1. OVERVIEW

This article examines the tension between the Restatement of the Law of Liability Insurance, which posits that the "emerging state-court majority rule" on recoupment of uncovered defense costs is that "the insurer does not have a right of recoupment of defense costs unless this right is stated in the insurance policy or otherwise agreed to by the parties" with the Restatement (Third) of Restitution and Unjust Enrichment, which provides that an insurer "may recover that part of its outlay that exceeds its policy obligation by a claim in restitution within the rule of this section."

The paper is organized as follows: First, we provide an overview of the legal theories associated with recoupment of defense costs. Second, we examine in detail the different approaches taken by Restatement of the Law of Liability Insurance and the Restatement (Third) of Restitution and Unjust Enrichment. Third, we survey relevant decisions from around the country. Finally, we provide a brief discussion of a closely related issue: the recoupment of uncovered settlement payments.

This paper reflects perspectives from the policyholder and carrier side. The authors do not necessarily agree with any view or perspective reflected in this paper, which is a joint project and contains sections written by other panelists.

2. LEGAL BASES FOR/AGAINST RECOUPMENT

There are a variety of legal theories under which insurers seek to recoup defense costs for uncovered claims, including contract, implied-in-fact contract, and equitable theories which may sometimes overlap, such as restitution, quantum meruit, unjust enrichment, implied-in-law contract, quasi-contract, and assumpsit. Both insurers and policyholders have found varying success with these theories in different jurisdictions.

A. Contract Language

Insurance coverage is, after all, a creation of contract, and courts will always look to the contract language first to determine the rights and responsibilities of a party. However, when the policy is silent on a particular issue, equitable theories may be advanced by the parties in support
of their arguments, for example: quasi-contract, implied-in-fact contract, quantum meruit, or unjust enrichment.

There are several well-known principles that will generally apply to insurance policy interpretation, such as:

- the intent of both parties to a contract at the time the contract was formed controls the interpretation of the contract;¹

- the intent of the parties is determined by the plain meaning of the words in the insurance policy;²

- any ambiguity in the writing is to be construed against the insurer, its drafter, and in favor of coverage, the purpose of the contract;³

- the duty to defend is broader than the duty to indemnify;⁴ and

- it is the potential, rather than the certainty, of a claim falling within the coverage provided by the policy that implicates an insurer's duty to defend.⁵

Insurance policies often lack explicit language governing the recoupment of defense costs. As a result, when faced with the issue of recoup, a court may not have specific contractual language to consider. In fact, court decisions deciding the issue of recoupment of defense costs frequently arise in just this scenario—no contractual language exists providing the insurer the right to recoup. Thus, strict contract language enforcement is frequently an argument that benefits policyholders. See, e.g., American & Foreign Insurance Co. v. Jerry's Sport Center, Inc., 2 A.3d 526, 544 (Pa. 2010) (disallowing recoupment; insurer's "contractual obligation to pay for the defense arose as a consequence of the rules of contract interpretation" and it was "undisputed that the policy did not contain a provision providing for reimbursement of defense costs under any circumstances").

B. Implied-In-Fact Contract

An implied-in-fact contract is often one of the first arguments an insurer will raise in support of recoupment, and it frequently depends on letters sent to the policyholder accompanying the insurer’s payment of defense costs under a reservation of rights. The argument is that, by conditioning the payment of defense costs on a later right to recoupment, the insurer has created a new contract with the policyholder – one that specifically provides for recoupment. While the

¹ 1 Restatement of the Law, Liability Insurance § 2 (2018); Restatement Second, Contracts § 200, comment b (1981).
³ Id. § 4(2).
⁴ Id. § 14, Reporter’s Note a.
⁵ Id. § 13.
facts surrounding this exchange are key, including the policyholder's response to such letters, many courts have accepted this argument in awarding recoupment to insurers.

This type of conditional payment was central to the court's finding that recoupment was permitted in United National Insurance Co. v. SST Fitness Corp., 309 F.3d 914, 921 (6th Cir. 2002). There, the court determined that when "an insurer conditions payment of defense costs on the condition of reimbursement if the insurer had no duty to defend, the condition becomes part of an implied in fact contract when the insured accepts payment." *Id.* Under the facts of United National, the court found that the policyholder had "entered into an implied in fact contract by accepting the defense costs subject to a reservation of the right to recoupment if a court determined that [the insurer] had no duty to defend [the policyholder] and a court found [the insurer] had no duty to defend, [the insurer] is entitled to reimbursement of its defense costs and pre-judgment interest." *Id.* The court allowed recoupment, noting that "allowing an insurer to recover under an implied in fact contract theory so long as the insurer timely and explicitly reserved its right to recoup the costs and provided specific and adequate notice of the possibility of reimbursement promotes the policy of ensuring defenses are afforded even in questionable cases." *Id.*

Other courts, however, have rejected arguments based on implied-in-fact contracts as the basis for recoupment. For example, in American, 2 A.3d at 54, the insurer made the argument that it had "created a new contract through its reservation of rights letters." The court rejected this argument, stating that "permitting reimbursement by reservation of rights, absent an insurance policy provision authorizing the right in the first place, is tantamount to allowing the insurer to extract a unilateral amendment to the insurance contract." *Id.* (citations omitted); see also Excess Underwriters at Lloyd's, London v. Frank's Casing Crew & Rental Tools, Inc., 246 S.W.3d 42, 49 (Tex. 2008).

C. Other Equitable Remedies

One hurdle insurers may face in seeking recoupment is the principle that courts will not entertain an equitable remedy where a written contract governs the relationship between the parties. See, e.g., Excess Underwriters, 246 S.W. 3d at 50. In jurisdictions that adopt this reasoning, it will be very difficult for an insurer to prevail on an equitable theory of recovery, be it restitution, quantum meruit, unjust enrichment, implied-in-law contract, quasi-contract, or assumpsit. Courts that disallow recoupment on this basis often hold that to "recognize an equitable right to reimbursement would require us to 'rewrite the parties' contract [or] add to its language.'" *Id.* (quoting Am. Mfrs. Mut. Ins. Co. v. Schaefer, 124 S.W.3d 154, 162 (Tex.2003)). In those jurisdictions, an implied-in-fact contract is a much more likely avenue for an insurer to succeed on a recoupment theory.

However, not all jurisdictions find that the written contract bars an equitable recovery. For example, in Chiquita Brands International, Inc. v. National Union Fire Insurance Co. of Pittsburgh, PA, 57 N.E.3d 97, 104 (Ohio 2015), the court was persuaded by equitable principles,
allowing restitution of defense costs paid for a non-covered claim. Though it rejected the insurer’s implied-in-fact contract argument, the Chiquita court relied heavily on the policyholder’s demand for coverage and the insurer’s reservation of rights letters in finding that the insurer had reserved its "right to seek restitution of defense cost should a court determine that there was no duty to defend." Id. (awarding recoupment).

Similarly, the court in Buss v. Superior Court, 939 P.2d 766, 776 (1997) found that where claims "are not even potentially covered," the insurer "has not been paid premiums" for and "did not bargain to bear these costs." Thus, "[t]he insurer therefore has a right of reimbursement that is implied in law as quasi-contractual, whether or not it has one that is implied in fact in the policy as contractual." Id. On this basis, the court allowed recoupment, while requiring the insurer to prove which specific defense costs could be allocated to the non-covered claims. Id. The court noted that "under the law of restitution," the right to recoupment "runs against the person who benefits from 'unjust enrichment' and in favor of the person who suffers loss thereby." Id. at 777. The court allowed recoupment, finding that the "'enrichment' of the insured by the insurer though the insurer's bearing of unbargained-for defense costs is inconsistent with the insurer's freedom under the policy and therefore must be deemed 'unjust.'" Id.

On the other hand, policyholders have found success in opposing equitable theories of recoupment on bases other than the existence of a written contract. For example, in Excess Underwriters, the Supreme Court of Texas disallowed recoupment and rejected a quantum meruit argument on two different grounds. First, following Texas precedent, the court found that for quantum meruit to apply, the policyholder would have had to agree to the insurer's declared right to recoup defense costs—and indeed that equitable concerns tilted in favor of requiring explicit agreement. Id. at 50 (holding that policyholder’s "'clear and unequivocal consent'" was necessary for a quantum meruit recoupment to avoid policyholder’s being pressured into making critical financial decisions "'at a time when the insured is most vulnerable.'"); citing Texas Ass’n of Counties County Gov’t Risk Mgmt. Pool v. Matagorda County, 52 S.W.3d 128, 135 (Tex. 2000)). The second ground was, as noted above, the existence of a written contract. Id. (citation omitted.)

D. The Doctrine of Voluntary Payments as a Defense to Recoupment

In United National, the district court rejected the insurer's arguments for recoupment in part based on the idea that the insurer had made defense cost payment as a "volunteer." 309 F.3d at 922. The policyholder argued that the insurer was a volunteer because it had made "a payment

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6 "Restitution is appropriate where one party to a contract demands from the other a performance that is not in fact due by the terms of that contract under circumstances where it is reasonable to accede to that demand, and where the party on whom the demand is made renders such performance under a reservation of rights, thereby preserving a claim in restitution to recover the value of the benefit conferred in excess of the recipient's contractual entitlement, 1 Restatement of the Law 3d, Restitution and Unjust Enrichment, Section 35 (2011)." Chiquita, 57 N.E.3d at 101.

7 Under a quantum meruit theory of recovery, "one who provides valuable service to another may establish that the service’s recipient has an implied-in-law obligation to pay when the recipient has reasonable notice that the service provide expects to be paid." Excess Underwriters, 246 S.W.3d at 49 (citing Heldenfels Bros., Inc. v. Corpus Christi, 832 A.W.2d 39, 41 (Tex. 1992)).
of money with knowledge of the facts and without legal or contractual obligation." *Id.* This is sometimes a strong defense to recoupment, particularly where jurisdictions recognize the rule that "equity will not aid a volunteer." *Id.* (citations omitted).

The Sixth Circuit in *United National* rejected the volunteer defense, however, giving significant weight to the insurer's payment of defense costs under a reservation of rights. The court reasoned that the "volunteer defense applies if the paying party has not been asked for the payment," and the policyholder had asked the insurer to pay. *Id.* It was also important to the court's analysis that the insurer sought recovery under an implied-in-fact contract established through reservation of rights letters, not an equitable remedy. *Id.* at 922-23.8

As with most coverage issues, the decisions of the relevant jurisdiction will control whether contracts (either the policy itself or a new contract created by reservations of rights letters) or equitable theories will provide an insurer with the strongest bases for recouping defense costs for non-covered claims – and conversely, which arguments will best benefit policyholders seeking to resist such efforts.9

3. **RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT**

The Restatement (Third) of Restitution and Unjust Enrichment was completed in 2011. Section 35 of that Restatement is titled "Performance of Disputed Obligation" and provides:

If one party to a contract demands from the other a performance that is not in fact due by the terms of their agreement, under circumstances making it reasonable to accede to the demand rather than to insist on an immediate test of the disputed obligation, the party on whom the demand is made may render such performance under protest or with reservation of rights, preserving a claim in restitution to recover the value of the benefit conferred in excess of the recipient's contractual entitlement.

Restatement (Third) of Restitution and Unjust Enrichment § 35 (2011).

One Illustrations in § 35 explicitly addresses an insurer's right to recoup defense costs:

Policyholder A demands that liability insurer B defend an action brought by C against A. B takes the view that C's claims are not even potentially covered by its policy, putting the C lawsuit outside B's duty to defend. By local insurance law,

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8 The *United National* court also noted that the volunteer defense was intended to prevent "sellers with no market for their goods from forcing these goods on unsuspecting customers and then seeking restitution," and that such public policy was not applicable where the policyholder had requested payment of defense costs. *Id.* at 923.

9 In at least one state, an analysis of a fee-shifting statute has also been relevant to arguments for recoupment. *See Medical Liability Mut. Ins. Co. v. Alan Curtis Enterprises, Inc.*, 285 S.W.3d 233 (Ark. 2008) (holding that Ark. Code § 16-22-308's plain language provides for recovery in coverage actions by policyholders only, not insurers).
an insurer has no duty to defend a suit that creates no risk of a covered liability under the policy; but if an insurer refuses to defend a suit that is subsequently determined to have been within its duty to defend, the insurer may be obliged to settle the underlying claims against the policyholder without regard to coverage defenses and even, in some circumstances, without regard to policy limits. To protect itself against additional exposure, B offers to defend the C action, reserving the right to seek reimbursement of defense costs that are held to be outside its contractual obligation. A repudiates the obligation to reimburse B, no matter what the outcome, but accepts B’s defense of C’s claims. B proceeds to defend A, having notified A that it is acting pursuant to a unilateral reservation of rights. B subsequently obtains a declaratory judgment that the C lawsuit is outside the scope of B’s duty to defend, because it states no claims that are even potentially covered under the policy. B has a claim under this section to recover the amounts reasonably expended in the defense of the C lawsuit.


The comments to § 35 acknowledge the "special difficulties for the law of restitution" in the insurance context. Restatement (Third) of Restitution and Unjust Enrichment, § 35, cmt. c (2011). Specifically, the comments note that "the risk of enhanced liability in coverage disputes may compel a performance by the insurer that is outside the scope of the insurance contract," thus giving rise to potential "extracontractual liability." Id. An insurer faced with such exposure typically has three options: (1) commence a declaratory judgment action; (3) negotiate some form of "nonwaiver agreement" with the insured; or (3) accept the defense subject to a unilateral reservation of rights." Id. The Restatement concludes that "[i]f the insurer—having given adequate notice that it is proceeding under reservation of rights—eventually prevails in the underlying coverage dispute, it may recover that part of its outlay that exceeds its policy obligation by a claim in restitution within the rule of this section." Id. (emphasis added; referencing Illustration 12).

4. RESTATEMENT OF THE LAW OF LIABILITY INSURANCE

The American Law Institute approved the Restatement of the Law for Liability Insurance at its 2018 annual meeting. Before the official Restatement is published, its Reporters are authorized to update citations, make stylistic improvements, and implement any agreed-upon substantive changes.

Section 21 of the Restatement of the Law of Liability Insurance is titled "Insurer Recoupment of Defense Costs" and sets forth a rule that is at odds with the Restatement (Third) of Restitution and Unjust Enrichment:

Unless otherwise stated in the insurance policy or otherwise agreed to by the insured, an insurer may not seek 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.
The comments to § 21 justify this rule with the following statement:

This Section follows the emerging state-court majority rule that the insurer does not have a right of recoupment of defense costs unless this right is stated in the insurance policy or otherwise agreed to by the parties. About half of the state courts that have considered this issue, and a majority of the federal courts making *Erie* predictions, have held to the contrary, based on a theory of unjust enrichment. State courts that have decided this issue for the first time in more recent years, however, have rejected the insurer's claim to recoupment in the absence of a provision in the policy or other agreement permitting reimbursement. This Section follows this emerging state-court majority rule as the more appropriate one in the context of coverage disputes arising under liability insurance policies.


The comments to § 21 also specifically address the relationship between the Restatement of the Law of Liability Insurance and the Restatement (Third) of Restitution and Unjust Enrichment. After noting that "[t]his Restatement does not question the [Restatement (Third) of Restitution and Unjust Enrichment's] analysis of a general pattern of unjust enrichment outside of the liability insurance context," the comments to § 21 state that "there are substantial reasons to conclude that recognition of such a claim by a liability insurer is inappropriate because of special considerations of insurance law." Restatement of the Law of Liability Insurance, § 21, cmt. b (2018).

First, the Restatement of the Law of Liability Insurance posits that "an insurer that chooses to defend under a reservation of rights receives substantial benefits from exercising that choice, beyond avoiding the risk of enhanced liability." *Id.* Those benefits included "maintaining control over the cost, quality, and direction of the defense, obtaining access to privileged defense-related materials, and participating in settlement discussions." *Id.*

Second, the Restatement of the Law of Liability Insurance suggests that the Restatement (Third) of Restitution and Unjust Enrichment "starts from a different assumption about what it refers to as 'local insurance law.'" *Id.* The "different assumption" is that the conclusions drawn by Restatement (Third) of Restitution and Unjust Enrichment "disappear once insurance law is understood to include a no-recoupment default rule" because, in that circumstance, the contractual obligation "incorporates the default no-recoupment rule implied by insurance law." *Id.*

Finally, the Restatement of the Law of Liability Insurance argues that "[m]ost restitution claims between insurers and policyholders arise in contexts unrelated to coverage disputes; they more typically involve problems of mistake or subrogation." *Id.* The rule set forth in § 21 of the Restatement of the Law of Liability Insurance "has no bearing on the insurer's entitlement to restitution in these fundamentally different liability insurance settings." *Id.*

5. **RESTATEMENT VS. RESTATEMENT**
As can be seen above, illustration 12 of Section 35, Restatement (Third) of Restitution and Unjust Enrichment, appears to contradict the default rule set forth in Section 21 of the Restatement of the Law of Liability Insurance. Are the two Restatements in conflict, and if so why? The ALI itself explains that the Restatement of the Law of Liability Insurance takes an approach that "differs from, but can be reconciled with," the general view of the Restatement (Third) of Restitution and Unjust Enrichment. See Restatement of the Law of Liability Insurance, Comment b (2018). In trying to reconcile the two rules, the authors of the Restatement of the Law of Liability Insurance provide several explanations:

**The "emerging" trend against recoupment.** The more recent Restatement of the Law of Liability Insurance explicitly joins what it perceives as the courts' evolving view on the issue of recoupment of defense costs. While recognizing the split among courts, the Restatement of the Law of Liability Insurance adopts what it refers to as the "emerging state-court majority rule" that an insurer does not possess a right of recoupment of defense costs unless that right is stated in the insurance policy or otherwise agreed to by the parties. See Restatement of the Law of Liability Insurance, § 21, cmt. a (2018). Of course, a lot depends on how the "emerging rule" is tabulated, an issue that the Restatement of the Law of Liability Insurance does not address. Only one decision appears to have considered the Restatement of the Law of Liability Insurance in resolving whether an insurer may recoup defense costs. See Catlin Specialty Ins. Co. v. CBL & Assocs. Properties, Inc., No. CVN16C07166PRWCCLD, 2018 WL 3805868 (Del. Super. Ct. Aug. 9, 2018). There, the court acknowledged that while the ALI "has revised its Restatement of the Law on Liability Insurance to reflect" a shift away from allowing recoupment, "Restatements are mere persuasive authority until adopted by a court; they never, by mere issuance, override controlling case law." Id. at *3. After recognizing that "the only authority to divine Tennessee law" was a federal court decision allowing recoupment under a quasi-contract theory of unjust enrichment, the court followed that decision and awarded the insurer defense costs it had expended on uncovered claims. *Id.*

**Competing assumptions about what "local insurance law" requires.** The Restatement of the Law of Liability Insurance also attempts to reconcile the apparent conflict between its default rule and Section 35 of the Restatement (Third) of Restitution and Unjust Enrichment by arguing that Section 35 makes certain assumptions about "local insurance law." According to the Restatement of the Law of Liability Insurance, Section 35 assumes that an insurer that agrees to defend an insured is providing an extra-contractual benefit pursuant to local insurance law (and is therefore entitled to restitution). The Restatement of the Law of Liability Insurance suggests that Section 35's "premise (about extra-contractual performance) and its conclusion (about unjust enrichment) disappear once insurance law is understood to include a no-recoupment default rule." Restatement of the Law of Liability Insurance, § 21, cmt. b (2018). There are two potential problems with this argument. *First,* it is not clear that Section 35 of the Restatement (Third) of Restitution and Unjust Enrichment makes the assumptions regarding local insurance law attributed to it by the Restatement of the Law of Liability Insurance. Section 35 does reference "local insurance law," but it does so with respect to different issues, *e.g.*, insurance regulations requiring an insurer accept or deny a claim with 45 days after receiving proof of loss and the potential consequences faced by an insurer who wrongfully refuses to defend its insured. *Second,* the reasoning relied on by the Restatement of the Law of Liability Insurance is arguably circular as it relies on its own no-recoupment default rule to "disappear" the differences between the two
Restatements. The more fundamental question, about which insurers and policyholders will no doubt disagree, is whether the rule proposed by the Restatement of the Law of Liability Insurance should be a "default rule" of local insurance law in the first place.

**Whether recoupment is better addressed by equitable principles or specific contract language.** While the Restatement (Third) of Restitution and Unjust Enrichment rejects the blanket rule that there can be no unjust enrichment claims in contract cases, it recognizes that "they occur at the margins, when a valuable performance has been rendered under a contract that is invalid, or subject to avoidance, or otherwise ineffective to regulate the parties' obligations." *Id.*, § 2, Comment c (2011). The Restatement of the Law of Liability Insurance takes this general principle—that unjust enrichment is disfavored when the parties are in a position to address the issue by contract—and applies it to the recoupment of defense costs. For example, the Restatement of the Law of Liability Insurance states that "[t]he issue of the right to recoup the costs of defending a noncovered legal action is a known uncertainty that the insurer can address in the liability insurance contract, as is frequently the case in Directors' and Officers' Liability Insurance policies." Restatement of the Law of Liability Insurance, § 21, cmt. a (2018). One response is that this approach assumes that the default rule against which parties bargain is the one suggested by the Restatement of the Law of Liability Insurance. For reasons noted above, that this argument is arguably circular. Another response is that equitable doctrines such as unjust enrichment are well-developed, flexible, and allow courts to take into account the facts and circumstances of a particular case in deciding whether a party has been unjustly enriched.

**The benefits obtained by an insurer that defends questionable claims.** Finally, the Restatement of the Law of Liability Insurance notes that unlike the typical situation in which a party to a contract agrees to perform a disputed obligation, when an insurer chooses to defend an action, it is acting—at least in part—in its own interest to secure certain benefits. In addition to avoiding the risk of enhanced liability, "[t]hese benefits include maintaining control over the cost, quality, and direction of the defense, obtaining access to privileged defense-related materials, and participating in settlement discussions." Restatement of the Law of Liability Insurance, § 21, cmt. b (2018). This suggestion, however, arguably ignores that insurers are not "benefited" when they comply with their obligations under local insurance law that that, in the typical case, directs them to defend under a reservation of rights.

6. **MAJORITY RULE – IS ONE "EMERGING"?**

6.1. Seven states allow for the reimbursement of defense costs.

**California:** In what has become a landmark decision, the Supreme Court of California held in 1997 that an insurer has a right to reimbursement of defense costs for non-covered claims. *Buss v. Superior Court*, 939 P.2d 766, 775-77 (Cal. 1997); *Scottsdale Ins. Co. v. MV Trans.*, 115 P.3d 460, 471 (Cal. 2005). The right is implied in law to prevent unjust enrichment. *Buss*, 939 P.2d at 776-77. The insurer must specifically reserve this right, and may do so regardless of whether the policyholder agrees. *Id.* at 784 n.27.

**Colorado:** The Supreme Court of Colorado suggested that an insurer possesses the right to recoup defense costs for non-covered claims. *Heckla Min. Co., v. N.H., Ins. Co.*, 811 P.2d
1083, 1089 (Colo. 1991). "The appropriate course of action is for an insurer who believes that it is under no obligation to defend, is to provide a defense to the policyholder under a reservation of its rights [and] seek reimbursement should the facts at trial prove that the incident resulting in liability was not covered by the policy, or to file a declaratory judgement action after the underlying case has been adjudicated." Id.; see also Valley Forge Ins. Co. v. Health Care Mgmt., 616 F.3d 1086 (10th Cir. 2010) (predicting that the Colorado Supreme Court would allow an insurer to recover defense costs for non-covered claims); Ace Am. Ins. Co. v. Dish Network, LLC, No. 13-560-REB-MEH, 2017 WL 4162117, at *4 (D. Colo. Mar. 27, 2017) (ordering insured to reimburse insurer $913,650).

**Connecticut:** In the context of addressing costs incurred to defend against claims that arose from a 17-year period in which the insured was uninsured, the Supreme Court of Connecticut held that "[w]here the insurer defends the policyholder against an action that includes claims not even potentially covered by the insurance policy, a court will order reimbursement for the cost of defending the non-covered claims in order to prevent the policyholder from receiving a windfall." Security Ins. Co. of Hartford v. Lumbermens Mut. Cas. Co., 826 A.2d 107, 125 (Conn. 2003). The U.S. District Court for the District of Connecticut, however, has on two occasions declined to construe Lumbermans as allowing an insurer to recoup costs expended to defend under a reservation of rights where it was later determined that there was no duty to defend. See Nationwide Mut. Ins. Co. v. Mortensen, No. 00-1180-CFD, 2011 WL 2881314, at *1 (D. Conn. July 18, 2011); Am. Int'l Specialty Lines Ins Co. v. Connecticut Res. Recovery Auth., No. 06-699-AVC, 2012 WL 13018434, at *5 (D. Conn. Sept. 10, 2012).

**Florida:** Although the Supreme Court of Florida has yet to address the issue, Florida's intermediate appellate court has twice held that an insurer is entitled to reimbursement of "clearly uncovered claims" when it expressly reserves that right. Colony Ins. Co. v. G & E. Tires & Serv. Inc., 777 So. 2d 1034, 1038-39 (Fla. Dist. Ct. App. 2000); Jim Black & Assoc. Inc. v. Transcontinental Ins. Co., 932 So. 2d 516 (Fla. Dist. Ct. App. 2006). The federal courts have followed Colony Insurance and Jim Black, although they have disagreed over whether the Florida Supreme Court would hold that a reservation of the right to recoup defense costs is ineffective if it does not provide a date-certain by which the insured can reject the offer. See Certain Interested Underwriters at Lloyd's, London v. Halikoytakis, 556 F. App'x 932, 933 (11th Cir. 2014) (following Colony Insurance and Jim Black); Nationwide Mut. Fire Ins. Co. v. Royall, 588 F. Supp. 2d 1306, 1318 (M.D. Fla. 2008) (predicting that the Florida Supreme Court "would require that some reasonable time elapse before the insured's acquiescence constitutes an acceptance" of a defense conditioned upon the right to recoup); James River Ins. Co. v. Arlington Pebble Creek, LLC, 188 F. Supp. 3d 1246, 1261 (N.D. Fla. 2016) (disagreeing with the prediction made by the court in Royall); see also Philadelphia Indem. Ins. Co. v. Stazac Mgmt., Inc., No. 16-369-J-MCR, 2018 WL 2445816, at *15 (M.D. Fla. May 31, 2018) (ordering insured to reimburse insurer for defense costs for non-covered claims).

**Montana:** The Supreme Court of Montana held that an insurer can seek reimbursement where it clearly reserves the right to recoup defense costs, the policyholder does "not object" to such a reservation and where the insurers is found to have no duty to defend. Travelers Cas. & Sur. Co. v. Ribi Immunochem Research, Inc., 108 P.3d 469, 480 (Mont. 2005).
New Jersey: The New Jersey Supreme Court held that "when the insurer has wrongfully refused to defend an action and is then required to reimburse the insured for its defense costs, its duty to reimburse is limited to allegations covered under the policy, provided that the defense costs can be apportioned between covered and non-covered claims." *SL Indus., Inc. v. America Motorists Ins. Co.*, 607 A.2d 1266, 1280 (N.J. 1992). A New Jersey appellate court suggested that an insurer may recoup defense costs under an unjust enrichment theory. *Hebela v. Healthcare Ins. Co.*, 851 A.2d 75, 86 (N.J. App. Div. 2004); *see also U.S. Specialty Ins. Co. v. Sussex Airport, Inc.*, No. 14-5494, 2016 WL 2624912, at *4 (D.N.J. May 9, 2016) ("The right of reimbursement exists in cases where an insurer honored its duty to defend but sought reimbursement from an insured for fees incurred in defending a non-covered claim 'because the insured would be unjustly enriched in benefiting by, without paying for, the defense of a non-covered claim.'") (quoting *Hebela*, 851 A.2d at 86).

Ohio: The Ohio Court of Appeals has held an insurer was entitled to recover defense cost. "where (1) an insurer does not provide a defense until after a court has entered judgment declaring that the insurer has a duty to defend, (2) the insured demands that the insurer provide a defense, (3) the insurer provides the defense under a reservation-of-rights stating that it may seek to be reimbursed, and later (4) an appellate court determines that a duty-to-defend never existed, then (5) the insurer is entitled to be reimbursed for its defense-cost expenditures under a theory of restitution."). *Chiquita Brands Int'l., Inc. v. Nat'l. Union Fire Ins. Co.*, 57 N.E.3d 97 (Ohio Ct. App. 2015). In addition, the Sixth Circuit predicted that the Ohio Supreme Court would permit reimbursement of defense costs under an implied contract theory. *United Nat'l Ins. v. SST Fitness*, 309 F.3d 914 (6th Cir. 2002).

6.2. Ten states disallow reimbursement.

Alabama: Although Alabama courts have not directly ruled on the issue, the Supreme Court of Alabama has refused to recognize an insurer's right to reimbursement for an uncovered indemnity payment, absent unusual circumstances. *Mt. Airy Ins. Co. v. The Doe Law Firm*, 668 So. 2d 534, 539 (Ala. 1995).

Alaska: The Supreme Court of Alaska has held that an Alaskan statute requiring an insurer to provide independent counsel in the event of a conflict of interest, AS 21.96.100, prohibits the recoupment of defense costs even where the insurer explicitly reserves that right, the insured accepts the defense subject to that reservation, and it is later determined that there is no possibility of coverage under the policy. *Attorneys' Liability Protection Society, Inc. v. Ingaldson Fitzgerald, P.C.*, 370 P.3d. 1101 (Alaska 2016); *see also Attorneys Liab. Prot. Soc'y, Inc. v. Ingaldson Fitzgerald, P.C.*, 838 F.3d 976, 981 (9th Cir. 2016) (holding that AS 21.96.100's prohibition on the recoupment of uncovered defense costs was preempted by the federal Liability Risk Retention Act).

Illinois: The Supreme Court of Illinois has held that an insurer has no right of reimbursement for defense costs of non-covered causes of action absent an express policy provision stating otherwise. *General Agents Ins. Co. of America, Inc. v. Midwest Sporting Goods Co.*, 828 N.E.2d 1092, 1102 (Ill. 2005).


Pennsylvania: The Supreme Court of Pennsylvania has held that an insurer is not entitled to reimbursement of defense costs when it is determined that the insurer has no duty to defend. *American & Foreign Ins. Co. v. Jerry's Sport Center, Inc.*, 2 A.3d 526, 546 (Pa. 2010). The Court held that allowing an insurer the right to recoup defense costs absent a reimbursement provision would be "tantamount to allowing the insurer to extract a unilateral amendment to the insurance contract." *Id.*

Texas: Two Texas Supreme Court cases suggest that Texas does not allow for reimbursement when there is no duty to defend. First, the Supreme Court of Texas 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." *Texas Ass'n of Counties County Government Risk Mgmt. Pool. v. Matagorda County*, 52 S.W.3d 128, 135 (Tex. 2000). Second, the Supreme Court of Texas acknowledged that while insurers and the insured are in a difficult position in cases where coverage is uncertain, because the insurer is in the business of evaluating and allocating risk it is "in the best position to assess the viability of its coverage dispute." *Excess Underwriters at Lloyd's London Casting Crew v. Frank's Casing Crew & Rental Tools, Inc.*, 246 S.W.3d 42, 43 (Tex. 2008).

Utah: In the context of an insurer's claim for reimbursement of a judgment paid in excess of limits, the Supreme Court of Utah held that "[t]here can be no extracontractual right to restitution between the insurer and its insured, and only the express terms of a policy create an enforceable right to reimbursement." *U.S. Fidelity v. U.S. Sports Specialty*, 270 P.3d. 464, 468 (Utah 2012).

Washington: The Supreme Court of Washington has held that an insurer is not entitled to reimbursement of defense costs for non-covered claims. *National Surety Corp. v. Immunex Corp.*, 297 P.3d 688 (Wash. 2013).

Wyoming: The Supreme Court of Wyoming has held that recoupment of defense costs for uncovered claims, even when the insurer reserved the right is not permitted. *Shoshone First*
Bank v. Pacific Employers Ins. Co., 2 P.3d 510, 513-16 (Wyo. 2000). "Unless an agreement to the contrary is found in the policy, the insurer is liable for all costs of defending the action and may not allocate any of those costs to the policyholder." Id. at 513-14. As the Court explained, "the insurer is not permitted to unilaterally modify and change policy coverage . . . . In light of the failure of the policy language to provide for allocation, we will not permit the contract to be amended or altered by a reservation of rights letter." Id. See also Employers Mut. Cas. Co. v. Bartile Roofs, Inc., 618 F.3d 1153, 1175 (10th Cir. 2010) (same; applying Shoshone).

6.3. Federal courts have allowed reimbursement in eleven states.

Arizona: A U.S. District Court concluded that an insurer is entitled to reimbursement for uncovered defense costs where it unilaterally reserved its right to do so and the insureds "did not disagree" with the insurer's reservation of rights. Phillips & Assocs., P.C. v. Navigators Ins. Co., 764 F. Supp. 2d 1174, 1177 (D. Ariz. 2011). The court declined to decide whether Arizona or California law applied to the case because both states "recognize that an insurer's unilateral reservation of rights is proper, absent bad faith and provided notice is given to the insured." Id. at 1175; but see Great Am. Assur. Co. v. PCR. Venture of Phoenix LLC, 161 F. Supp. 3d 778, 788 (D. Ariz. 2015) (predicting that the Arizona Supreme Court would determine that "one party cannot unilaterally alter the terms of a contract by issuing a reservation of rights letter with new terms" and "unjust enrichment is not an available remedy when a contract exists.").

Georgia: A U.S. District Court has held that an insurer was entitled to reimbursement of defense costs. 846 F. Supp. 2d 1366 (N.D. Ga. 2012); see also Ga. Interlocal Risk Mgmt. Agency v. City of Sandy Springs, 788 S.E.2d 74 (Ga. Ct. App. 2016). But see Transportation Ins. Co. v. Freedom Electronics, Inc. 264 F. Supp. 2d 1214, 1221 (N.D. Ga. 2003) (holding that "in the absence of a provision requiring reimbursement or case law instructing the Court otherwise, the Court is unwilling to require the [insured] to repay the costs already expended by [the insurer].").

Hawaii: The Ninth Circuit concluded that an insurer can seek reimbursement of defense costs for non-covered claims if the insurer reserves that right. Okada v. MGIC Indem. Corp., 823 F.2d 276 (9th Cir. 1986). However, a U.S. District Court predicted that an insurer could seek reimbursement of defense costs under Hawaii law only if it had no duty to defend the underlying action; the Court did not reach the issue of whether the insurer could seek reimbursement for non-covered claims when some claims are covered. Scottsdale Ins. Co. v. Sullivan Properties, Inc. 2006 WL 505170, at *1 (D. Haw. Feb. 27, 2006).

Kentucky: The Sixth Circuit held that Kentucky law permits reimbursement where an insurer asserts a timely reservation of rights, notifies the insured, and gives the insured meaningful control of defense and settlement negotiations. Travelers Prop. & Cas. Co. of America v. Hillerich & Bradsby Co., Inc., 598 F.3d 257, 268 (6th Cir. 2010). Similarly, a U.S. District Court held that an insurer is entitled to reimbursement under Kentucky law where no coverage exists and the right to recoup was properly reserved since the insured could have objected to the reservation. Employers Reinsurance Corporation v. Mutual Ins. Co. Ltd., 2006 WL 2734437 (W.D. Ky. Aug. 22, 2006).
**Michigan:** A U.S. District Court applying Michigan law held that an insurer may recoup the cost of defense for claims that "clearly and unequivocally do not give rise to a duty to defend." *Travelers Prop. Cas. Co. R.L. Polk & Co.*, 2008 WL 3843512 (E.D. Mich. Aug. 13, 2008). "Under the policy, the insurer does not have a duty to defend the insured as to the claims that are not potentially covered. With regard to defense cost for these claims, the insurer has not been paid premiums by the insured. It did not bargain to bear these costs. To attempt to shift them would not upset the arrangement." *Id.*

**Nevada:** The Ninth Circuit affirmed the district court's decision to grant "reimbursement of expenditures made after the date of the express reservation of rights" on the theory that "acceptance of monies constitutes an implied agreement to the reservation" of the right to seek reimbursement. *Forum Ins. Co. v. County of Nye*, 1994 WL 241384, at *3 (9th Cir. June 3, 1994). The Court concluded that such a right existed because the insurer unilaterally, but explicitly reserved it. *Id.* at *2. Furthermore, a U.S. District Court held that an insurer may be reimbursed for costs incurred in defending against "claims not potentially covered under the insurance policy only if there was a clear understanding between the parties that [the insurer] reserved the right to reimbursement for the costs of the investigation and/or defense." *Capitol Indem. Corp. v. Blazer*, 51 F. Supp. 2d 1080, 1090 (D. Nev. 1999) (emphasis in original).

**New Mexico:** A U.S. District Court held that an insurer was entitled to reimbursement for uncovered claims under New Mexico law, but suggested that a right of reimbursement might not be available if the policyholder objects to the insurer's reservation of rights. *Resure, Inc. v. Chemical Distrib. Inc.*, 927 F. Supp. 190, 193 (M.D. La. 1996) (applying New Mexico law).

**New York:** A U.S. District Court held that an insurer was entitled to reimbursement of defense costs. *Gotham Ins. Co. v. GLNX, Inc.*, 1993 WL 312243 (S.D.N.Y. Aug. 6, 1993). The court allowed the insurer to pursue reimbursement against the policyholder for defense costs allocable to non-covered claims. The Court reasoned that the insurer was entitled to do so because it explicitly reserved its right to seek reimbursements if it was later determined that no duty to defend existed. *Id.; see also Max Specialty Ins. Co. v. WSG Investors, LLC*, 2012 WL 3150579 (E.D.N.Y. Apr. 20, 2012) (holding that because the insurer had made an explicit reservation of the right to pursue recoupment in its letter to the insured, it reserved the right to recover defense cost).

**Oklahoma:** An U.S. District Court held that an insurer is entitled to reimbursement of a settlement payment when no coverage was owed. The Court relied on the fact that, under Oklahoma law, an insurer who settles an underlying claim does not waive any coverage defense costs incurred prior a determination that the insurer has no duty to defend. *Melton Truck Lines, Inc. v. Indem. Ins. Co. of N. Am.*, 2006 WL 1876528, *2 (N.D. Okla. June 26, 2006).

**Tennessee:** A U.S. District Court adopted a magistrate judge's decision predicting that under Tennessee law an insurer is entitled to recoup defense costs where the insurer properly reserved its rights and it was later determined that no duty to defend exists. *Cincinnati Ins. Co. v. Grand Pointe, LLC*, 501 F. Supp. 2d 1145, 1168 (E.D. Tenn. 2007). The *Grand Pointe* decision was recently reaffirmed by the Delaware Superior Court in *Catlin Specialty Insurance Company v. CBL & Associates Properties, Inc., et al.*, No. CVN16C07166PRWCCLD, 2018 WL 3805868.
In that case, the court rejected the insured's attempt to rely on the ALI's Restatement of the Law of Liability Insurance to avoid Tennessee and Sixth Circuit law supporting an insurer's right to recoup uncovered defense costs: "True, most recently, the American Law Institute has revised its Restatement of the Law on Liability Insurance to reflect such a shift. But just as Tennessee state courts had never before directly spoken on this reimbursement issue, they have also not yet adopted the new Restatement's rule. Moreover, the Restatements are mere persuasive authority until adopted by a court; they never, by mere issuance, override controlling case law. And this Restatement itself acknowledges that '[s]ome courts follow the contrary rule[.]'"


6.4. Federal courts have disallowed reimbursement in seven states.


Iowa: A U.S. District Court acknowledged that a majority of courts permit an insurer to recover defense costs based on an implied contract or unjust enrichment theory, but predicted that the Iowa Supreme Court would not adopt such a rule. Pekin Ins. Co. v. Tysa, Inc., 2006 WL 3827232 (S.D. Iowa Dec. 27, 2006).

Indiana: A U.S. District Court expressed doubt that an insurer could recoup defense costs: "While there do not appear to be any reported cases applying Indiana law to this issue, other courts have found that an insurer does not have a right to recoup fees it pays under a duty to defend after resolution of the underlying litigation absent a policy provision allowing it to do so." Selective Ins. Co. of America v. Smiley Body Shop, Inc., 260 F. Supp. 3d 1023, 1033 (S.D. Ind. 2017).
Maryland: The Fourth Circuit held that an insurer did not have a right to partial reimbursement under Maryland law even though the insurer had agreed to defend subject to a reservation of rights for non-covered claims. *Perdue Farms, Inc. v. Travelers Cas. & Sur. Co. of Am.*, 448 F.3d 252, 258 (4th Cir. 2006). The Court concluded that a right of reimbursement for defense costs for non-covered claims would "serve only as a backdoor narrowing of the duty to defend, and would appreciably erode Maryland’s long-held view that the duty to defend is broader than the duty to indemnify." *Id.*

Minnesota: The Eighth Circuit held that an insurer was not entitled to reimbursement based on a unilateral reservation of rights: "[A]lthough Minnesota appellate courts have not announced whether they would permit a right of reimbursement, we find the most recent state and federal court decisions' adoption of the minority position more persuasive. Here, Westchester could have included in the policy an express provision for such reimbursement. Westchester cannot now unilaterally amend the policy by including the right to reimbursement in its reservation-of-rights letter." *Westchester Fire Ins. Co. v. Wallerich*, 563 F.3d. 707, 719. (8th Cir. 2009); *see also Select Comfort Corp. v. Arrowood Indem. Co.*, No. 13-2975, 2014 WL 7073093, at *9 (D. Minn. Dec. 12, 2014) ("[T]he Eighth Circuit has determined that an insured may not be made to reimburse the insurer for defense costs where the insured did not agree to such a condition on the insurer's contractual duty to defend.").

Mississippi: A U.S. District Court held that an insurer is not entitled to recoup defense costs where it’s policy does not provide a right to reimbursement and where the insurer's reservation of rights letter was insufficiently clear to provide adequate notice. *Certain Underwriters at Lloyd's London v. Magnolia Mgmt. Corp.*, 2009 WL 1873026 (S.D. Miss. June 26, 2009). The U.S. District Court held that payments made to defend an insured against uncovered claims cannot be recovered from another insurer under Mississippi's voluntary payments doctrine where the insurer failed to file a declaratory judgment action on the duty to defend or secure an agreement with the other insurer to litigate at a future time their respective obligations to defend the insured. *See Mississippi Farm Bureau Cas. Ins. Co. v. Amerisure Ins. Co.*, 2013 WL 286364, at *7-10 (S.D. Miss. Jan. 24, 2013).

Missouri: The Eighth Circuit held that under Missouri law an insurer was not entitled to reimbursement of defense cost following a determination that it had no duty to defend. *Liberty Mut. Ins. Co. v. FAG Bearings Corp.*, 153 F.3d 919, 924 (8th Cir. 1998).

6.5. No Instructive Authority In Sixteen Jurisdictions

There is little or no instructive authority in the sixteen jurisdictions: Delaware; District of Columbia; Kansas; Louisiana; Maine; Nebraska; New Hampshire; North Carolina; North Dakota; Oregon; Rhode Island; South Carolina; South Dakota; Vermont; West Virginia; and Wisconsin.

7. DEFENSE COSTS V. SETTLEMENTS

A related issue that includes many of the considerations discussed above is an insurer's right to recoup a settlement payment that it contends was uncovered. As with defense costs,
there is a conflict between the Restatement (Third) of Restitution and Unjust Enrichment and the Restatement of the Law of Liability Insurance on an insurer’s right to recoup a settlement payment. The Restatement (Third) of Restitution and Unjust Enrichment takes the view that an insurer’s settlement payment made under a unilateral reservation of rights is recoverable. *Id.*, § 35, Illustration 11. If the insurer were denied the opportunity to participate in the settlement under a unilateral reservation of rights (at least where prior adjudication of the coverage dispute is unavailable), the insurance contract would in effect be reformed to provide insurance for which the insured has not bargained or paid.

The Restatement of the Law of Liability Insurance, on the other hand states the default rule as follows: "[u]nless otherwise stated in an insurance policy or agreed to by the insured, an insurer may not settle a legal action and thereafter demand recoupment of the settlement amount from the insured on the ground that the action was not covered." *Id.*, § 25(2). As compared to the "emerging" rule related to the recoupment of defense costs, the Restatement of the Law of Liability Insurance states that a "clear majority" of state courts to have addressed the issue have not permitted recoupment in the absence of a provision in the insurance policy granting the insurer this right or an express agreement by the insured. *Id.*

As with defense costs, courts are forced to balance numerous public policy considerations in determining whether recoupment of uncovered settlement payments should be allowed. Factors favoring recoupment include the recognition that a rule against recoupment may result in insurers paying settlements for claims that were not covered by their policies. In addition, courts have recognized that "[w]here an insurer pays a claim or contributes to settlement to fulfill its fiduciary obligations and potential legal obligations for the insured's benefit, it seems logical that it might be afforded an opportunity to contest whether its insurance policy actually obligated it to make these payments." *Travelers Prop. Cas. Co. of Am. v. Hillerich & Bradsby Co.*, 596 F. Supp. 2d 1020, 1025 (W.D. Ky. 2008), *aff'd*, 598 F.3d 257 (6th Cir. 2010). Finally, a pro-recoupment regime may provide benefits to underlying tort claimants. See, e.g., *Blue Ridge Ins. co. v. Jacobsen*, 22 P.3d 313, 321 (Cal. 2001) (allowing recoupment of settlement payment made under unilateral reservation of rights because it "encourages insurers to defend and settle claims for which insurance coverage is uncertain" and "[i]n doing so, it transfers from the injured party to the insurer the risk that the insured may not be financially able to pay the party's damages").

On the other hand, a no-recoupment rule recognizes that insurance policies typically do not include settlement-recoupment provisions in their policies. As explained by the Restatement of the Law of Liability Insurance, "[g]iven that such provisions would be enforceable, the absence of such provisions in policies can be taken as evidence that the fairest and most efficient default rule, and the one that is most consistent with the parties' reasonable expectations, is one of no recoupment." *Id.*, at § 25, Comment c. In addition, a no-recoupment approach arguably encourages full and final resolutions rather than piecemeal litigation. Finally, courts have recognized that "allowing an insurer to settle claims and then sue its policyholder 'foster[s] conflict and distrust in the relationship between an insurer and its insured . . . .'" *Excess Underwriters at Lloyd’s London v. Frank’s Casing Crew & Rental Tools, Inc.*, 246 S.W.3d 42, 46-47 (Tex. 2008). In addition to reducing the insurer’s incentive to negotiate settlements favorable to its insured, it could encourage the insurer to minimize its defense costs. It would likewise create a significant conflict of interest for defense counsel during settlement discussions. *Id.*, at 47.