



Recouping Costs For Claims Not Covered By Policy

ONE OPTION FOR INSURERS IS TO ISSUE RESERVATION OF RIGHTS LETTER

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More and more insurers are threatening to, or actually filing, claims to recover defense costs expended on “non-covered claims.” But where does Connecticut law stand on this issue? Whether an insurer is entitled to recoup defense costs for claims that are not covered by the policy varies from state to state, and many jurisdictions have not yet ruled on the question. The seminal case on this subject comes from the California Supreme Court, which recognized that an “insurer’s duty to defend runs to claims that are merely potentially covered...” and that in a “mixed” action, the insurer has a duty to defend the action in its entirety, even if some of the claims are not covered. *Buss v. Superior Court*, 16 Cal. 4th 35, 46-48 (1997).

The *Buss* Court further held that the insurer cannot recoup defense costs for claims at least potentially covered where the insurer has a duty to defend those claims under the policy and the policy does not expressly provide for reimbursement. The Court noted that the insurer may not create a right of reimbursement merely by issuing a reservation letter asserting such a “right.” This would contradict the policy and cannot be done without a separate contract supported by consideration. The Court recognized that the insurer can, however, recoup defense costs for claims that are not even potentially covered.

In other states that have considered this issue, there are variations on whether the

policy must expressly provide for reimbursement, whether the insurer must expressly reserve its rights to recoup defense costs, and whether an insured’s objection to such a reservation minimizes its effect. Where reimbursement is allowed, the burden is on the insurer to prove allocability. “*Bruner & O’Connor on Construction Law*,” § 11:46; *Buss* at 56-60; *Jostens Inc. v. CNA Ins. Continental Cas. Co.*, 336 N.W.2d 544, 545 (Minn. 1983).

In some jurisdictions, for example, an insurer cannot recover defense costs unless the policy specifically provides for reimbursement in the event a court determines that the insurer owes no duty to defend. See *St. Paul Fire & Marine Insurance Co. v. Holland Realty Inc.*, No. CV07-390-S-EJL, 2008 WL 3255645 (D. Idaho Aug. 6, 2008) (recognizing that Idaho law requires the policy to contain a reimbursement provision); *General Agents Ins. Co. of Am. v. Midwest Sporting Goods Co.*, 215 Ill.2d 146, 293 (Ill. 2005) (refusing to permit insurer to recover defense costs pursuant to a reservation of rights where no right to recoupment existed under the policy); *American and Foreign Ins. v. Jerry’s Sport Center Inc.*, 606 Pa. 584 (Pa. 2010) (holding that insurer cannot recoup defense costs where policy does not provide for recoupment merely by issuing a letter reserving the right to recoup defense costs).

In other jurisdictions, it has been held that an insurer may recoup defense costs where it explicitly reserves its right to do so and the insured does not expressly object to the insurer’s reservation of rights. See *Gotham Ins. Co. v. GLNX Inc.*, 1993 WL 312243, at



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*4 (S.D.N.Y. 1993); *Knapp v. Commonwealth Land Title Ins. Co. Inc.*, 932 F. Supp. 1169 (D. Minn. 1996).

In still others, an insurer may be entitled to reimbursement of defense costs based on a reservation of rights letter even if the insured objects to the reservation. See *Forum Ins. Co. v. County of Nye, Nev.*, 26 F.3d 130 (9th Cir. 1994). Within some jurisdictions, such as New York, the courts have varied in their rulings on this issue. Compare *Gotham Ins. Co. with American Guarantee and Liability Ins. Co. v. CNA Reinsurance Co.*, 16 A.D.3d 154 (1st Dep’t 2005) (allowing recoupment where there was no indication that the insurer had expressly reserved the right to recoup defense costs) and *Fieldston Property Owners Assn. Inc. v. Hermitage Ins. Co.*, 2011 NY Slip Op 01361 (Feb. 24, 2011) (concluding no right to recoupment for uncovered claims.)

In those jurisdictions recognizing a right to recoup defense costs upon a reservation of rights, the content of the reservation is critical. “Where the insurer’s reservation of rights letter recounts all the claims and expresses why each claim is not potentially

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covered and expressly reserves the right to recoup defense costs, it will be deemed sufficient in those jurisdictions permitting recoupment.” “Bruner & O’Connor,” § 11:46; *Colony Ins. Co. v. G&E Tires & Service Inc.*, 777 So. 2d 1034 (Fla. Dist. Ct. App. 1st Dist. 2000); *Jim Black & Associates, Inc. v. Transcontinental Ins. Co.*, 932 So. 2d 516 (Fla. Dist. Ct. App. 2d Dist. 2006).

Recoupment jurisprudence in Connecticut is only now beginning to develop.

Reservation Of Rights

In 2003, the Connecticut Supreme Court adopted the general principals of *Buss*, ruling that an insurer can maintain an action against its insured for reimbursement of

defense costs for claims that are not even potentially covered. *Security Ins. Co. of Hartford v Lumbermans Mut. Cas. Co.*, 264 Conn. 688, 716–18 (2003).

This year, the U.S. District Court of Connecticut has faced this issue twice. In July, the court refused to allow an insurer to recoup its defense costs for claims that were potentially covered, and determined that a reservation of rights letter does not create a separate contract between the parties. *Nationwide Mut. Ins. Co v. Mortensen*, No. 3:00-CV-1180(CFD), 2011 WL 2881314 (D. Conn. July 18, 2011). In August, the court allowed an insurer to recoup its defense costs relating to certain claims that the court decided in an earlier declaratory judgment action the insurer had no duty

to defend. *Scottsdale Ins. Co. v. R.I. Pools Inc.*, No. 3:09CV01319(AWT), 2011 WL 3563169 (D. Conn. Aug 15, 2011). In *Scottsdale*, expenses associated with settlements and claims investigations were excluded from such reimbursement.

In states like Connecticut that have not ruled definitively on this issue, insurers should protect themselves by issuing a detailed reservation of rights letter reserving the right to recoup defense costs even where the policy does not expressly provide for it. Insureds should timely object to an insurer’s reservation of rights letter to preserve the argument that any acceptance of a defense does not constitute an agreement by the insured that the insurer has a right to recoupment. ■