Expert Commentary

The Insurer Wants Its Money Back—Can It Do That?

You were sued and tendered the claim to your liability insurer. The insurer defended you under a reservation of rights, and the lawsuit was eventually settled. Now, the insurance company says it wants its money back because it believes it never had a duty to defend and the claims were not covered. Yikes! Can it do that? The answer is the dreaded "it depends."

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September 2017

Defense and Settlement

Indeed, it depends on a lot of things; perhaps, most importantly, where you are because this will mean which state's law will govern. The answer may also be different on reimbursement of the defense costs and the settlement payment. And, of course, a lot more facts will be required than my tale of woe provides.

Under most general liability policies, the insurer's "right and duty to defend" gives it the power to control the insured's defense as well as the right to decide how, when, and with whom to settle within policy limits. *See State Farm Mut. Auto Ins. Co. v. Traver*, 980 S.W.2d 625, 627–28 (Tex. 1998). In exercising control of its insured's defense, the insurer owes the insured a duty to exercise reasonable care to investigate the claim, prepare for the defense of the lawsuit, try the case if necessary, and attempt a reasonable settlement in good faith where appropriate. *American Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 849 (Tex. 1994). An insurer's duty to defend (even it is triggered by only one claim) generally encompasses the entire lawsuit. *Evanston Ins. Co. v. Legacy of Life, Inc.*, 370 S.W.3d 377, 380 (Tex. 2012); *Buss v. Superior Court*, 939 P.2d 766, 775 (Cal. 1997). On the other hand, in most situations, "an insurer has no duty to settle a claim that is not covered under its policy." *Garcia*, 876 S.W.2d at 848.

Although the conditions required to trigger a duty to settle vary, most jurisdictions recognize a duty to accept a reasonable offer to settle a lawsuit within policy limits. *See Garcia*, 876 S.W.2d at 849; *Johansen v. California State Auto. Ass'n Inter-Ins. Bureau*, 538 P.2d 744 (Cal. 1975). An insurer that foregoes a reasonable offer that triggers the settlement duty exposes itself to liability for the entire judgment rendered against the insured in the underlying litigation—even if that judgment exceeds policy limits. *Johansen*, 538 P.2d at 746; *Phillips v. Bramlett*, 288 S.W.3d 876, 879 (Tex. 2009).

Duty To Indemnify

An interesting question arises once the underlying plaintiff makes a reasonable offer to settle when the insurer is defending under a reservation of rights and contesting its duty to indemnify the insured. Suppose the insurer agrees to fund a settlement to avoid a potential excess verdict. If it later turns out in the coverage suit that the insurer had no duty to indemnify, is the insurer entitled to reimbursement by the insured? Not in Texas, but possibly elsewhere.

This question was addressed in *Texas Ass'n of Counties Gov't Risk Mgmt. Pool v. Matagorda County*, 52 S.W.3d 128 (Tex. 2000) and again in *Excess Underwriters at Lloyd's v. Frank's Casing Crew & Rental Tools, Inc.*, 246 S.W.3d 42 (Tex. 2008). In *Matagorda County*, several inmates of the Matagorda County jail were assaulted by other prisoners and sued the county. The county had law enforcement insurance provided by the Texas Association of Counties (TAC). Because the jail had fallen below state standards several years before, the TAC had included an endorsement to the county's policy excluding coverage for any claim "arising out of jail."

Accordingly, when the inmates' lawsuit was presented to TAC, it initially denied coverage. After negotiations with the county, however, it later decided to pay for the county's defense under a reservation of rights while simultaneously seeking a declaratory judgment on its argument of no coverage.

After several years of litigation, the plaintiffs in the underlying suit offered to settle for $300,000, which was within the policy limit. There was no dispute the settlement offer was reasonable. The county was asked to fund the settlement, but it refused, continuing to insist the claim was covered. TAC sent a second reservation-of-rights letter to the county, this time stating it was funding the settlement to avoid a potentially much greater jury verdict, but it was reserving its rights to dispute coverage and to seek reimbursement of the settlement amount from the county in the coverage action. The county did not respond to the letter. TAC settled with the plaintiffs.

After the settlement, TAC amended its declaratory judgment action to add a claim for reimbursement of the $300,000 it paid in the settlement. The insurance policy itself did not expressly provide a right to reimbursement, but the insurer argued such a right arose from the reservation of rights or as an equitable claim for restitution.

First, the Texas Supreme Court held "a unilateral reservation-of-rights letter cannot create rights not contained in the insurance policy." *Id.* Instead, a reservation-of-rights letter seeking a right to reimbursement not provided in the policy is merely "a unilateral offer to append a reimbursement provision to the insurance contract." *Id.* Therefore, no right of reimbursement is created unless the insured accepts the insurer's offer. Because the county never responded to TAC's second reservation-of-rights letter, the court held TAC had no contractual right to reimbursement.

The court likewise rejected TAC's argument that it had an equitable right to restitution under equitable subrogation, *quantum meruit*, and unjust enrichment claims. Expressing concern for the vulnerability of the insured in such circumstances, the court held that "when coverage is disputed and the insurer is presented with a reasonable settlement demand within policy limits, the insurer may fund the settlement and seek reimbursement only if it obtains the insured's clear and unequivocal consent to the settlement and the insurer's right to seek reimbursement." *Id.* at 135. The court's opinion ended on a policy note, observing that "[o]n balance, insurers are better positioned to handle this risk, either by drafting policies to specifically provide for reimbursement or by accounting for the possibility that they may occasionally pay uncovered claims in their rate structure." *Id.* at 136.

The Texas Supreme Court reaffirmed and expanded the *Matagorda County* holding 8 years later in *Frank's Casing*, 246 S.W.3d at 46–48. The court rejected the insurer's argument that because Frank's Casing had taken an active role in procuring the settlement offer and had demanded the insurers pay the claim, there was an implied-in-fact agreement to reimburse the insurers if the coverage court decided the claims were not covered. The court noted the insured had consistently maintained its position when communicating with the insurers that it believed the claims were covered and it would seek a *Stowers* remedy if the claims did not

settle and resulted in a verdict against the insured in excess of policy limits. Likewise, the court again refused to recognize an equitable right to reimbursement based on the law of restitution (in this case, claims for *quantum meruit* and *assumpsit*). *See also Gotham Ins. Co. v. Warren E&P, Inc*., 455 S.W.3d 558, 562 (Tex. 2014).

Stowers Choices

Under Texas law, therefore, absent an explicit agreement by the insured, an insurer facing a *Stowers* demand has two choices: (A) fund the settlement, but lose any claim to reimbursement of the money it pays to settle the underlying suit, or (B) if the insurer is confident the court in the coverage dispute will find no duty to indemnify, refuse to fund the settlement, and face the risk of potentially greater liability on a *Stowers* claim if the plaintiffs in the underlying suit obtain a verdict in excess of policy limits. *See Frank's Casing*, 246 S.W.3d at 46 (identifying the two choices and observing that option A "in effect creates coverage in those cases where coverage is ultimately determined not to exist," but reaffirming its reasoning in *Matagorda County* that this risk is better placed on the insurer, who can adjust for it in its premium structure).

To Reimburse or Not

Some states have likewise refused to allow insurers to recoup amounts paid to settle suits against their insureds; others have approved reimbursement. Courts that have taken positions similar to Texas include the following.

- *Mount Airy Ins. Co. v. Doe Law Firm*, 668 So.2d 534 (Ala. 1995) (The insurer's settlement payment was "voluntary" and thus unrecoverable, even where it had notified the insured it disputed coverage and intended to seek reimbursement.)
- *Medical Malpractice Jt. Underwriting Ass'n v. Goldberg*, 60 N.E.2d 1121 (Mass. 1997) ("Where an insurer defends under a reservation of rights to later disclaim coverage, … it may later seek reimbursement for an amount paid to settle the underlying action only if the insured has agreed that the insurer may commit the insured's own funds to a reasonable settlement with the later right to seek reimbursement from the insured, or if the insurer secures specific authority to reach a particular settlement which the insured agrees to pay.")
- *Steadfast Ins. Co. v. Sheridan Children's Healthcare Servs., Inc*., 34 F.Supp.2d 1364, 1366-67 (S.D. Fla. 1998) (The court cites *Goldberg* and *Mount Airy* to support the conclusion that Florida law would likewise bar an insurer from recovering from its insured "payment made to a third-party to settle a claim against the insured.")

The California Supreme Court has taken a very different approach than its Texas counterpart. *See Blue Ridge Ins. Co. v. Jacobsen*, 22 P.3d 313 (Cal. 2001). In *Blue Ridge*, the California court held an insurer could recover settlement payments from its insured if it:

> [S]atisfied the prerequisites for seeking reimbursement for noncovered claims included in a reasonable settlement payment: (1) a timely and express reservation of rights; (2) an express notification to the insureds of the insurer's intent to accept a proposed settlement offer; and (3) an express offer to the insureds that they may assume their own defense when the insurer and insureds disagree whether to accept the proposed settlement.

Id. at 320-21.

Where the Texas court held the insurer was attempting to "reserve" a right not provided by the policy, the California court held "the right to reimbursement is implied by the terms of the insurance policy." *Id*. at 321. The court considered this conclusion simply an extension of the same court's reasoning in *Buss v. Superior Court*, 939 P.2d 766 (Cal. 1997), concerning reimbursement of defense costs. 22 P.3d at 322.

Other courts that have allowed insurers to recoup settlement payments from their insureds include the following.

- *Travelers Prop. Cas. Co. v. Hillerich & Bradsby Co*., 596 F.Supp.2d 1020, 1023-25 (W.D. Ky. 2008) (The court criticized *Frank's Casing*, approving cases from other jurisdictions allowing recoupment of defense costs and applying the same reasoning to the settlement-reimbursement issue.)
- *Lumbermens Mut. Cas. Co. v. RGIS Inventory Specialists*, No. 08 Civ. 1316 (HB), 2010 WL 2017272, *5 (S.D.N.Y. May 20, 2010) (The court predicted Michigan would "follow the logic of *Hillerich* and allow [the insurer] to seek recoupment of settlement costs.")
- *Phillips & Assoc., P.C. v. Navigators Ins. Co*., 764 F.Supp.2d 1174, 1175-77 (D. Az. 2011) (The court found *Blue Ridge* consistent with Arizona law, criticizing conflicting Texas cases.)

What about the defense costs incurred by the insurer before obtaining a "no coverage" ruling? Whether such costs are recoverable has been addressed by many more courts; the results fall generally into the same categories described above. Like California, most courts that have considered both issues have applied the same principles and reached the same conclusion on defense costs as they have on settlement payments. *See, e.g*., *Blue Ridge*, 22 P.3d at 321 ("applying *Buss's* reasoning regarding reimbursement of defense costs to reimbursement of reasonable settlement costs"); *Hillerich & Bradsby*, 596 F.Supp.2d at 1024 ("Conceptually, the same analysis should apply under a reservation of rights in both circumstances."); and *Phillips*, 764 F.Supp.2d at 1178 (holding insurer "may recoup amounts paid in defending and settling the [underlying] action, provided it prevails on the merits of the coverage dispute").

Some courts, however, have been careful to confine recovery of defense costs to cases in which a court has later determined the insurer never had a duty to defend any of the asserted claims rather than simply holding the damages were not covered. *See, e.g., Georgia Interlocal Risk Mgt. Agency v. City of Sandy Springs*, 788 S.E.2d 74, 79 (Ga. Ct. App. 2016); *United Nat'l Ins. Co. v. SST Fitness Corp*., 309 F.3d 914, 919 (6th Cir. 2002); and

Colony Ins. Co. v. G&E Tires & Serv., Inc., 777 So.2d 1034, 1039 (Fla. Ct. App. 2000). The California Supreme Court in *Buss* limited recovery to "costs that can be allocated ***solely*** to the claims that are not even ***potentially*** covered." 939 P.2d at 778 (emphasis added).

The Wyoming Supreme Court declined to follow *Buss* and refused to permit allocation of defense costs between covered and uncovered claims. *Shoshone First Bank v. Pac. Empl'rs Ins. Co*., 2 P.3d 510 (Wyo. 2000); *see also American & Foreign Ins. Co. v. Jerry's Sport Center, Inc.*, 2 A.3d 526, 542 (Pa. 2010) ("The court's resolution of the question of coverage does not … retroactively eliminate the insurer's duty to defend the insured during the period of uncertainty.").

In *Jerry's Sport Center*, the Pennsylvania Supreme Court thoroughly surveyed the jurisdictions that had weighed in on the recovery of defense costs and came down on the side of denying reimbursement. The Sixth Circuit did a similar survey in 2002 and predicted Ohio courts would reach a contrary conclusion. *See SST Fitness*, 309 F.3d at 917-19; *see also Illinois Union Ins. Co. v. NRI Constr., Inc*., 846 F.Supp.2d 1366, 1374 (N.D. Ga. 2012) (similar survey and prediction of Georgia law).

Most recently, a different federal district court in Georgia reviewed the developing caselaw and observed "a recent trend of courts not allowing recoupment, which calls into question whether jurisdictions allowing recoupment actually remain in the majority. "*Evanston Ins. Co. v. Sandersville Railroad Co*., No. 5:15-CV-247 (MTT), 2017 WL 3166730, *8 & n.8 (M.D. Ga. July 25, 2017). The court concluded it "need not predict" which rule Georgia would follow because the insurer's reservation-of-rights letter was defective under either rule.

Conclusion

So, can your insurer get its money back? The answer remains: "It depends."
