

ALERT

Insurer May Recoup Uncovered Defense Costs in Suit Filed After Final Adjudication of its Coverage Obligations

March 18, 2014

Applying New York law, the United States District Court for the Southern District of New York has held that, where an insurer reserves rights to recoup uncovered defense costs and a court subsequently deems these costs uncovered, the insurer may recoup these costs even if it did not seek them in prior coverage litigation. *Women's Integrated Network, Inc. v. U.S. Specialty Ins. Co.*, 2014 WL 894501 (S. D.N.Y. Mar. 7, 2014).

After the insured tendered an underlying claim to its D&O insurer, the insurer agreed to pay a portion of the insured's defense costs while reserving its right to deny coverage. The relevant policy provided that: "[i]f it is finally determined that any Defense Costs paid by the Insurer are not covered ... the Insureds agree to repay such non-covered Defense Costs to the Insurer." After a trial court subsequently ruled that the policy did not afford coverage for the underlying action, the insurer sought repayment for the defense costs it had advanced. The insured then sought a declaratory judgment that the insurer could not recover these costs because, *inter alia*, its recoupment claim was a compulsory counterclaim in the parties' earlier coverage dispute and, accordingly, *res judicata* barred this claim. The court granted the insurer's motion to dismiss the insured's complaint, leaving only the insurer's recoupment counterclaim in the instant action.

With respect to the counterclaim, the court held that, given that only compulsory counterclaims are subject to *res judicata*, *res judicata* did not preclude the insurer's recoupment effort. The court determined that this counterclaim was not compulsory in prior coverage litigation

Practice Areas

- D&O and Financial Institution Liability
- E&O for Lawyers, Accountants and Other Professionals
- Insurance
- Professional Liability Defense

given that it was not ripe at that stage, as there had not yet been a final determination that its advanced defense costs were uncovered. The court additionally noted that, where a party engages in actionable conduct after a suit's commencement, res judicata does not preclude the adverse party from bringing a subsequent suit based on that conduct. The court maintained that, because the "actionable conduct" giving rise to the insurer's counterclaim—the insured's decision to file suit rather than repay defense costs at the insurer's behest—occurred after the filing of the prior coverage litigation, res judicata could not bar the insurer's recoupment counterclaim.