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Insurance Coverage Decisions: Issued Today - Impact Tomorrow
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August 18, 2010

No Magic Buss For Insurers in Pennsylvania

State High Court Rejects Insurer's Right To Reimbursement Of Defense Costs

When I was a kid I had this boomerang. But no matter how hard I tried, I could never get it to do the things it was supposed to. Now, years later, as a lawyer representing insurance companies, my boomerang skills are not going to be much better. Thanks to yesterday's Supreme Court of Pennsylvania decision in *American & Foreign Insurance Company v. Jerry's Sport Center, Inc.*, when my clients pay defense costs, those dollars are not coming back.

Simply put, in *Jerry's Sport* -- what had surely been the most closely-watched insurance coverage case on the Pennsylvania Supreme Court's docket – the court unanimously ruled that "an insurer may not obtain reimbursement of defense costs for a claim for which a court later determines there was no duty to defend, even where the insurer attempted to claim a right to reimbursement in a series of reservation of rights letters." *Jerry's Sport* at 31.

The decision is on the lengthy side and the court seems to have addressed every argument that any party has ever made for and against an insurer's right to reimbursement of defense costs. The court also cited a mountain of cases from around the country that have gone both ways on the issue and gave shout-outs to the various *amicus* parties.

In the end, after letting everyone say their peace, the Supreme Court generally relied on the following reasons to deny an insurer the right to obtain reimbursement of defense costs for a claim for which a court later determines there was no duty to defend:

"[W]hether a complaint raises a claim against an insured that is potentially covered is a question to be answered by the insurer in the first instance, upon receiving notice of the complaint by the insured. Although the question of whether the claim is covered (and therefore triggers the insurer's duty to defend) may be difficult, it is the insurer's duty to make that decision. Insurers are in the business of making this decision. The insurer's duty to defend exists until the claim is confined to a recovery that the policy does not cover." *Jerry's Sport* at 23 (citation omitted).

"It is undisputed that the policy did not contain a provision providing for reimbursement of defense costs under any circumstances. Thus, the right [the insurer] attempts to assert in this

case, the right to reimbursement, is not a right to which it is entitled based on the policy. … We are persuaded that permitting reimbursement by reservation of rights, absent an insurance policy provision authorizing the right in the first place, is tantamount to allowing the insurer to extract a unilateral amendment to the insurance contract." *Jerry's Sport* at 27-28.

"Insured was not unjustly enriched by [insurer's] payment of defense costs. [The insurer] had not only the duty to defend, but the right to defend under the insurance contract. This arrangement benefited both parties. The duty to defend benefited Insured to protect it from the cost of defense, while the right to defend allowed [the insurer] to control the defense to protect itself against potential indemnity exposure." *Jerry's Sport* at 29. "As the Third Circuit explained in *Terra Nova*, an insurer faced with uncertainty about its duty to indemnify offers a defense under a reservation of rights 'to avoid the risks that an inept or lackadaisical defense of the underlying action' may expose it to if it ultimately turns out there was a duty to indemnify." *Jerry's Sport* at 29-30.

Coincidentally, and not that further evidence is needed of the Zip Code-based nature of the reimbursement issue, just one day before *Jerry's Sport* was decided, the Tenth Circuit Court of Appeals issued a published decision holding the exact opposite. The appeals court predicted that the Colorado Supreme Court would allow an insurer to recover defense costs from its insured, where it reserved the right to do so by letter, regardless whether the insurer also reserved that right in the underlying insurance policy itself. *See Valley Forge Ins. Co. v. Health Care Management Partners* (10th Cir. Aug. 16, 2010) (Colorado).

For insurers with cases in Pennsylvania, who may be feeling a little down in the dumps, and in need of a quick pick-me-up after yesterday's supreme court decision in *Jerry's Sport*, just say this word – Gambone.

A copy of yesterday's Supreme Court of Pennsylvania decision in *American & Foreign Insurance Company v. Jerry's Sport Center, Inc.* can be accessed here:

http://www.pacourts.us/OpPosting/Supreme/out/J-48-2009mo.pdf

By the way, if you are coming to the Coverage College, and are good with a boomerang, I'd love to get a lesson. The Convention Center has loads of huge rooms and we could just cut a class and toss the thing around.

Please let me know if you have any questions.

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