.[24]

The Seventh Circuit's analysis was animated by the seemingly conflicting approaches to occupancy requirements reflected in Galarza and the First District's 2007 decision in Stark v. Illinois Emcasco Insurance Co.[25] In the latter, the appellate court enforced the occupancy requirement in a commercial auto policy to deny coverage to the sole officer, director and shareholder of a corporate named insured who was struck by an underinsured motorist while walking in a parking lot.[26]

In Galarza, the Illinois Supreme Court distinguished Stark, rather than overturn it, which the Seventh Circuit took as indication that the public policy concerns that predominate in personal insurance policies, such as not infringing on the intended scope of uninsured motorist coverage under Section 143a of the Illinois Insurance Code, did not apply with equal force to commercial insurance policies.[27]

Reconciling Galarza and Stark, the Seventh Circuit reasoned in its July 11 decision that "[o]ccupancy requirements are permissible in commercial policies but void in personal policies simply because the purposes of the two policies differ."[28]

Because the plaintiff was not occupying a covered vehicle at the time of the accident, and was not otherwise an insured for purposes of liability coverage, the Seventh Circuit held that he was not entitled to underinsured motorist coverage under his employer's commercial auto policy.[29]

Conclusion

Looking ahead, many eyes will be on the Illinois Supreme Court in anticipation of it providing much-needed guidance on the relevance of regulatory permits and approvals to application of the standard-form pollution exclusion. In the meantime, the decisions discussed above provide helpful guidance on Illinois law pertaining to appraisals, the effect of settlement language on the duty to indemnify and the validity of occupancy requirements in commercial auto policies.

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[1] See, e.g., Culvey v. Auto-Owners Ins. Co., 670 F. Supp. 3d 657 (N.D. Ill. 2023); Runaway Bay Condo. Ass'n v. Philadelphia Indem. Ins. Cos., 262 F. Supp. 3d 599 (N.D. Ill. 2017).

[2] Zhao v. State Farm Fire & Cas. Co., 2025 IL App (2d) 240723 (May 12, 2025).

[3] Id. at ¶ 5.

[4] Id. at ¶ 6.

[5] Id. at ¶ 14.

[6] Id. at ¶ 34.

[7] Id. at ¶ 32.

[8] Zhao v. State Farm Fire & Cas. Co., 2025 WL 2719387 (Ill. Sup. Ct. Sept. 24, 2025) (table decision).

[9] Guillen v. Potomac Ins. Co. of Illinois, 203 Ill. 2d 141, 785 N.E.2d 1 (2003).

[10] Id. at 161

[11] ISMIE Mutual Ins. Co. v. Pergament, 2025 IL App (1st) 230787 (June 16, 2025).

[12] Id. at ¶¶ 35-38.

[13] Id. at ¶¶ 44, 46.

[14] Guillen v. Potomac Ins. Co. of Illinois, 203 Ill. 2d 141, 785 N.E.2d 1 (2003).

[15] ISMIE Mutual Ins. Co., 2025 IL App (1st) 230787, ¶¶ 113-116.

[16] Griffith Foods Int'l v. Nat'l Union Fire Ins. Co., 134 F.4th 483 (7th Cir. Apr. 11, 2025).

[17] Id. at 483-484.

[18] Id. at 490-491; American States Insurance Co. v. Koloms, 177 Ill. 2d 473, 687 N.E.2d 72 (1997); Erie Insurance Exchange v. Imperial Marble Corp., 2011 IL App (3d) 100380.

[19] Griffith Foods Int'l, 134 F.4th at 492-493.

[20] Id.

[21] Griffith Foods Int'l Inc. v. Nat'l Union Fire Ins. Co., Case No. 24-1217 (Ill. Sup. Ct. Apr. 17, 2025).

[22] Galarza v. Direct Auto Insurance Company, 2023 IL 129031 (2023) ¶ 56.

[23] Rahimzadeh v. Ace American Ins. Co., 142 F.4th 972 (7th Cir. July 11, 2025).

[24] Id. at 974.

[25] Id. at 977-979; Stark v. Illinois Emcasco Ins. Co., 373 Ill. App. 3d 804, 869 N.E.2d 957 (2007); Galarza v. Direct Auto Insurance Company, 2023 IL 129031 (2023).

[26] Rahimzadeh, 142 F.4th at 977-979.

[27] Id.

[28] Id. at 978.

[29] Id. at 978-979.