

# BINDING AUTHORITY

Insurance Coverage Decisions: Issued Today - Impact Tomorrow



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## **Pennsylvania Federal Court Gives Policyholders An Enhanced TSA Pat-Down**

### **Eastern District Recognizes Insurer's Right of Reimbursement of Settlement Payments**

*Binding Authority's* Thanksgiving greetings to you:

1. Place your left hand out in front of you, fingers spread out and palm facing you
2. Make a fist with your right hand and place it in the center of your left palm; Keep your thumb in the fist position and pointed straight up
3. While still keeping your thumb in the fist position, move it so that your thumb-print points upward
4. Keeping your hand and fist still, move your thumb forward and backward

Happy Thanksgiving!

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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 issue – perhaps one of the most challenging of them all – wants for guidance. While the landscape is not completely barren, such a critical issue would certainly benefit from more instruction.

Last week the Eastern District of Pennsylvania helped to fill the void in issuing *Axis Specialty Insurance Company v. The Brickman Group, Ltd.* The issue in *Brickman* was not the one just described. Rather, the specific issue in *Brickman* was whether an insurer that settles a case can then seek recovery of a \$250,000 SIR from its insured.

But the court's resolution of the SIR reimbursement issue was in broad enough terms to include the uber-challenge faced by insurers that are defending insureds under a reservation of rights and are then confronted with a demand to settle and threat of an excess verdict for failure to do so.

The *Brickman* Court first addressed the relatively clean-slate on which it would be writing with respect to the reimbursement issue:

“[T]he question of whether an insurer is entitled to reimbursement for settlement payments has not received extensive judicial scrutiny.” *Utica Mutual Insurance Co. v. Rohm&Haas Co.*, 683 F. Supp. 2d 368, 376 (E.D. Pa. 2010). Indeed, we have been unable to identify any Pennsylvania state court opinion directly addressing this issue. There is, however, authority interpreting Pennsylvania law with respect to two analogous issues: (1) whether an insurer is entitled to reimbursement of defense costs when it is subsequently determined that the insured was entitled to no indemnity coverage under the insurance policy, see *American&Foreign Ins. Co. v. Jerry's Sport Ctr., Inc.*, 2 A.3d 526 (Pa. 2010) (“*Jerry's Sport*”); and (2) whether an insurer is entitled to be reimbursed for a state court judgment it paid for non-covered claims, see *Essex Insurance Co. v. RMJC, Inc.*, 306 F. App'x 749 (3d Cir. 2009) (“*Essex*”).

*Brickman* at 13-14.

The *Brickman* Court concluded that, based on *Jerry's Sport* and *Essex*, “under Pennsylvania law, an insurer who makes a settlement payment on its insured's behalf may assert an unjust enrichment claim for reimbursement if it is determined after the payment is made that the insurer was not obligated to make the payment under the terms of the insurance policy.” *Id.* at 17.

This is a particularly important conclusion, considering that, in *Jerry's Sport*, the Supreme Court of Pennsylvania recently held that an insurer was not entitled to reimbursement of defense costs following a determination that it had no duty to defend. No doubt policyholders would argue that the *Jerry's Sport* Court's pronouncement for defense costs compelled the same conclusion for purposes of settlement payments.

The *Brickman* Court concluded that an insurer may not seek reimbursement on a breach of contract theory unless there is a specific provision in the insurance policy that provides for reimbursement claims. This will almost never be the case. However, the insurer can seek reimbursement of a settlement payment on an unjust enrichment theory if the insurer can establish that “(1) [the insurer] did not make the payment due to a mistake of law; (2) the insured was on notice at the time of the payment that the insurer disputed its obligations to pay; (3) [the insurer] did not make the payment primarily to protect its own interest; and (4) permitting reimbursement under the circumstances presented would not

upset the delicate incentive structure inherent in the insurer/insured relationship.” *Id.* at 17-18.

In *Brickman*, based on the particular facts, the court held that the insurer was not entitled to reimbursement of the SIR that it paid to settle the claim. This was principally because Axis did not reserve its rights concerning the SIR obligation and because Axis was proceeding under a mistake of law (it initially believed that defense costs satisfied the SIR and then concluded that they did not).

But despite the court’s specific holding in *Brickman*, an insurer should generally be able to satisfy the 4-part test set out by the court to enable it to settle a case within limits (following the insured’s demand that it do so) -- thereby avoiding any risk of an excess verdict -- and then seek reimbursement of the settlement payment based on coverage defenses set out in its reservation of rights letter. Of course, as a practical matter, the insured needs to be in a financial position to make such re-payment. But putting that practical problem aside, *Brickman* is a significant decision as it levels the playing field for insurers and insureds when there is a demand to settle within limits and the insurer has coverage defenses.

A copy of the Eastern District of Pennsylvania’s November 18<sup>th</sup> decision in *Axis Specialty Insurance Company v. The Brickman Group, Ltd.* can be accessed here:

<http://www.paed.uscourts.gov/documents/opinions/10D1191P.pdf>

Please let me know if you have any questions.

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