

Insurer Not Entitled to Reimbursement of Defense Costs Incurred in Connection with Non-Covered Claims

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The United States Court of Appeals for the Fourth Circuit, applying Maryland law, has denied an insurer's request for partial reimbursement of defense costs for non-covered claims, explaining that "we are unwilling to grant insurers a substantial rebate on their duty to defend." *Perdue Farms, Inc. v. Travelers Cas. & Sur. Co. of Am.*, 2006 WL 1320626 (4th Cir. May 16, 2006).

The court also found that the insurer was not liable to indemnify the amount of the policyholder's settlement arising from the non-covered claims.

The insurer issued a pension and welfare fund fiduciary responsibility policy to the policyholder. The policy covered ERISA claims but not claims under wage and hour laws. The policy included a duty to defend covered claims. A class action was filed against the policyholder, seeking recovery based on ERISA, the Fair Labor Standards Act and the wage and hour laws of several states arising out of compensation and record-keeping practices. Since the complaint included ERISA claims, the insurer paid defense costs and reserved its rights as to the non-covered claims. The underlying action settled, but the settlement did not allocate amounts between the ERISA claim and other causes of action. The insurer refused to contribute to the settlement, arguing that most of the settlement was for non-covered claims.

The appellate court denied the insurer's request for reimbursement of defense costs for the non-covered claims. The court explained that Maryland law requires the insurer to defend the entire action if any claim is potentially covered. As the court explained, "a partial right of reimbursement would thus 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."

The court then determined that the insurer's indemnity obligations only extended to covered claims, rejecting the policyholder's contention that the insurer was responsible for indemnifying claims "reasonably related" to the ERISA claims. According to the court, an extension of the insurer's indemnification obligations was inappropriate because such an extension was limited under Maryland law to assessing covered defense costs under policies that did not include a duty to defend. The court explained that "[b]ecause even a suit with

multiple claims will typically involve both a similar set of operative facts and overlapping legal theories, applying the reasonably related rule to indemnification would often leave insurers footing the bill for an entire judgment or settlement, even for those claims the policy did not reach." Accordingly, the appellate court remanded the case for the district court to consider appropriate allocation of the settlement amount. In doing so, the court indicated that the policyholder carried the burden of proving which portions of the settlement were paid in connection with covered claims.