

BINDING AUTHORITY

Insurance Coverage Decisions: Issued Today - Impact Tomorrow



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Sixth Circuit Hits it Out of the Park for Insurer

Appeals Court Permits Insurer to Settle and then Recover the Proceeds

Warning: To avoid long-term financial consequences, seek immediate settlement in the event of a coverage dispute lasting more than four years.

Well that advice certainly wasn't taken by any party in today's Sixth Circuit Court of Appeals decision in *Travelers Prop. & Cas. Company v. Hillerich & Bradsby Company, Inc.*, resolving a coverage dispute that grew out of an underlying action that was filed against Hillerich & Bradsby Company (manufacturer of Louisville Slugger baseball bats) in 1998. While the decision was a long time coming, insurers will certainly think that the dozen years was worth the wait. The Sixth Circuit handed insurers a win in one of the most vexing problems that they face.

We've all been there. An insurer is defending its insured in an action under a reservation of rights on account of a potential coverage defense. An opportunity to settle the case – perhaps close to trial – arises. The insurer is getting tremendous pressure from its insured to settle the case to avoid any risk of a verdict in excess of policy limits. But if the insurer does what its insured is demanding, and settles the case, what happens to its coverage defense? Did the insurer just pay to settle an uncovered claim and now has no recourse? Was the insured able to use the threat of saddling the insurer with liability for an excess verdict as a means to obtain (read as extort) coverage for uncovered claims? It is the proverbial damned-if-you-do and damned-if-you-don't for the insurer? This was the issue in today's decision in *Travelers Prop. & Cas. Company v. Hillerich & Bradsby Company*.

The underlying action giving rise to the coverage dispute – *Baum Research and Development Co. v. Hillerich & Bradsby Company* -- may have alleged that Hillerich disparaged the Baum Bat and Baum Hitting Machine. Hillerich sought coverage from Travelers under Coverage B, Personal and Advertising Injury, of its Commercial General Liability policies. Travelers initially refused to defend Hillerich but then undertook its defense following the filing of a Second Amended Complaint. Travelers maintained that the underlying *Baum* action did not involve a disparagement claim that was covered under the policy.

In 2005, after trial in the underlying action had commenced, the parties settled. Hillerich's portion of the settlement was \$500,000. In the time leading up to the settlement, Travelers informed Hillerich that it would only fund settlement costs while reserving a right to seek reimbursement for any contribution found to be funding noncovered claims.

Needless to say, Hillerich did not agree to this condition:

Hillerich acknowledged Travelers' claim of a right to seek reimbursement but expressly objected to this right, instead arguing that the claims at issue in the *Baum* litigation should be covered by Travelers. Hillerich demanded that Travelers settle the case while still refusing to recognize a right to reimbursement, which Travelers again invoked as a condition for funding settlement. Hillerich threatened to sue Travelers for bad faith for defending under a reservation of rights if Travelers did not settle the underlying litigation. Travelers again invoked its reservation of rights to seek reimbursement for noncovered claims included in the settlement while it funded the settlement on March 18, 2005.

Id. at 6.

Travelers initiated coverage litigation in 2005 seeking reimbursement of its settlement if it were determined that funds were paid to resolve uncovered claims. The Kentucky District Court concluded that Travelers had such right to reimbursement. The case was appealed to the Sixth Circuit, which framed the issue as follows: “[W]hether Travelers can seek reimbursement of settlement for noncovered claims when it funded the settlement under a reservation of rights, when Hillerich was given notice of its intent to seek reimbursement, and when Hillerich retained meaningful control of the defense and negotiation process.” *Id.* at 8.

The Sixth Circuit – following a review of the issue nationally -- affirmed the lower court -- allowing “reimbursement for an insurer after a unilateral reservation of rights by the insurer over the objection of the insured in at least the narrow circumstances posed in this case.” *Id.* at 12. The court concluded that the right to reimbursement exists under an implied-in-law / unjust enrichment theory. In other words, the insured only paid premiums for coverage of the specified claims in the policy and the insured had full knowledge of the consequences of accepting the defense and settlement under the insurer's reservation of rights. *Id.* at 10 (discussing *Blue Ridge Ins. Co. v. Jacobsen*, 22 P.3d 313 (Cal. 2001)).

While the court couched its decision on legal doctrine, the money paragraph indicates that the court's decision was also based on what it perceived as fundamental fairness for insurers. The Sixth Circuit clearly appreciated the conundrum facing insurers:

Travelers was in a difficult position – either settle the claim without an agreement on reimbursement when Travelers was contesting coverage or delay settlement when that would increase defense costs that it had already waived the right to recoup and might lead to liability on a bad faith claim. Kentucky favors fair and reasonable settlements, and all parties agree that the underlying settlement was fair and reasonable. Allowing insurers to reserve a right to seek reimbursement in at least some limited circumstances where it is done expressly and where the insured retains meaningful control over the defense encourages settlements when coverage is uncertain, while not permitting unjust enrichment to the insured who demands settlement but refuses to recognize a right to reimbursement. Here the insured was arguing that coverage was afforded for both defense and settlement costs, but refused to allow the insurer to seek reimbursement if a court later determined that the insured's position was incorrect. It would seem to be an unjust outcome for the insurer if this Court were to sanction that position. The insured would be both getting the settlement at the time it preferred and having that settlement funded by the insurer when no coverage was afforded under the policy. It is unlikely Kentucky would approve such a position.

Id. at 13-14.

A copy of the March 12, 2010 decision in *Travelers Prop. & Cas. Company v. Hillerich & Bradsby Company* can be accessed here:

<http://www.ca6.uscourts.gov/opinions.pdf/10a0068p-06.pdf>

Please let me know if you have any questions.

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