

FC&S LEGAL

The Insurance Coverage Law Information Center

RECOUPMENT OF DEFENSE COSTS: AN OHIO COURT WEIGHS IN ON THE DEBATE

April 3, 2016

Frederic J. Giordano and Denise N. Yasinow

An Ohio appellate court recently addressed the much-debated issue of recoupment of defense costs, holding in a 2–1 decision, and on very narrow grounds, that an insurer could recoup nearly \$12 million it expended on the defense of its insured. In the unpublished opinion *Chiquita Brands International, Inc. v. National Union Fire Insurance Company of Pittsburgh, Pa.*,^[1] (“*Chiquita*”), the court determined that National Union Fire Insurance Company of Pittsburgh, PA (“National Union”) was entitled to recover, on restitutionary grounds, defense costs that it paid on behalf of Chiquita Brands International, Inc. (“Chiquita”) after the trial court ruled that National Union owed Chiquita a duty to defend, when the appellate court subsequently reversed the trial court’s order and held that National Union owed no duty to defend.

Although the *Chiquita* court cautioned that its holding was applicable only to the narrow circumstances before the court, the decision is alarming for policyholders because it permitted the insurer to recoup defense costs, in the absence of any policy language creating such right, based on the insurer unilaterally reserving the right to seek reimbursement in letters accompanying the payments it made, despite no evidence that the policyholder agreed to the creation of this right.

Background

In *Chiquita*, numerous tort claims were filed against Chiquita alleging that the company had financed terrorist groups in Colombia.^[2] National Union declined to defend the underlying lawsuits, which led to both parties moving before a trial court for declaratory judgment. In January 2010, the trial court entered an order that was not final and appealable, declaring that National Union owed a duty to defend.^[3] National Union thereafter began funding Chiquita’s defense, ultimately making a total of 16 defense cost payments. Each payment, except one, was accompanied by a cover letter stating, in pertinent part, that National Union reserved its right to seek reimbursement of the payment.^[4]

After National Union made the payments, the trial court issued a final appealable order, which National Union appealed. The appellate court subsequently determined that National Union owed Chiquita no duty to defend in the underlying lawsuits and remanded to the trial court to decide whether National Union was entitled to recoup defense costs.^[5]

The National Union policies were silent on the issue of recoupment of costs in the event of a judicial determination that the insurer had no duty to defend a claim.^[6] On remand, however, the trial court determined that National Union was entitled to recoup the payments based on an implied-in-fact contractual right to reimbursement created by the cover letters that had accompanied its payments to Chiquita.^[7] Chiquita appealed.

The Chiquita Majority

On appeal, the majority affirmed. The court disagreed that the letters accompanying the payments created a new, implied-in-fact contract, but nevertheless found that the letters had reserved National Union’s rights to restitution. The majority reasoned that despite the fact that the National Union policies were silent on the issue of defense cost recoupment, National Union was entitled to recover under a restitution theory.^[8] The court relied solely on the Restatement, and no Ohio caselaw, for its invocation of the restitution theory, stating:

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.^[9]

The court then found that the two elements of “restitution” were fulfilled. First, the court found it reasonable for National Union to accede to Chiquita’s demand for payment after losing before the trial court since “[t]he practical reality . . . is that National Union had little choice but to begin funding Chiquita’s defense until the court’s order became final and National Union was able to appeal it. Refusing to fund the defense could have subjected National Union to a claim of bad faith, as well as prejudiced it in the underlying litigation.”[10] Second, the court found that the cover letters were sufficient to reserve National Union’s right to seek restitution.[11]

The majority further emphasized that its holding was very limited:

Based on the particular facts of this case, National Union is entitled to restitution of its defense costs and interest payments. But our holding is a narrow one. Specifically, 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.[12]

The Chiquita Dissent

By contrast, and with better reasoning, the minority sided with Chiquita. The dissent reasoned that the relationship between Chiquita and National Union was contractual, and none of the policies contained provisions permitting National Union to recoup defense costs it paid that were subsequently determined not to be owed. The dissent went so far as to articulate the three ways in which National Union *could* have recouped defense costs:

First, National Union could have had a policy provision allowing it to seek recovery or reimbursement of previously paid defense costs in the event, like here, an appellate court reverses a finding of a duty to defend. Second, National Union could have reached an express agreement with Chiquita (outside of the insurance policy) that defense costs would be reimbursed in the event the trial court’s determination was reversed. Third, National Union could have withheld payment of defense costs pending the outcome of the appeal of the trial court’s declaratory judgment. National Union did none of these.[13]

The dissent further noted that the theory of implied-in-fact contract had no bearing on the case since it was undisputed that the National Union policies contained no right to recoupment. The cover letters to the defense payments “were letters from National Union’s counsel reserving and disclaiming waivers of rights of National Union to seek reimbursement. National Union did not and could not reserve any right it did not possess. A reservation of rights is only effective as to the rights possessed. Chiquita, in turn, never agreed to reimburse National Union.”[14] Therefore, in the dissent’s view, there was no contract, implied or express, for reimbursement of defense costs.

Further, the dissent inspected the broad scope of the duty to defend under Ohio law. The dissent noted that “National Union has now asked this court to narrow its broad obligation to defend, so that the duty to defend is coterminous with the duty to indemnify.”[15] The dissent rightfully rejected this request, especially where the record showed that National Union recognized the existence of potentially covered claims early in the litigation.

Finally, the dissent addressed the nationwide split in authority regarding an insurer’s right to recoupment, recognizing that “the ability of an insurer to recover defense costs already paid has been the subject of much debate.”[16] The dissent noted that cases from the Sixth Circuit, the Eighth Circuit, the District of Hawaii, and appellate courts in Florida and California have allowed reimbursement of defense costs. The dissent then described cases from the Eighth Circuit and the Supreme Courts of Illinois, Washington, Wyoming, and Pennsylvania that found that reimbursement of defense costs was not available.[17] Ultimately, the dissent correctly sided with the latter line of cases, stating that if recoupment were allowed:

[t]his “all reward, no risk” proposition renders the defense portion of a reservation of rights defense illusory. The insured receives no greater benefit than if its insurer had refused to defend outright.[18]

The dissent rightly found that “allowing recoupment to be claimed in a reservation of rights letter would allow the insurer to impose a condition on its defense that was not bargained for.”[19]

The Take-Away for Policyholders

Chiquita is an unfortunate decision for policyholders since the split decision permitted an insurer to recoup defense costs based on a weak rationale rooted only in a treatise's definition of "restitution." In fact, this rarely cited provision of the Restatement had been relied upon by a court only a dozen times ever before, in any context. However, the majority's holding was extremely narrow and limited to the specific procedural posture before the court. While no information is yet available as to whether *Chiquita* will seek certification to appeal to the Supreme Court of Ohio, policyholders should keep abreast of developments in this case as well as other cases across the country that address the issue of recoupment of defense costs. Also, at a very minimum, policyholders would be well-advised to object to reservation of rights letters purporting to allow insurers to seek reimbursement of paid defense costs under any theory, including implied contract and restitution.

Notes

[1] No. C-140492, 2015 WL 9594035 (Ohio Ct. App. Dec. 30, 2015).

[2] See *id.* at ¶ 2.

[3] *Id.*

[4] *Id.* at ¶¶ 3-4.

[5] *Id.*

[6] *Id.*

[7] *Id.* at ¶ 4.

[8] *Id.* at ¶ 7.

[9] *Id.* at ¶ 8 (citing 1 Restatement of the Law 3d, Restitution and Unjust Enrichment, Section 35 (2011)).

[10] *Id.* at ¶ 15.

[11] *Id.* at ¶ 23.

[12] *Id.* at ¶ 24.

[13] *Id.* at ¶ 35.

[14] *Id.* at ¶ 37.

[15] *Id.*

[16] *Id.* at ¶ 46.

[17] *Id.* at ¶¶ 47-50.

[18] *Id.* at ¶ 50 (quoting *Natl. Sur. Corp. v. Immunex Corp.*, 176 Wash. 2d 872, 885 (2013)).

[19] *Id.* at ¶ 51 (quoting *Natl. Sur. Corp.*, 176 Wash. 2d at 886).

About the Authors

Frederic J. Giordano is a partner at **K&L Gates LLP** focusing his practice on insurance coverage litigation and counseling and complex civil and commercial litigation. Mr. Giordano may be contacted at frederic.giordano@klgates.com.

Denise N. Yasinow is an associate at **K&L Gates LLP** and a member of the firm's Insurance Coverage, Commercial Disputes, and Construction practice groups. Ms. Yasinow may be contacted at denise.yasinow@klgates.com.



For more information, or to begin your free trial:

- Call: 1-800-543-0874
- Email: customerservice@nuco.com
- Online: www.fcandslegal.com

FC&S Legal guarantees you instant access to the most authoritative and comprehensive insurance coverage law information available today.

This powerful, up-to-the-minute online resource enables you to stay apprised of the latest developments through your desktop, laptop, tablet, or smart phone —whenever and wherever you need it.

NOTE: The content posted to this account from **FC&S Legal: The Insurance Coverage Law Information Center** is current to the date of its initial publication. There may have been further developments of the issues discussed since the original publication.

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting or other professional service. If legal advice is required, the services of a competent professional person should be sought.

Copyright © 2016 The National Underwriter Company. All Rights Reserved.

Call 1-800-543-0874 | Email customerservice@nuco.com | www.fcandslegal.com