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11th Circ. Ruling May Impede Insurers' Defense Cost Recoup

By **Christy Maple and Robert Whitney** (July 31, 2023, 5:31 PM EDT)

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The U.S. Court of Appeals for the Eleventh Circuit **recently clarified** in Continental Casualty Co. v. Winder Laboratories LLC, as a matter of first impression under Georgia law, that insurers cannot obtain reimbursement of defense costs from their insureds where the policy itself does not require such reimbursement.

In Continental Casualty v. Winder Laboratories,[1] the insurers defended the insureds against a third-party lawsuit pursuant a reservation of rights, including the right to seek reimbursement of defense costs incurred for claims not covered by the policies.

The named insured, a manufacturer of generic versions of prescription medication, and its manager were sued for false advertising violations of the Lanham Act and for common law unfair competition and tortious interference with contract.

The complaint against the insureds went through three unsuccessful iterations, with the U.S. District Court for the Northern District of Georgia dismissing certain claims before allowing the case to move forward on a fourth amended complaint.

Importantly, the only theory on which the underlying plaintiff was permitted to proceed was harm caused by statements on the insured's labels to the effect that the insured's generic product was comparable to and could serve as a substitute for the plaintiff's brand-name product. The plaintiff's claims against the insured for copying its labels were dismissed at the pleading stage.

The insurers then filed a declaratory judgment action seeking declarations that they had no ongoing duty to defend the operative complaint and that they were entitled to reimbursement of the fees they incurred in defending the insured.

The trial court granted the insurers' motion for judgment on the pleadings and found that they owed no duty to defend and granted summary judgment in favor of the insured, finding no obligation for the insured to reimburse defense costs. Both sides appealed the rulings against them to the Eleventh Circuit.

After affirming the district court's decision that the insurers did not have an ongoing duty to defend the insureds, the Eleventh Circuit turned to the question of reimbursement of defense costs, which it characterized as an open question under Georgia law.

The insurers first argued that, by accepting the defense while aware of the insurers' claim for reimbursement in the reservation of rights letters and signing the reservation of rights letters, the insureds implicitly and explicitly agreed to the terms of the reservation of rights letters, which included the reimbursement provision.

The Eleventh Circuit rejected that argument, finding that the reservation of rights letters did not create a new contract between the insurers and the insureds because there was no new

consideration for the reimbursement provision in the reservation of rights letters.

In other words, the court found that the reservation of rights letters were a promise to perform a preexisting contractual obligation that did not constitute consideration for a new agreement.

The Eleventh Circuit also rejected the insurers' argument that the insureds were unjustly enriched because they retained the benefit of an expensive defense to which they knew they were not entitled.

As detailed below, this rationale forms the basis for many state courts' decisions to allow recoupment. The court explained that there was nothing unjust about requiring insurers to fulfill their contractual obligations, and that imposing such a requirement would not confer a windfall on the insureds, as the insurers argued.

Finally, the Eleventh Circuit predicted that the Georgia Supreme Court would not allow an insurer to recoup its expenses based on a reservation of rights letter without any contractual provision allowing for reimbursement. In evaluating the state of recoupment law, the court rejected the notion that there was a majority rule favoring insurers' right to recoupment.

Instead, the court opined that while such a majority rule may have existed in the past, courts have more recently trended in favor of finding no right to reimbursement inherent in an insurance policy, absent an express provision.

The court then evaluated the insurers' claim for reimbursement under available Georgia authorities. Like many states, Georgia law establishes a very broad duty to defend an insured with a much narrower obligation to indemnify. Where a carrier is faced with a mixed action with both covered and noncovered causes of action, Georgia requires the carrier to defend the entire suit.

The court reasoned that a wide-ranging right for an insurer to recoup defense costs where the carrier was ultimately deemed to have no ongoing obligation to defend would effectively collapse the duty to defend into the duty to indemnify, resulting in less protection for the insured.

Based on the precedents establishing the broad duty to defend, the court predicted that the Supreme Court of Georgia would adopt a rule barring the insurer's right to recoupment where it was not expressly provided in the policy.

Importantly, the court suggested that its analysis was predicated on the specific situation before it, where the claims and theories asserted against the insureds in the underlying litigation were narrowed due to pleadings motions.

In a footnote, the court differentiated previous federal court cases, including another Eleventh Circuit case, that had allowed an insurer to recover defense costs where the insured had never been entitled to a defense in the first instance.

Here, unlike in those cases, the court noted that an arguable duty to defend the insured at the outset of the case was "eroded into non-existence" through subsequent amendments to the complaint. The court's logic leaves open the potential that insurers in Georgia may be entitled to recoup defense costs incurred in defending an insured where there is not even an argument for coverage at the outset of litigation.

In making its ruling, the court predicted that Georgia would not follow the rule espoused by some of the nation's largest jurisdictions, including California, Florida and New Jersey.

Courts in those states have found that an insurer is entitled to recoup defense costs incurred with respect to noncovered claims under an unjust enrichment theory, as the insurers in Winder Laboratories argued.

For example, in Buss v. Superior Court, the California Supreme Court ruled in 1997 that for those causes of action that were not even arguably subject to coverage, the insured had not paid premiums to cover the risk and the carrier had not bargained to bear such costs on behalf of the insured.

The court ruled that because the insured had not paid for that coverage, it would be unjustly enriched in the form of receiving defense costs to which it was not entitled were the carrier not permitted to reimbursement of those costs.

California, like Georgia, requires carriers to defend entire actions asserted against insureds, including those containing noncovered causes of action, but the California Supreme Court in Buss found that insurers were entitled to recoup costs attributable solely to noncovered claims.

In Hebela v. Healthcare Insurance Co., a New Jersey intermediate appellate court held similarly in 2004, citing to Buss. In Colony Insurance Co. v. G&E Tires & Service Inc., a Florida intermediate appellate court found in 2000 that the insured would be no worse off than if the insurer had refused the defense altogether where it is forced to reimburse the carrier for defense costs attributable to noncovered claims.

However, the Eleventh Circuit accurately pointed out that the recent trend is in favor of barring recoupment unless a policy provision expressly provides for it.

Perhaps the most prominent example of the trend is American and Foreign Insurance Co. v. Jerry's Sport Center Inc., in which the Pennsylvania Supreme Court rejected an insurer's claim in 2010 for recoupment because no such right existed in the policy.

In Jerry's, an insurer sought to recoup defense fees it incurred on behalf of an insured while its ultimately successful declaratory judgment action was pending and on appeal. The insurer's policy did not contain a provision granting it the right to recover such costs. On these facts, the Pennsylvania Supreme Court held that an insurer was not entitled to recoup costs.

The court found that the insurer's act of accepting the defense pursuant to reservation of rights and initiating a declaratory judgment action constituted a recognition of the possibility that the suit involved covered claims — Pennsylvania's standard for the duty to defend — and that the insurer's attempt to recover defense costs based on the outcome of its declaratory judgment action would "retroactively erode" the duty.

The court also found no equitable right to recoupment, as the insurer benefited from controlling the defense, protecting itself against any indemnity exposure and securing the insured's cooperation in defending the suit.

The Eleventh Circuit cited to Jerry's as forming part of the basis for its holding. States following the view that a carrier must have a policy provision allowing for reimbursement of costs by the insured include Illinois and Texas.

As it stands, there is a roughly even split in jurisdictions allowing carriers to recoup defense costs without an express policy provision and those barring the practice. The issue remains open in many jurisdictions, without any on-point authority to guide carriers and policyholders. In others, like in Georgia, the issue has been predicted by federal courts in the absence of a decision by a state appellate court.

Further, despite the more recent trend of decisions favoring insureds recognized by the Eleventh Circuit, the Nevada Supreme Court in 2021 found a right of recoupment in favor of an insurer in Nautilus Insurance Co. v. Access Medical LLC. Thus, while the trend has favored policyholders, there are exceptions to that rule and many jurisdictions that continue to recognize an insurer's ability to recoup.

If there is room to square these competing rulings with one another, it is found in the posture of the case where the court determines the duty to defend. In Winder Laboratories, the insurer's duty to defend was terminated based on the then-operative fourth amended complaint.

The Eleventh Circuit noted that the potential for coverage was whittled down over the course of multiple pleadings motions and iterations of the complaint.

The court suggested that because the carrier sought to terminate its ongoing duty to defend, recoupment would not apply where the duty appeared to have existed at an earlier point in time.

In cases such as Buss, however, courts determined that no duty to defend ever existed with respect to at least some of the claims asserted against the insured and granted recoupment in that posture.

Winder Laboratories did not consider the question of whether a Georgia insurer can seek recoupment where it argues that it has no duty to defend in the first instance, and the court's reasoning leaves room for a carrier to argue in favor of such a rule.

However, the Jerry's case cited in Winder Laboratories found that the carrier's uncertainty as to the existence of the duty rendered it unable to recoup defense costs even where it sought a declaration with respect to the original complaint against the insured, because that uncertainty triggered the obligation to defend the insured.

In states without clear recoupment precedent whose courts turn to Buss, Jerry's and Winder Laboratories for guidance on resolving the issue, that state's case law concerning the time at which the duty to defend arises may be key in determining whether recoupment might be allowed. In states where any lack of clarity, either legal or factual, would give rise to the duty to defend, recoupment is less likely to be permitted.

However, where the duty is deemed to either exist or not exist upon the facts as alleged in the complaint, as in Buss, courts may be more receptive to allowing the carrier to recoup defense costs in the absence of express policy language.

Although the Winder Laboratories decision technically is not binding on Georgia state courts, it is likely to be cited as persuasive authority for the argument that an insurer that provides a defense in Georgia cannot recover defense costs from its insureds unless the insurance policy explicitly provides for such recovery.

The case may also prove persuasive in states without clear precedent on an issue with relatively little nationwide case law.

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[1] https://media.ca11.uscourts.gov/opinions/pub/files/202111758.pdf.
