

It's Payback Time: California Ruling Highlights Recoupment Risks in Liability Claims

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One of the most valuable aspects of liability insurance is defense coverage, which protects policyholders from significant costs to defend against and litigate claims that may never result in a judgment or settlement. Companies and their directors and officers can incur thousands or even millions of dollars in defending against claims that are resolved long before trial. Even after purchasing robust defense coverage and getting an insurer to defend a claim, however, companies may be surprised when months or even years later the insurer reverses its position and not only withdraws from the defense but also demands repayment of all defense costs paid to date. A recent case, *Evanston Insurance Co. v. Winstar Properties, Inc.* No. 218CV07740RGKES, 2022 WL 1309843 (C.D. Cal. Apr. 14, 2022), shows the perils of insurer “recoupment” and underscores the importance of assessing insurer recoupment rights, if any, throughout the claims process.

Recoupment allows insurance companies to recover defense costs paid on behalf of the policyholder. However, insurance companies [are not always able to recoup defense costs](#), and an insurer’s right to recoup depends on the policy language, applicable law, and sometimes even the party’s conduct during the claim. Given all of these variables, courts continue to be split regarding an insurer’s right to recoupment.

In the recent *Winstar Properties* decision, a California federal judge [found](#) that *Winstar Properties’* insurer, *Evanston*, could recoup costs it paid defending a property owner and a manager in a discrimination lawsuit. *Evanston* had already won summary judgment in 2019 when the court held that it did not have a duty to defend *Winstar* under the tenant discrimination liability policy, so the parties turned to whether *Evanston* had a right to recoup the costs it paid in defense of the discrimination suit.

In California, courts have held that an insurer may reserve its rights to seek reimbursement of defense costs through a reservation of rights letter unilaterally, even if the right to recoupment is not expressly stated in the policy. The issue in *Winstar Properties*, therefore, was whether *Evanston* could prove it had sent a 2017 letter to *Winstar* properly reserving its right to reimbursement. *Winstar* denied that it ever received the letter. The court recognized it was “a close call,” but held that *Evanston* had shown by a sufficient margin that it is more likely than not that the 2017 letter was

mailed to Winstar. It recently entered [judgment](#) in Evanston's favor for more than \$83,000 in defense costs, plus prejudgment interest.

The decision in Winstar Properties is not surprising given California's rule that a right to recoup can arise solely from an insurer's unilateral reservation of rights. Other jurisdictions, however, are far less insurer-friendly—if they recognize a recoupment right at all—and require more stringent proof, such as an express policy provision or a clear understanding between both parties. Nevertheless, the Winstar Properties decision raises several important issues that policyholders should consider when assessing potential recoupment risks.

Be Proactive. Timing is critical, and waiting to react to an insurer's demand for repayment months or even years into litigation (after significant defense costs have already been incurred) may be too late. The ideal time to understand potential recoupment rights is at the time the policy is purchased or renewed or, alternatively, at the outset of the claim.

- Does the policy specify a duty to defend or a duty to advance? Can the policyholder elect between the two and, if so, under what circumstances?
- Does the policy contemplate repayment of advanced legal fees and, if so, under what terms?
- If the policy is silent, which state's law would govern a potential recoupment claim, and does the policy include a choice-of-law or venue provision that would impact that analysis?

Addressing these kinds of questions early on in the claim process can help maximize defense coverage.

Be Diligent. The right to recoup may change over time and should be evaluated throughout the claims process. For instance, in some jurisdictions, an insurer may not have a right to recoup if not expressly reserved in a coverage letter or, after such a letter is issued, the policyholder accepts the defense subject to the insurer's right to recoup. Thus, policyholders should carefully review the entirety of reservation of rights letters, including any right to recoupment, along with any other coverage communications addressing that issue.

Understand Governing Law. Policyholders should not assume that a right to recoup exists, even if stated in a reservation of rights letter, because the availability and scope of recoupment rights vary by state. As noted above, because recoupment rights are highly dependent on state law, assessing choice of law and identifying what law is likely to govern a particular claim can be dispositive on the issue of recoupment.

Recoupment can be a challenging issue to confront, especially in the later stages of a claim when the losses at issue are greater and the stakes are higher. Following the above tips and retaining experienced brokers and counsel to assist in policy placement, claim presentation, and ongoing claims handling can help mitigate the risk of successful recoupment claims and avoid surprises in the event of a claim.

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