Factors in Insurers' Ability to Recoup Defense Costs for Uncovered Claims

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Mar 09, 2024 5 min read

Summary

- Insurers wishing to recover uncovered defense costs should include such language in the policy.
- An insurer should always timely include express language reserving its right to recoup uncovered defense costs.
- Policyholders wanting to avoid "recoupment" should avoid policies including reimbursement provisions.

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Just before the holiday hustle and bustle, the Supreme Court of Hawai'i answered a certified question that an insurer does not have the right to recover defense costs for uncovered claims. *St. Paul Fire & Marine Ins. Co. v. Bodell Constr. Co.*, 538 P.3d 1049 (Haw. 2023). While courts around the country that have addressed this have gone different ways, the growing recent trend is to deny an insurer the ability to recover defense costs absent express language in the policy allowing recoupment. But even in those cases allowing the recoupment of defense costs, courts have limited it to specific circumstances.

Results Vary by State

The California Supreme Court issued the first seminal case on this issue in 1997. *Buss v. Superior Court*, 939 P.2d 766 (Cal. 1997); *see also* 3 New Appleman on Insurance Law Library Edition § 17.01[3][b][i]. There, the California Supreme Court held that under certain circumstances, an insurer may recover the costs to defend the uncovered claims of a "mixed" action. *Buss*, 939 P.2d at 776–77.

A "mixed" action is an "action [that] involves both potentially covered and noncovered claims." 3 New Appleman on Insurance Law Library Edition § 17.01[3][a]. "Virtually all courts agree that if an action involves [a] "mixed" action—the insurer must defend the entire action."

Buss addressed how and when insurers may seek reimbursement for the defense costs of the noncovered claims. Under *Buss* the insurer must (i) timely reserves rights to seek recoupment; and (ii) prove that the costs are attributable to a non-covered claim only. *Buss*, 939 P.2d at 778. Other courts have imposed further limitations on the circumstances in which an insurer may recover its defense costs, such as the policyholder accepting the insurer's proffered defense conditioned on the insurer's reservation of rights to seek reimbursement. 3 New Appleman on Insurance Law Library Edition § 17.01[3][b][i] ("[T]he insured [must] accept[] the insurer's offer to defend both covered and noncovered claims with knowledge of the insurer's reservation of the right to seek reimbursement".)

There are a significant number of states that generally follow *Buss* and allow an insurer to recoup uncovered defense costs in certain circumstances (*e.g.,* CA, CT, FL, MI, MO, NJ, NM, NV, OH, TN, UT). *United Nat'l Ins. Co. v. SST Fitness Corp.*, 309 F.3d 914, 917-23 (6th Cir. 2002) (applying Ohio law); *Great Am. Fid. Ins. Co. v. Stout Risius Ross, Inc.*, 638 F. Supp. 3d 763, 769-70 (E.D. Mich. 2022*)* (applying Michigan law); *Westport Ins. Corp. v. Ong*, No. 1:07CV10 DAK, 2008 U.S. Dist. LEXIS 26683, at *10-19 (D. Utah Mar. 28, 2008) (applying Utah law); *Cincinnati Ins. Co. v. Grand Pointe LLC*, 501 F. Supp.2d 1145 (D. Tenn. 2007) (applying Tennessee law); *Resure, Inc. v. Chemical Distributors, Inc.*, 927 F. Supp. 190 (M.D. La. 1996) (applying New Mexico law); *Nautilus Ins. Co. v. Access Medical, LLC*, 482 P.3d 683, 987-90 (Nev. 2021); *Scottsdale Ins. Co. v. MV Transp.,* 115 P.3d 460, 466-71 (Cal. 2005); *Sec. Ins. Co. v. Lumbermens Mut. Cas. Co.*, 826 A.2d 107, 125 (Conn. 2003); *Travelers Cas. & Sur. Co. v. Ribi Immunochem Research*, 108 P.3d 469, 479-80 (Mont. 2005); *Hebela v. Healthcare Ins. Co.,* 851 A.2d 75, 86 (NJ Super. Ct. App. Div. 2004); *Colony Ins. Co. v. G & E Tires & Serv., Inc.*, 777 So. 2d 1034, 1038-39 (Fla. Dist. Ct. App. 2000).

However, a large number of courts—like *Bodell*—have gone the other way (*e.g.,* AR, GA, HI, IL, IN, MD, MN, MO, VI, WA, WY). *Continental Cas. Co. v. Winder Labs., LLC*, 73 F.4th 934 (11th Cir. 2023); *Westchester Fire Ins. Co. v. Wallerich*, 563 F.3d 707, 714-19 (8th Cir. 2009) (applying Minnesota law); *Perdue Farms, Inc. v. Travelers Cas. & Sur. Co. of Am.*, 448 F.3d 252, 258-59 (4th Cir. 2006) (applying Maryland law); *Liberty Mut. Ins. Co. v. FAG Bearings Corp.*, 153 F.3d 919, 924 (8th Cir.1998) (applying Missouri law); *Gen. Star Indem. Co. v. V.I. Port Auth.*, 564 F. Supp. 2d 473, 476-80 (D.V.I. 2008) (applying Virgin Island law); *St. Paul Fire & Marine Ins. Co. v. Bodell Constr. Co.*, 538 P.3d 1049 (Haw. 2023); *Nat'l Sur. Corp. v. Immunex Corp.*, 297 P.3d 688, 691-95 (Wash. 2013); *Am. & Foreign Ins. Co. v. Jerry's Sport Ctr., Inc.,* 2 A.3d 526 (Pa. 2010); *Medical Liability Mut. Ins. Co. v. Alan Curtis Enterprises,*

Inc., 285 S.W.3d 233, 237 (Ark. 2008); *Gen. Agents Ins. Co. v. Midwest Sporting Goods Co.*, 828 N.E.2d 1092, 1098-104 (Ill. 2005); *Shoshone First Bank v. Pacific Employers Co.*, 2 P.3d 510, 514-17 (Wyo. 2000).

Historically, the former was considered the "majority rule." Restatement of the Law of Liability Insurance 21 *cmt. a.* However, a more consistent, recent application of the historical "minority view" has evened the score to were there is now no clear "majority" view. *Id. Reporter's Note [a]*.

Furthermore, the Restatement of the Law of Liability Insurance recognizes this trend and concludes the best rule is: "Unless otherwise stated in the insurance policy or otherwise agreed to by the insured, an insurer may not obtain recoupment of defense costs from the insured, even when it is subsequently determined that the insurer did not have a duty to defend or pay defense costs." Restatement of the Law of Liability Insurance 21.

Courts are generally in agreement that insurers are free to include "recoupment" provisions in their policies. *E.g.,* Restatement of the Law of Liability Insurance 21 *cmt. a* ("When an insurer's claim to recoupment is based on an express contractual right to reimbursement--whether because of a provision of the insurance policy or a subsequent express agreement with the insured--it presents no legal difficulty.") *But see Attorneys Liab. Prot. Soc'y, Inc. v. Ingaldson Fitzgerald, P.C.*, 370 P.3d 1101 (Alaska 2016) (invalidating policy's recoupment provision due to a contrary statutory provision).

Takeaways

While the case law is mixed and several states have yet to decide whether an insurer may recoup uncovered defense costs, there are a few take-a-ways for insurers and policyholders. Insurers wishing to recover uncovered defense costs should include such language in the policy. This generally entitles the insurer to recover its costs. If that is not an option (and even when such a provision is included in the policy) an insurer should always timely include express language reserving its right to recoup uncovered defense costs. A failure to reserve the right, may eliminate it even if the matter is governed by favorable state law and/or the policy expressly states a right to reimbursement.

Policyholders, on the other hand, wanting to avoid "recoupment" should avoid policies including reimbursement provisions. And where policies lack such provisions and insurers condition its defense on the right to recover, policyholders should be sure to timely object to the insurers' reservation.

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