

June 2008 Vol. 9

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Arkansas Supreme Court Holds that Insurer is not Entitled to Reimbursement of Defense Costs

On May 29, 2008, the Arkansas Supreme Court answered a certified question from the United States District Court for the Eastern District of Arkansas and held that a general liability insurer was not entitled to reimbursement of defense costs that the insurer paid for an uncovered lawsuit. *Medical Liability Mut. Ins. Co. v. Alan Curtis Enterprises, Inc.*, No. 07-991 (Ark. May 29, 2008).

Factual and Procedural Background

A nursing home sought a defense and indemnity from its liability insurer for a wrongful death and negligence lawsuit. The nursing home's insurer agreed to defend the nursing home and reserved its right "to recoup and seek reimbursement for any and all costs and expenses" incurred in providing the defense.

The insurer filed a declaratory judgment action in federal court seeking a declaration of no coverage and requesting reimbursement of the defense costs it had paid to defend the insured. The federal district court held that there was no coverage, but certified the question of whether the insurer was entitled to reimbursement of defense costs to the Arkansas Supreme Court.

Holding

The Arkansas Supreme Court held that the insurer was not entitled to reimbursement because Arkansas followed the American

Rule, which does not allow a prevailing litigant to recover its attorney fees unless there is a statute expressly permitting such relief.

The court recognized that the majority of courts that had addressed the issue allow reimbursement if the insurer (1) timely reserved its right to recoup defense costs; and (2) provided specific notice of the possibility of reimbursement. *See, e.g., United Nat'l Ins. Co. v. SST Fitness Corp.*, 309 F.3d 914, 921 (6th Cir. 2002) (Ohio law) ("We agree that allowing an insurer to recover under an implied in fact contract theory so long as the insurer timely and explicitly reserved its right to recoup the costs and provided specific and adequate notice of the possibility of reimbursement promotes the policy of ensuring defenses are afforded even in questionable cases."); *Cincinnati Ins. Co. v. Grand Pointe LLC*, 501 F. Supp.2d 1145, 1168 (D. Tenn. 2007) (concluding that Supreme Court of Tennessee would follow majority position and recognize reimbursement is available to an insurer when an adequate reservation of rights has been made even if policy contains no express reimbursement provision). It also noted the minority position, which does not permit reimbursement unless there is a provision in the policy expressly permitting reimbursement. *See, e.g., Ass'n of Counties Gov't Risk Management Pool v. Matagorda Cty.*, 52 S.W.3d 128, 135 (Tex. 2000) ("when coverage is disputed and the insurer is

presented with a reasonable settlement demand within policy limits, the insurer may fund the settlement and seek reimbursement only if it obtains the insured's clear and unequivocal consent to the settlement and the insurer's right to seek reimbursement.""); *Westchester Fire Ins. Co. v. Wallerich*, 527 F. Supp.2d 896, 908 (D. Minn. 2007) (holding that unless policy provides for reimbursement of defense costs, a unilateral reservation of rights will not create such a right).

The court adopted the minority rule and held that the insurer was not entitled to reimbursement. The court rejected the reasoning of other minority jurisdictions in reaching its decision. Instead, the court analyzed whether an Arkansas statute permitted an insurer to recover defense costs it paid on the insured's behalf after a finding of no coverage.

The court explained that there were only two statutes that could possibly apply. One statute permitted fee awards only to insureds prevailing in litigation against their insurers. The other statute allowed for the recovery of attorneys fees when there was a breach of contract. Because the insurer, not the insured, prevailed, and because there was no contractual breach, the court concluded that neither statute applied. Consequently, the insurer was not entitled to reimbursement of the underlying defense costs.

A well-reasoned dissent argued that the American Rule had no bearing on the reimbursement issue. The dissent argued that the case at issue did not concern the recoupment of fees by a prevailing litigant, but whether the insurer's reservation of rights created an implied contract obligating the insured

to reimburse the insurer. Under these circumstances, the dissent claimed that the American Rule was irrelevant.

Implications

Arkansas has adopted the minority view and held that an insurer is not entitled to reimbursement of defense costs incurred in defending an uncovered lawsuit. Arkansas relied on the American Rule to reach this holding. No other jurisdiction that has considered the reimbursement issue has employed the American Rule as a ground for its holding because the American Rule addresses whether a prevailing litigant is entitled to recover its attorney fees, not whether an insurer has a contractual right to reimbursement. It is thus unlikely that other jurisdictions will adopt the reasoning of the Arkansas Supreme Court.

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