UIM Arbitration And The Trial *De Novo* Provision

James T. Nyeste

Automobile policies generally contain identical arbitration clauses for uninsured motorist ("UM") and underinsured motorist ("UIM") claims or employ the same clause applicable to both types of claims. Although the arbitration clause will require the UM or UIM claim to be arbitrated, the clause will also typically provide that an award exceeding the minimum limit of liability specified in the state's financial responsibility law[1] will not be binding and that either party (insured or insurer) may demand the right to a trial. This provision in the arbitration clause has come to be known in the insurance industry as the "trial *de novo* provision" or as the "escape hatch." In the context of UM claims, the Illinois Supreme Court has considered the trial *de novo* provision, held it to be enforceable, and rejected a public policy challenge. In the context of UIM claims, however, the Illinois Supreme Court has not yet considered the trial *de novo* provision, and the Appellate Court case law is unsettled.

For UM claims, the Illinois Supreme Court in *Reed v. Farmers Ins. Group*, 188 Ill. 2d 168 (1999), held that the trial *de novo* provision was fully enforceable by either the insured or the insurer. In rejecting the insured's public policy argument that the trial *de novo* provision unfairly favors the insurer who is able to set aside high awards, the court held that Illinois public policy was established by the uninsured motorist statute (215 ILCS 5/143a) which allows such a provision. "[W]e do not believe that the provision challenged here, requiring arbitration but allowing parties to reject awards in excess of a specified threshold, can be said to be violative of public policy – the provision is required by statute and appears in the plaintiff's insurance contract by virtue of legislative action." *Id*. at 175. Thus, under *Reed*, if the insured obtains a sizeable UM arbitration award exceeding the minimum financial responsibility limit, the insurer can reject the award and demand a trial. Likewise, the insured can reject the award and demand a trial if the insured believes that the award, though exceeding the financial responsibility limit, is insufficient.[2]

In the context of UIM claims, several Illinois Appellate Court decisions hold that it is contrary to public policy to permit *the insurer* to employ the trial *de novo* provision to set aside

[1] The minimum limit in Illinois for bodily injury to or death of a one person is presently $20,000; and, subject to the per person limit, the limit for two or more persons is $40,000. 625 ILCS 5/7-203.

[2] Effective January 1, 2004, the binding/nonbinding threshold in the UM statute (215 ILCS 5/143a) was changed by deleting reference to the limits set forth in the financial responsibility law and making the threshold $50,000 for bodily injury to or death of one person and $100,000 for bodily injury to or death of two or more persons, or the corresponding policy limits for bodily injury or less, whichever is less. This statutory change will prevail over trial *de novo* provisions in insurance policies which may still refer to the limits set by the financial responsibility law. Consider an insurance policy with a per person bodily injury liability limit of $100,000 and a UM arbitration award of $35,000. Because the award does not exceed $50,000, the UM statute makes the award binding on both the insured and the insurer regardless whether the policy sets the trial *de novo* threshold at the lower financial responsibility limit ($20,000).

the arbitration award and get a trial in court, with one decision also holding that the provision *can* be employed *by the insured* to reject the arbitration award and get a trial. The most recent decision, however, holds that the trial *de novo* provision does not violate public policy in any respect and, thus, can be enforced by either party to reject the arbitration award and get a trial.

The first Appellate Court case of note is *Mayflower Ins. Co. v. Mahan*, 180 Ill. App. 3d 213 (1st Dist. 1988), wherein the insurer sought a trial of the insured's UIM claim after the arbitration resulted in an award of $400,000 (which exceeded the minimum limit of the financial responsibility law, then $15,000). The insured's motion to dismiss was denied, and an interlocutory appeal was allowed on the certified issue phrased as "whether [UIM claims] are required to be determined by binding arbitration." The appellate court first explained that, under established Illinois precedent, non-binding arbitration in and of itself is not contrary to public policy. The court then looked to the statute concerning UIM coverage, 215 ILCS 5/143a-2, found no requirement for arbitration of any kind, binding or non-binding, and concluded that nonbinding arbitration of UIM claims is not contrary to Illinois public policy. *Id.* at 219. Apparently, the insured never argued, and the court never addressed, whether making only *high* awards nonbinding contravenes public policy by unfairly favoring the insurer.

The public policy argument was cast in that fashion, however, in *Fireman's Fund Ins. Cos. v. Bugailiskis*, 278 Ill. App. 3d 19 (2nd Dist. 1996). In that matter, the insured's UIM claim resulted in an arbitration award of $139,500.85 which exceeded the financial responsibility minimum limit of $20,000. The insurer rejected the award and filed suit seeking a jury trial of the UIM claim. The insured moved to dismiss, arguing that the trial *de novo* provision unfairly favors the insurer and violates public policy. The trial court denied the insured's motion to dismiss but found that the insurer was entitled to a trial only as to the damages issue and not on the issue of liability. An interlocutory appeal was allowed on whether the trial *de novo* provision violates public policy and, if not, whether it allows a trial as to liability and damages or only as to damages. The appellate court held that the trial *de novo* provision does violate public policy (precluding any trial) and that the arbitration award was binding. In holding that the trial *de novo* provision violates public policy, the appellate court noted that several courts from other jurisdictions have examined such provisions and that the majority of those courts have held the clause to be void. The appellate court explained that, although the provision is ostensibly neutral in allowing either party to demand a trial if the arbitration award exceeds the minimum liability limit, in practice the provision would favor the insurer by allowing it to avoid high awards and by binding the insured to low awards. Considering the unequal application of the escape clause, the cost and delay of allowing arbitration awards to be rejected, and the fact that the insurance policy possessed many of the earmarks of a contract of adhesion, the court was persuaded that the trial *de novo* provision violates public policy. *Id.* at 23.

The next case to consider the trial *de novo* provision in the context of a UIM claim was *Parker v. American Family Ins. Co.*, 315 Ill. App. 3d 431 (3rd Dist. 2000). *Parker* arose, like *Bugailiskis*, on the insurer's request for a trial after the arbitration award exceeded the minimum financial responsibility limit. The *Parker* court found *Bugailiskis* persuasive and likewise held that the unequal application of the trial *de novo* provision violates public policy for favoring the insurer. Unlike *Bugailiskis*, in *Parker* there was a stinging dissent, with Justice Holdridge

criticizing the majority for assuming that only the insurer would seek to avoid an arbitration award exceeding the financial responsibility minimum:

> Such an assumption is nothing more than pure speculation. I see no empirical evidence to support the majority's bald assertion that "as a matter of common sense, the party who is likely to be dissatisfied with an amount over $20,000 is the insurer, not the insured."
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> Unlike appeals based upon the law, appeals to common sense often depend upon who is the appellant. Indeed, as long as we are engaging in pure speculation and appeals to common sense to support our holdings, I could speculate that a plaintiff expecting a $100,000 award from an arbitrator would invoke the *de novo* provision to avoid an arbitration award of $21,000, much to the chagrin of the insurance company that would have been happy to pay the arbitrator's award.

Parker, 315 Ill. App. 3d at 436 (Holdridge, J., dissenting).

The situation of the insured rejecting the arbitration award and seeking a trial was presented in the next case, *Kost v. Farmers Auto. Ins. Ass'n.*, 328 Ill. App. 3d 649 (5th Dist. 2002). In *Kost*, the insured was killed in an auto accident, and the co-administrators of his estate rejected an arbitration award of $150,000 on the UIM claim. The co-administrators filed suit and sought a trial on the issue of damages. The insurer moved to dismiss based on *Bugailiskis* and *Parker*, and the trial court dismissed the complaint with prejudice. On appeal, the Fifth District agreed with the *Bugailiskis* and *Parker* courts that the trial *de novo* provision violates public policy but disagreed with the insurer that the provision had to be read out of the policy entirely. The court explained that *Bugailiskis* and *Parker* found the provision unconscionable because of the unfairness to the insured. The court held that it would be inequitable to allow the insurer, who drafted the provision, to deny the insured the right to invoke the provision in the situation where it might be to the insured's benefit:

> Allowing an insurer who has placed a biased trial *de novo* provision in a policy to then claim that the provision is void against public policy when an insured attempts to enforce the provision should not be sanctioned by the courts. Policies with such clauses bear the earmark of adhesion because they lack a mutuality of remedy for the insured and because the insured has little opportunity for arms-length negotiation. Such clauses create a manifest inequity by allowing the insurer to escape an unwary but meritorious claimant. [citing *Parker*, 315 Ill. App. 3d at 433-34].
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> The benefit of a trial *de novo* should not be withheld from an insured simply because the insurer drafted the provision unfairly. The court should not shelter defendant's duplicity. Defendant unfairly attempted to limit a benefit paid for by the decedent and should not be allowed to enforce this clause. In contrast, the decedent's expectation that he would be allowed a trial *de novo* after arbitration was legitimate. Allowing plaintiffs to enforce this provision does not frustrate public policy. Refusing to allow plaintiffs to enforce the provision would deny a

> benefit contracted for by the decedent and would reward defendant for drafting an unconscionable provision.

328 Ill. App. 3d at 654. Interestingly, the court in *Kost* did not address the argument in the *Bugailiskis* dissent that the unfairness of the trial *de novo* provision is premised on the assumption that only insurers will reject "high" awards and seek trials.

The next case to address the trial *de novo* provision in the context of UIM claims was *Samek v. Liberty Mut. Fire Ins. Co.*, 341 Ill. App. 3d 1045 (1st Dist. 2003). *Samek*, like *Bugailiskis* and *Parker*, arose from the insurer's rejection of an arbitration award and request for a trial on the UIM claim. Justice South, writing for the court, traced the treatment of trial *de novo* provisions in *Reed* (involving the UM statute), *Bugailiskis*, *Parker*, and *Kost*, and held that the trial *de novo* provision violates public policy because it unfairly favors the insurer:

> While one can certainly visualize an endless number of scenarios wherein the insured might want to invoke the trial *de novo* clause on a high amount because he or she believes the amount award[ed] is inadequate and wants an even higher amount, in most cases the insured would choose to accept the higher award. However, if the award is low, the insured is powerless to attack it under the provision and lacks the remedy afforded to the insurer if the award is high. We agree with the *Parker* and *Bugailiskis* courts, which state that in more instances than not the insurance companies will invoke the trial *de novo* provisions on high awards.

341 Ill. App. 3d at 1050. Justice Wolfson, specially concurring, wrote that the Illinois Supreme Court in *Reed* provided a signal that *Bugailiskis* was correctly decided. In *Reed*, the Supreme Court held that the trial *de novo* provision in the UM context did not violate public policy but rested its decision on the ground that public policy regarding UM claims was established by the UM statute which permitted rejection of arbitration awards over the financial responsibility threshold. Justice Wolfson wrote that the Supreme Court easily could have criticized the *Bugailiskis* public policy analysis but, instead, simply distinguished *Bugailiskis* on the basis that the UIM statute is unlike the UM statute in that it does not include an arbitration provision. Finally, like Justice Holdridge in *Parker*, Justice Hoffman in *Samek* wrote a dissent strongly criticizing the majority for assuming, without any support, that only the insurance company would seek to avoid a UIM arbitration award above the minimum liability amount. As Justice Hoffman correctly pointed out, one need look no further than *Kost* to find a case in which the insured rejected an arbitration award in excess of the minimum liability amount and sought a trial. Further, Justice Hoffman wrote that the public policy expressed by the legislature in the UM statute (permitting trial *de novo* for UM claims) should be taken as an expression of public policy relevant to the UIM context as well:

> I find it somewhat anomalous for the judiciary of this state to find a contractual provision relating to the arbitration of underinsured-motorist claims to be contrary to public policy when, at the same time, an almost identical provision relating to the arbitration of uninsured-motorist claims is mandated by the legislature. As the supreme court has acknowledged, the legislature occupies a superior position in

> determining public policy (*Reed*, 188 Ill. 2d at 175), and I can conceive of no difference in the public and private interest factors which are relevant to a determination as to the propriety of permitting trial *de novo* clauses to be included in arbitration provisions governing uninsured-motorist coverage as compared to those governing underinsured-motorist coverage.

Samek, 341 Ill. App. 3d at 1053 (Hoffman, J., dissenting).

As of the decision in *Samek*, the status of the trial *de novo* provision in the Appellate Court was that all four Districts having considered the provision (First, Second, Third and Fifth) had held that it contravenes public policy. The consensus was that the insurer was not entitled to reject a UIM arbitration award exceeding the threshold and demand a trial in court but that the insured (at least in the Fifth District) could reject the award and obtain a trial.

This status was upset, however, with the recent First District decision in *Zappia v. St. Paul Fire and Marine Ins. Co.*, ___ Ill. App. 3d ___ (1st Dist. 2006). In an opinion by Justice O'Brien, with Justices Gallagher and Neville concurring, the court held that the trial *de novo* clause does not violate public policy and that an arbitration award exceeding the specified threshold can be rejected and the UIM claim tried in court. After summarizing the prior cases' treatment of the trial *de novo* provision, the court expressly adopted the dissenting views of Justices Holdridge and Hoffman in *Parker* and *Samek*, stating as follows:

> As Justice Holdridge and Justice Hoffman discussed, such a trial *de novo* provision does not constitute a contract of adhesion, nor does it provide a lack of mutuality, as both the insured and the insurance company have the right to demand trial *de novo* when the arbitral award exceeds the $20,000 minimum liability amount. Further the trial *de novo* provision does not contravene the policy of binding arbitration, as Illinois encourages arbitration even when it is nonbonding. Accordingly, we adopt the reasoning of Justice Holdridge and Justice Hoffman and hold that the trial *de novo* provisions included in the arbitration provisions governing underinsured-motorist coverage do not violate public policy. We respectfully disagree with majority opinions in *Bugailiskis*, *Parker*, and *Samek* to the extent that they are in conflict with this opinion.

___ Ill. App. 3d at ___.

In *Zappia*, as in *Kost*, it was the insured who successfully sought to reject a UIM arbitration award and to obtain a trial in court. While the two cases reached the same result (*i.e.*, the insured's suit was allowed to proceed), the reasoning was diametrically opposed. *Kost* held the trial *de novo* provision to violate public policy, but, as it was the insurer who drafted it, the court prohibited the insurer from objecting to the insured's request for a trial so as to honor the insured's contractual expectations and to prevent the insurer from being rewarded for drafting an unconscionable provision. In *Zappia*, on the other hand, the court held that the trial *de novo* provision simply does not violate public policy; either party is free to demand a trial when the UIM arbitration award exceeds the financial responsibility threshold.

Zappia makes clear that, ultimately, the Illinois Supreme Court will have to resolve the enforceability of the trial *de novo* clause in the UIM context as it is a recurring issue that has vexed the Appellate Court.