

POLICYHOLDERS' REIMBURSEMENT OF THEIR LIABILITY INSURANCE COMPANY'S DEFENSE EXPENSES OR INDEMNITY PAYMENTS: AS FLORIDA GOES, SO GOES THE NATION (EXCEPT TEXAS, FOR ONE)

By Dennis J. Wall

If your practice crosses state borders, you may already have encountered a conflict in insurance defense law regarding the ability of insurers to demand reimbursement from their insureds for certain payments made on the insureds' behalf. Florida represents the majority of states in allowing insurers to seek reimbursement when they defend a claim under a reservation of rights, and when a judicial ruling later establishes that the insurer was under no duty to defend the claim in question. However, a minority of jurisdictions, including Texas, have developed a stricter requirement for the reservation of rights as it relates to defense payments. The Texas Supreme Court also recently took a more restrictive approach to reimbursement in a case involving indemnity payments.

Florida and Texas represent the two sides of a conflict in insurance law concerning whether and, if so, when, a liability insurance company can demand that its insureds reimburse it for defense expenses or for indemnity payments. This conflict has existed for approximately twenty years.¹ It is only in the past several years, however, that the outlines of the conflict have become clear.

I. The First Of Two Conflicts: Reimbursement Of Defense Expenses

The decided cases leave no doubt concerning reimbursement of defense expenses. By far, the cause of action most successfully pursued by liability insurance companies seeking recovery from an insured of defense expenses for noncovered claims is "reimbursement."² Until recently, Florida and Texas courts both appeared to align themselves with a majority rule that allows liability insurers to successfully pursue reimbursement of their defense expenses for noncovered claims and causes of action. This majority view can be traced to a 1977 decision from the California Supreme Court, *Buss v. Superior Court*.³ The California Supreme Court's holdings in *Buss* shaped the law in many jurisdictions outside of California in cases that have since been decided by courts across the country.

The first significant holding that has attracted a wide judicial following is that a liability insurance company will *not* be permitted a claim or cause of action of reimbursement for defense expenses incurred in the defense of *clearly covered* or *potentially covered claims*. In *Buss*, there were 27 counts or claims in the underlying complaint against the insured. Only one of those 27 counts or claims invoked a duty to defend. The remaining 26 claims and counts were clearly not covered.

Second, the California Supreme Court held that where a liability insurer provides a defense to the entire underlying liability case, then that liability insurer will be permitted to recover such of its defense costs as can be allocated *only to noncovered* claims for which there was *never a potential* for coverage.⁴ The burden of proof of allocating the costs was placed on the insurance company, and the measure of meeting that burden of proof was by a preponderance of the evidence.⁵

In the *Buss* case, the facts included a reimbursement agreement between the insured and the insurance company by which the insured would reimburse the carrier under certain circumstances. Irrespective of that agreement, the California Supreme Court instead based its holdings on the *unilateral right of the liability insurer to a reimbursement claim or cause of action*: "[B]ecause the right is the insurer's alone, it may be

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reserved by it unilaterally.”⁶

It was also extremely important to the outcome of the *Buss* decision that a liability insurer in such a case may *not* seek reimbursement for defense costs *as to claims that are at least potentially covered*, “even if the insured agrees to the ‘reservation’.”⁷

After *Buss*, Florida and Texas took up the struggle over reimbursement of defense expenses. For a while, they seemed to come out on the same side. As will be seen, however, the Texas Supreme Court recently held that it is not at all on the same side of this question with the Florida courts.

A. Florida Leads The Majority Of Courts Allowing Reimbursement Of Defense Expenses

In a decision that broke new ground in Florida, *Colony Insurance Co. v. G & E Tires & Service, Inc.*,⁸ a Florida appellate court in 2000 confronted the *Buss*-driven issues for the first time. In that case, the Florida appellate court established a lengthy list of criteria for courts ruling on cases in which liability insurers have claimed a right of reimbursement for their defense expenses. These criteria have since been accepted as the majority rule by courts ruling in cases decided across the United States.

The *Colony Insurance* court became the first court in Florida to allow a liability insurer to claim reimbursement of certain defense expenses, at least where:

(1) the liability carrier “timely and expressly reserved the right to seek reimbursement of the costs of defending clearly uncovered claims,”

(2) the policyholder clearly accepted the insurer’s “offer of a defense with a reservation of the right to seek reimbursement,” and

(3) the liability insurer’s assertion of recovery from the policyholder follows a judicial determination “that no duty to defend ever existed” for the underlying claims or counts which were filed against the policyholder.

These elements have been followed by every subsequent Florida court in which the question has been addressed of a liability insurer’s right to reimbursement for its payment of defense expenses incurred on behalf of its policyholders.⁹

This comprehensive Florida holding also represents what has since become the clear majority view on the issue of a liability insurer’s reimbursement by its insured for the liability insurer’s defense expenses whenever there is an “express”¹⁰ or “affirmative” reservation by the insurance company of its right to be reimbursed for such defense expenses.¹¹

B. Texas Leads The Remaining States (Or So It Appears) On The Issue Of Reimbursement Of The Liability Insurer’s Defense Expenses

In *Alliance General Insurance Co. v. Club Hospitality, Inc.*,¹² a federal judge applied settled Texas law on the issue of whether a liability insurance company can successfully claim reimbursement from its insureds of defense expenses it paid on their behalf. Texas courts deny reimbursement of defense costs for noncovered claims unless a Reservation of Rights letter notifies the insured, with specificity, that reimbursement costs will later be sought. Absent a reservation of rights letter which conveys such notice with specificity to the insured, the federal court held that the plaintiff liability insurance company in that case could not state a claim for reimbursement of defense expenses. As the court put it in the *Club Hospitality* case, under Texas law the facts require a clear statement of the liability insurer’s reserved right as against its *policyholder* to recover *defense expenses* incurred on *clearly noncovered claims*:

Most, if not all, of the cases permitting an insurer to be reimbursed for the expenses it paid for the defense of the insured require the

insurer to clearly state that the carrier reserved its right to recover attorney’s fees paid for the defense upon a judicial determination of no coverage. Dennis J. Wall, *Insured’s Reimbursement of Insurer’s Defense Expenses: Some Practical Steps*, 65 DEF. COUNS. J. 68, 71 (1998). The mere judicial determination of no coverage is generally not sufficient for the insurer to recover attorney’s fees and expenses.¹³

This general rule has consistently been followed in later cases applying Texas law to similar facts.¹⁴ The Texas holdings appeared to be consistent with the Florida *Colony Insurance* decision and the majority rule. In February, 2008, however, the Texas Supreme Court set up an express and direct conflict with *Colony Insurance* and renounced the majority rule concerning liability insurers’ rights to claim reimbursement of their payments. However, the Texas Supreme Court rejected *Colony Insurance* by name — and renounced the majority view — in a case involving insurers’ reimbursement claims for *indemnity* payments rather than for *defense* expenses.

II. The Second Conflict: Reimbursement Of Liability Insurers By Their Insureds For Indemnity Payments

Courts that address the separate issue of whether, and if so, under what circumstances liability insurers may successfully claim reimbursement from their own insureds of the liability insurers’ indemnity payments, generally require four things.

First, there should be evidence of an agreement with the insured; second, the liability insurance company should openly reserve the right to deny and disclaim its liability under the policy to make payment, because there is no coverage for the payment, in the liability insurer’s estimation; third, the liability insurer-

ance company should make a reasonable settlement on behalf of the insured with the injured claimant, and fourth, the insurance company subsequently and successfully should obtain a judicial determination that the indemnity payments were not covered under the liability policy after all.¹⁵

In 2008, the Texas Supreme Court made a significant addition to that list of “elements” of reimbursement of indemnity payments. After three years of changing its mind in a pending case, or changing majorities, or both, the Supreme Court of Texas ultimately required that the agreement with the insured has to be definite and clear, particularly in the face of the insured’s objections to the insurance company’s reserved right of reimbursement of the indemnity payments.

In *Excess Underwriters at Lloyd’s of London v. Frank’s Casing Crew & Rental Tools, Inc.*,¹⁶ the Texas Supreme Court initially held that a liability insurer’s reimbursement claim for its indemnity payments can be valid and available under certain facts, but then granted rehearing. On February 1, 2008, the Texas Supreme Court withdrew its earlier opinion in that case, and substituted another.¹⁷ In doing so, the Texas Supreme Court announced that it was adhering to its earlier decision in the case of *Texas Association of Counties County Government Risk Management Pool v. Matagorda County*,¹⁸ and that it was rejecting by name the Florida appellate court decision in *Colony Insurance Co. v. G & E Tires & Service, Inc.*¹⁹

Specifically, in the new decision in *Frank’s Casing*, the Texas Supreme Court rejected non-Texas decisions in which, the court said, a unilateral reservation of rights letter was permitted to serve as the basis for fashioning a reimbursement obligation which the insurance contract did not provide. This result “would require us to overrule *Matagorda County*, which we decline to do.”²⁰

To the contrary, given the absence of any such agreed right of reimbursement of indemnity payments by an excess liability insur-

ance company, the Texas Supreme Court rejected the claim, stating:

In Texas, an insurer that settles a claim against its insured when coverage is disputed may seek reimbursement from the insured should coverage later be determined not to exist if the insurer “obtains the insured’s clear and unequivocal consent to the settlement and the insurer’s right to seek reimbursement.” *Tex. Ass’n of Counties County Gov’t Risk Mgmt. Pool v. Matagorda County*, 52 S.W.3d 128, 135 (Tex. 2000). In this case, which involves excess coverage, the insured consented to the settlement but not to the excess insurer’s asserted reimbursement right. We must decide whether to recognize an exception to the rule in *Matagorda County* and imply a reimbursement obligation when the policy involves excess coverage, the insurer has no duty to defend under the policy, and the insured acknowledges that the claimant’s settlement offer is reasonable and demands that the insurer accept it. Because none of these distinctions alleviates the concerns that drove the Court’s analysis in *Matagorda County*, we decline to recognize such an exception.²¹

In announcing this holding, the Texas Supreme Court was not yet finished with the issue of a liability insurance company’s reimbursement claim against its own insured for the liability insurance company’s indemnity payments. The Texas court went on to disclaim what it saw as a contrary view under Florida law in *Colony Insurance*:

In *Colony Insurance*, the Florida appeals court held

that a liability insurer’s reservation of rights letter, coupled with the insured’s acceptance of a defense, entitled the insurer to reimbursement for defense costs it had paid. 777 So. 2d at 1039. We held in *Matagorda County*, however, that a unilateral reservation-of-rights letter could not create a reimbursement obligation not contained in the insurance contract. *Matagorda County*, 52 S.W.3d at 131. As we have noted, to follow *Colony Insurance* would require us to overrule *Matagorda County*, which we decline to do.²²

The Texas Supreme Court was not concerned that the Florida decision in *Colony Insurance* was perhaps distinguishable on the ground that *Colony Insurance* involved the question of entitlement to reimbursement of defense costs, whereas the issue in *Frank’s Casing* and in its own earlier *Matagorda County* case involved instead the question of entitlement to reimbursement of indemnity payments. The distinction of concern to the Texas Supreme Court in *Frank’s Casing* was instead its holding that Texas law requires a contract provision for any and all reimbursement claims, whether for defense costs or indemnity payments, whenever a liability insurance company has issued a unilateral reservation of rights letter. Under such facts, the insured may or may not agree to the reserved right of reimbursement, but if the facts show only a unilateral reservation of the right, then in Texas the right of reimbursement does not exist unless the insurance contract expressly provides for it.

The issue apparently has not arisen under Florida law in a reported case involving the same or remotely similar facts. No such case has been found to date. When and as such a case presents this discrete issue to a court under Florida law, the best guide at this time as

to how *Florida* law would answer this question is found in the *Colony Insurance* decision in 2000 rather than in the *Frank's Casing* Texas Supreme Court decision in 2008.

Conclusion

The law, for its part, takes its shape from the facts. The facts, for their part, determine what law applies. These principles are illustrated by many recent cases in which courts address insurers' claims for insureds' reimbursement of the insurers' defense expenses or indemnity payments.

There is a conflict among the courts deciding these issues. One view, represented by Florida law, has attracted a present majority of decisions that a liability insurance company can reserve its right of reimbursement to defense expenses where (1) the liability carrier timely and expressly reserves the right to seek reimbursement of the costs of defending clearly uncovered claims; (2) the policyholder clearly accepts the insurer's offer of a defense with a reservation of the right to seek reimbursement, and (3) the liability insurer asserts its right of recovery from the policyholder after the liability insurer obtains a judicial determination that no duty to defend ever existed for the underlying claims or counts against the policyholder.

A minority view conflicts with the views followed by Florida and most other courts. The minority view is exemplified by Texas, where the law is interpreted to require an insurance contract with a provision for the liability insurance company's reimbursement whenever the liability insurance company unilaterally reserves its right to reimbursement, i.e., when the insured does not manifest agreement or even objects to the insurance company's reserved right of reimbursement. That view applies, according to the Texas Supreme Court, whether reimbursement rights are asserted against an insured by a liability insurance company for defense costs, or for indemnity payments.

The issue appears to be open in Florida whether a liability insurance company can unilaterally assert its right as against its own insured, to

reimbursement for indemnity payments the liability insurer has made on behalf of that insured.

¹ For example, the author reported on this conflict at about the midpoint of its existence in this earlier article, which has since been cited with approval by many courts: Dennis J. Wall, *Insured's Reimbursement of Insurer's Defense Expenses: Some Practical Steps*, 65 Def. Couns. J. 68 (January 1998).

² *E.g.*, *United Nat'l Ins. Co. v. SST Fitness Corp.*, 309 F.3d 914, 921 (6th Cir. 2002) (applying Ohio law); *Buss v. Superior Court*, 16 Cal. 4th 35, 51, 939 P.2d 766, 776, 65 Cal. Rptr. 2d 366, 376 (1997); *Colony Ins. Co. v. G & E Tires & Serv., Inc.*, 777 So. 2d 1034, 1039 (Fla. 1st DCA 2000); see also, e.g., *Travelers Cas. & Sur. Co. v. Ribi Immunochem Research, Inc.*, 326 Mont. 174, 189-90 ¶150, 108 P.3d 469, 480 ¶150, 2005 MT 50 ¶150 (2005) (apparently addressing possible cause of action of "reimbursement", and also noting that the insurance company reserved rights to "recoup" certain defense expenses); cf. *First Federal Sav. & Loan Ass'n of Fargo, N.D. v. Transamerica Title Ins. Co.*, 793 F. Supp. 265, 269 (D. Colo. 1992) (apparent dicta under Colorado substantive law), *aff'd with opinion*, 19 F.3d 528 (10th Cir. 1994). One court joined this undisputed majority view and allowed reimbursement in 1996, then changed its mind ten years later. In *Knapp v. Commonwealth Land Title Ins. Co.*, 932 F. Supp. 1169, 1170 (D. Minn. 1996), the United States District Court for the District of Minnesota allowed a claim or cause of action for "reimbursement". Later, in *Employers Mut. Cas. Co. v. Industrial Rubber Prods., Inc.*, 2006 WL 453207 *5-*6 (D. Minn. Feb. 23, 2006), the same court now limited such reimbursement, unless there is a contractual provision for reimbursement in the insurance policy, and even if the insurer reserved the right to pursue such reimbursement in the insurer's reservation of rights letter, as was the case in *Knapp* ten years before. Similar to the holding in *Employers Mutual* is the Wyoming Supreme Court's decision in the case of *Shoshone First Bank v. Pacific Employers Ins. Co.*, 2 P.3d 510, 515-16 (Wyo. 2000).

³ 16 Cal. 4th 35, 939 P.2d 766, 65 Cal. Rptr. 2d 366 (1997).

⁴ *Id.* at 49-50, 939 P.2d at 775-76, 65 Cal. Rptr. 2d at 375-76.

⁵ *Id.* at 53, 939 P.2d at 778, 65 Cal. Rptr. 2d at 378. Parenthetically, this latter holding apparently conflicts with the seemingly contrary procedural or evidentiary holding in a United States District Court case in California, also involving allocation of defense costs between covered and clearly noncovered claims: "However, the burden to prove allocation rests on the insured." *International Ins. Co. v. Red & White Co.*, Case No. C-93-0659 MHP, Memorandum and Order dated April 30, 1997, page 6 (N.D. Cal. April 30, 1997).

⁶ *Id.* at 61 n.27, 939 P.2d at 784 n.27, 65 Cal. Rptr. 2d at 384 n. 27.

⁷ *Id.* at 50, 939 P.2d at 776, 65 Cal. Rptr. 2d at 376. See also Dennis J. Wall, *Insured's Reimbursement of Insurer's Defense*

Expenses: Some Practical Steps, 65 Def. Couns. J. 68 (Jan. 1998).

⁸ 777 So. 2d 1034 (Fla. 1st DCA 2000).

⁹ *Id.* at 1039. *Accord*, *Jim Black & Assocs., Inc. v. Transcontinental Ins. Co.*, 932 So. 2d 516, 517 (Fla. 2d DCA 2006). Where liability insurers in other cases did *not* reserve such a right, reimbursement of such defense expenses has not been allowed in Florida as it has not been allowed under similar circumstances in most jurisdictions. *E.g.*, *Underwriters at Lloyd's, London v. STD Enterprises, Inc.*, 395 F. Supp. 2d 1142, 1150-51 (M.D. Fla. 2005) (Jenkins, United States Magistrate Judge); *Wendy's of N.E. Fla., Inc. v. Vandergriff*, 865 So. 2d 520, 522 (Fla. 1st DCA 2004) (in this case, the liability insurer "belatedly" attempted to reserve such rights "some 16 months after accepting" the defense, but the policyholder "never agreed").

¹⁰ See *Travelers Cas. & Sur. Co. v. Ribi Immunochem Research, Inc.*, 326 Mont. 174, 189-90 ¶50, 108 P.3d 469, 480 ¶150, 2005 MT 50 ¶150 (2005): Travelers expressly reserved its right to recoup defense costs if a court determined that it had no duty to provide such costs. Travelers also provided specific and adequate notice of the possibility of reimbursement. Ribi implicitly accepted Traveler's defense under a reservation of rights when it posted no objections. Under these circumstances, the District Court appropriately concluded that Travelers may recoup its defense costs.

¹¹ *E.g.*, *Old Republic Ins. Co. v. FSR Brokerage, Inc.*, 80 Cal. App. 4th 666, 95 Cal. Rptr. 2d 583, 591 (Cal. 2d DCA 2000).

¹² 1999 WL 500229 *1 (N.D. Tex. 1999).

¹³ *Club Hospitality*, 1999 WL 500229 at *1.

¹⁴ *E.g.*, *St. Paul Fire & Marine Ins. Co. v. Compaq Computer Corp.*, 377 F. Supp. 2d 719, 722-23 (D. Minn. 2005), *aff'd with opinion*, 457 F.3d 766 (6th Cir. 2006).

¹⁵ *E.g.*, *Johansen v. California State Auto. Ass'n Inter-Ins. Bureau*, 15 Cal. 3d 9, 538 P.2d 744, 750, 123 Cal. Rptr. 288 (Cal. 1975); *Truck Ins. Exch. v. Superior Ct.*, 51 Cal. App. 4th 985, 59 Cal. Rptr. 2d 529, 534 (Cal. 2d DCA 1996), *review denied (unreported)* (Cal. March 12, 1997); *Maryland Cas. Co. v. Imperial Contracting Co.*, 212 Cal. App. 3d 712, 260 Cal. Rptr. 797, 803-04 (Cal. 4th DCA 1989). Cf. *Standard Oil Co. v. United States*, 121 F. Supp. 770, 773 (S.D.N.Y. 1952) (treating United States as "a private insurer" for the purpose of successfully obtaining reimbursement under a claim of restitution of indemnity payments made by the United States for damage to a vessel).

¹⁶ 2005 WL 1252321 (Tex. May 27, 2005, rehearing granted Jan. 6, 2006).

¹⁷ *Excess Underwriters at Lloyd's, London v. Frank's Casing Crew & Rental Tools, Inc.*, 246 S.W.3d 42 (Tex. 2008).

¹⁸ 52 S.W.3d 128 (Tex. 2000).

¹⁹ 777 So. 2d 1034 (Fla. 1st DCA 2000).

²⁰ *Frank's Casing*, 246 S.W.3d at 51.

²¹ *Id.* at 43-44. The Texas Supreme Court also held in *Frank's Casing* "that the excess insurers failed to establish that Louisiana law regarding an insurer's right to reimbursement differs from Texas law." *Id.* at 44.

²² *Id.* at 51.