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Insurance in the Know (Part 3): Recoupment of Defense Costs Is Not a "Right" in a Standard CGL Policy

Article By:

A. Kate Margolis

The foundation of a policyholder's agreement to pay premiums for a standard commercial general liability policy (CGL) is the insurer's agreement to defend the policyholder against lawsuits and shoulder the costs of the defense. The insurer has "the right and duty to defend any 'suit'" containing any allegation that potentially falls within the policy's coverage. In other words, the insurer has agreed to defend the entire suit, even if it also includes non-covered claims. But along with that duty, the insurer has the valuable right to control the defense and use its resources to combat a finding of liability against the policyholder that would trigger its duty to indemnify. (Note that an insurer may have a conflict of interest in a "mixed action" alleging both covered and non-covered claims, requiring the insurer to pay for the policyholder's choice of independent counsel, which we've covered previously.)

What a standard CGL does not give the insurer the right to do is seek recoupment of defense costs. Period. Yet insurers often attempt to do just that if it is later determined (usually through a declaratory judgment action) that none of the claims in the suit was covered.

Reserving a Non-Existent Right Doesn't Make It So

In a mixed action or when potential coverage is doubtful, the insurer is obligated to reserve the right to later deny coverage and explain the reservation to the policyholder. These so-called reservation-of-rights letters may also include the insurer's assertion of a "right" to seek reimbursement of defense costs for claims ultimately determined to be non-covered, including those claims with the potential for coverage that triggered the defense duty in the first place.

Despite the absence of any such right in the wording of the insurance contract and lack of additional consideration, some courts, most notably in California, have upheld a right of recoupment based on the equitable doctrines of implied-in-fact contract and unjust enrichment. Their theory is that the policyholder (1) could have objected to recoupment and instead impliedly consented to that condition by accepting the defense, or (2) was unjustly enriched because it ultimately turned out the insurer had no defense duty.

These rationales turn the insurer's broad duty to defend on its head, permitting insurers to retroactively narrow the CGL's principal benefit to policyholders. The result is certainly not equitable

given that insurers could readily resolve the issue by amending policy wording to specifically enshrine a right to recoupment. Fortunately, the number of courts rejecting insurers' recoupment arguments now predominates, perhaps in part due to the American Law Institute's position in the Restatement of the Law of Liability Insurance that recoupment is unavailable absent an express right in the policy itself.

When a CGL insurer elects to defend a claim subject to a reservation of rights, policyholders should challenge unwarranted assertions of a right to recoup defense costs as nothing more than a unilateral attempt to diminish the very benefit the insurer agreed to provide.

Read Part One **and** Part Two**.**

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