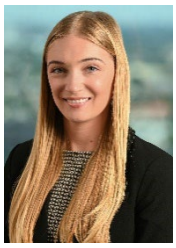
Lawyer Insights

Lessons From Calif. Liability Claim Recoupment Ruling

By Geoffrey Fehling and Veronica Adams
Published in Law360 | June 22, 2022

One of the most valuable aspects of liability insurance is defense coverage, which protects policyholders from significant costs of defending against and litigating claims that may never result in a judgment or settlement.

Companies and their directors and officers can incur thousands or even millions of dollars in defending against claims that are resolved long before trial.

Even after purchasing robust defense coverage and getting an insurer to defend a claim, however, companies may be surprised when months or even years later the insurer reverses its position and not only withdraws from the defense but also demands repayment of all defense costs paid to date.

Recoupment allows insurance companies to recover defense costs paid on behalf of the policyholder. However, insurance companies are not always able to recoup defense costs, and an insurer's right to recoup depends on the policy language, applicable law and sometimes even the party's conduct during the claim.

Given all of these variables, courts continue to be split regarding an insurer's right to recoupment.

A recent case in the U.S. District Court for the Central District of California, Evanston Insurance Co. v. Winstar Properties Inc.,[1] shows the perils of insurer recoupment and underscores the importance of assessing insurer recoupment rights, if any, throughout the claims process.

The court found that Winstar insurer Evanston could recoup costs it paid defending a property owner and a manager in a discrimination lawsuit.[2]

Evanston won summary judgment in 2019 when the court held that it did not have a duty to defend Winstar under the tenant-discrimination liability policy, so the parties turned to whether Evanston had a right to recoup the costs it paid in defense of the discrimination suit.[3]

In California, courts have held that an insurer may reserve its rights to seek reimbursement of defense costs unilaterally through a reservation of rights letter, even if the right to recoupment is not expressly stated in the policy.[4]

The issue in Winstar Properties, therefore, was whether Evanston could prove it had sent a 2017 letter to Winstar properly reserving its right to reimbursement.[5]

Winstar denied that it ever received the letter.[6] The court recognized it was a close call, but held that

Lessons From Calif. Liability Claim Recoupment Ruling
By Geoffrey Fehling and Veronica Adams
Published in Law360 | June 22, 2022

Evanston had shown by a sufficient margin that it is more likely than not that the 2017 letter was mailed to Winstar.[7] It entered judgment in Evanston's favor for more than $83,000 in defense costs, plus prejudgment interest.[8]

The decision in Winstar Properties is not an outlier given California's rule that a right to recoup can arise solely from an insurer's unilateral reservation of rights.

Other jurisdictions, however, are far less insurer-friendly — if they recognize a recoupment right at all — and require more stringent proof, such as an express policy provision or a clear understanding between both parties.[9]

These decisions — and the material differences between state law governing reimbursement of defense costs — raise several important issues that policyholders should consider when assessing potential recoupment risks.

Be Proactive

Timing is critical, and waiting to react to an insurer's demand for repayment months or even years into litigation, after significant defense costs have already been incurred, may be too late. The ideal time to understand potential recoupment rights is at the time the policy is purchased or renewed, or, alternatively, at the outset of the claim.

- Does the policy specify a duty to defend or a duty to advance? Can the policyholder elect between the two and, if so, under what circumstances?
- Does the policy contemplate repayment of advanced legal fees and, if so, under what terms?
- If the policy is silent, which state's law would govern a potential recoupment claim, and does the policy include a choice-of-law or venue provision that would impact that analysis?

Addressing these kinds of questions early on in the claim process can help maximize defense coverage.

Be Diligent

The right to recoup may change over time and should be evaluated throughout the claims process. For instance, in some jurisdictions, an insurer may not have a right to recoup if not expressly reserved in a coverage letter or, after such a letter is issued, the policyholder accepts the defense subject to the insurer's right to recoup.

Moreover, in California, courts have held that an insurer may only preserve its recoupment rights in a so-called mixed action involving potentially covered and uncovered claims when it defends the action completely without parsing claims.[10]

Thus, policyholders should carefully review the entirety of reservation of rights letters, including any right to recoupment, along with any other coverage communications addressing that issue to determine whether an insurer has properly reserved its right to reimbursement and if there is anything to be done to mitigate the risk of a future reimbursement claim.

Lessons From Calif. Liability Claim Recoupment Ruling
By Geoffrey Fehling and Veronica Adams
Published in Law360 | June 22, 2022

Understand Governing Law

Policyholders should not assume that a right to recoup exists, even if stated in a reservation of rights letter, because the availability and scope of recoupment rights vary by state. As noted above, because recoupment rights are highly dependent on state law, assessing choice of law and identifying what law is likely to govern a particular claim can be dispositive on the issue of recoupment.

Conclusion

Recoupment can be a challenging issue to confront, especially in the later stages of a claim when the losses at issue are greater and the stakes are higher. Following the above tips and paying attention to policy placement, claim presentation and ongoing claims handling can help mitigate the risk of successful recoupment claims and avoid surprises in the event of a claim.

Notes

1. Evanston Insurance Co. v. Winstar Properties, Inc., No. 218CV07740RGKKES, 2022 WL 1309843 (C.D. Cal. Apr. 14, 2022).

2. Id. at *1.

3. Id.

4. See Buss v. Superior Ct., 939 P.2d 766, 784 & n.27 (Cal. 1997) (recognizing that an insurer can reserve its right of reimbursement for defense costs by itself, without the insured's agreement, through a unilateral reservation of rights). Other jurisdictions have followed the California Supreme Court's rule in Buss. See, e.g., Hebela v. Healthcare Ins. Co., 851 A.2d 75, 86 (N.J. Super. Ct. App. Div. 2004) (holding that an insurer, having honored its duty to defend, may seek reimbursement for fees incurred in defending uncovered claims to prevent unjust enrichment of the insured in benefiting from the defense of non-covered claims (citing Buss, 939 P.2d at 776-78)).

5. Winstar Props., 2022 WL 1309843, at *3.

6. Id.

7. Id. at *4.

8. Id. at *7.

9. See, e.g., Am. W. Homes Ins. Co. v. Gjonaj Realty & Mgt. Co., 192 A.D. 3d 28 (N.Y. App. Div. 2d Dep't 2020) (holding that an insurance company could not recover defense costs based on a unilateral reservation of rights "absent an express provision to that effect in the policy"); Med. Liab. Mut. Ins. Co. v. Alan Curtis Enters., Inc., 285 S.W.3d 233, 237 (Ark. 2008) (holding that an insurer may not recoup attorneys' fees based on a unilateral reservation of rights in the absence of a statute or rule authorizing such recoupment); Capitol Indem. Corp. v. Blazer, 51 F. Supp. 2d 1080, 1090 (D. Nev. 1999) (holding that an insurer may only be reimbursed for defense costs if there was a "clear understanding" between the parties that the insurer had reserved its recoupment rights).

10. See, e.g., Hewlett Packard Co. v. ACE Prop. & Cas. Ins. Co., No. C 99-20207 JW, 2010 WL 11469575, at *3 (N.D. Cal. Dec. 15, 2010) ("[I]n a 'mixed action,' in which a carrier determines that at least some of the claims are 'potentially covered' by the policy, the carrier may only seek reimbursement when it defends the action completely, without parsing claims.").

Geoffrey B. Fehling *is a partner in the firm's Insurance Coverage group in the firm's Boston office. Geoff represents corporate policyholders and their officers and directors in insurance coverage disputes involving directors' and officers' (D&O), errors and omissions (E&O), and other professional liability claims, cybersecurity and data breaches, representations and warranties, employee theft and fidelity claims, government investigations, breach of fiduciary duty, environmental liabilities, and property damage. He can be reached at +1 (617) 648-2770 or gfehling@HuntonAK.com.*

Veronica P. Adams *is an associate in the firm's Insurance Coverage group in the firm's Miami office. Her practice focuses on complex insurance litigation and advising policyholders in insurance coverage matters. She can be reached at +1 (305) 810-2529 or vadams@HuntonAK.com.*