

Pennsylvania Supreme Court: Insurer Has No Right To Recoup Defense Costs

October 2010

The Pennsylvania Supreme Court has held that an insurer may not obtain reimbursement of defense costs for a claim for which a court later determines there was no duty to defend where such a recoupment right is not provided in the policy, even where the insurer attempts to reserve that right in its coverage letters. *Am & Foreign Ins. Co. v. Jerry's Sport Center, Inc.*, 2010 WL 3222404 (Pa. Aug. 17, 2010).

The insured, a firearms wholesaler, was sued by various associations attempting to hold the firearms industry liable for injury to association members through the negligent creation of a public nuisance. The associations sought injunctive relief and monetary damages to establish a fund for the education, supervision and regulation of gun dealers. The wholesaler's commercial liability and umbrella insurer initially accepted coverage for the claim subject to a reservation of rights and specifically reserved the right to seek reimbursement of defense costs in a declaratory judgment action. The insurer later issued a final coverage determination that there was no duty to indemnify or to defend the wholesaler and sought a declaratory judgment to that effect. After obtaining a ruling that it was not required to defend because the relief sought in the underlying claim did not fall within the coverage grant of the policy, the insurer sought reimbursement of defense fees from the date it filed the declaratory judgment action.

The Pennsylvania Supreme Court determined that, absent a policy provision specifically allowing such a right, the insurer could not obtain reimbursement. The court rejected the insurer's argument that the underlying claim was not potentially covered and therefore never triggered its duty to defend. According to the court, if an insurer believes there is no possibility of coverage, it should deny its insured a defense. If the insurer is uncertain about coverage, then it should provide a defense and seek declaratory judgment about coverage. However, the court's role in the declaratory judgment action, according to the Pennsylvania court, is to resolve uncertainty, and a judicial resolution of the question of coverage does not "retroactively eliminate the insurer's duty to defend the insured during the period of uncertainty." Because "uncertainty existed about coverage" when the insurer initially provided a defense, the claim was "potentially covered," and the insurer was required to pay defense costs.

The court determined that an insurer cannot "employ a reservation of rights letter to reserve a right it does not have pursuant to the contract" and therefore that the insurer's reservation of the right to seek reimbursement of defense costs was insufficient. The court further rejected the insurer's argument based on unjust enrichment,

reasoning that the insurer's control of the defense of the underlying claim benefited the insurer by allowing it to protect itself from potential indemnity exposure and from a bad faith claim.