Mass Business Litigation Session Ups the Ante for Insurers Assessing Coverage

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By Timothy O. Egan on June 22, 2017

In a case of first impression in Massachusetts, Judge Mitchell Kaplan of the Superior Court Business Litigation Session recently ruled that under Massachusetts law an insurer could not recoup defense costs even after it is determined in a declaratory judgment action that there is no coverage under the policy. The case in question is styled Holyoke Mutual Insurance Company in Salem, et al. v. Vibram USA, Inc., Suffolk Superior Court Civil Action No. 15-2321BLS1 (Kaplan, J.). The decision puts the onus on the insurer to either decline to provide a defense and run the risk of a bad faith claim if the coverage position is later deemed to be erroneous or agree to fund a defense at least until a judicial determination has been made concerning coverage.

The plaintiff insurers in Holyoke Mutual initially agreed to provide a defense to its insured but simultaneously brought a declaratory judgment action to clarify whether they had a duty to provide such a defense under the terms of their policies. The plaintiff insurers prevailed and then sought to recover the amounts they had already paid in defense costs. The insurers' theory was that the insured had enjoyed a windfall by receiving a defense for claims that were not covered by insurance. Multiple other jurisdictions, most notably California's Supreme Court, in Buss v. Superior Court, 939 P.2d 766 (Cal. 1997), had sided with insurers by finding a right to recoupment.

In ruling for the insured, Judge Kaplan relied upon contrary case law from the Supreme Court of Pennsylvania, American & Foreign Ins. Co. v. Jerry's Sport Center, Inc., 2 A.3d 526 (Pa. 2010), which held that insurers have no right to recoup defense costs. Judge Kaplan adopted the Pennsylvania Supreme Court's reasoning that insurers have a financial incentive to provide a defense even where coverage is unlikely. Insurers have a business incentive to fund a defense because paying for a partial defense where coverage is unlikely is preferable to disclaiming coverage only to face a bad faith claim if the coverage position is in error. Judge Kaplan also noted that there was no provision in the insurance contract to recoup defense costs and the Court was unwilling to judicially create a term that the parties did not agree upon.

The critical language of the decision states the following:

"This court, like the District Court in Welch [Foods Inc. v. Nat'l Union Fire Ins. Co., No. 09-12087-RWZ 2011 WL 576600 (D. Mass. Feb. 9, 2011)], finds that the Pennsylvania Supreme Court's decision in American & Foreign Ins. Co. v. Jerry's Sport Center, Inc. comports with Massachusetts law. In Massachusetts, the insurer's duty to defend arises when the underlying complaint 'show[s] only a possibility that the liability claim falls within the insurance coverage. There is no requirement that the facts alleged in the complaint specifically and unequivocally make out a claim within the coverage.' … Even in cases in which the insurer may believe that coverage is unlikely under the terms of the policy, it has financial incentives to provide a defense. If it is determined in a separate action brought by the insured (or the insurer) that coverage existed, the insurer will be responsible for paying the insured's costs of establishing a right to a defense, even if the denial of coverage was made in good faith. … Of course, a bad faith refusal to provide a defense could constitute a violation of chapter 93A and expose the insurer to multiple

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damages. … In consequence, when in doubt, an insurer has an economically sound and self-interested reason to provide a defense under a reservation of right until the coverage issue can be resolved.

"With those basic tenets of Massachusetts law in mind, we turn to the language of the contracts that define the parties' rights and obligations, in this case the Policies. … There is simply nothing in the Policies that provides a right to recoup defense costs that the Insurers have advanced because they concluded that it was in their economic interest to do so. The court rejects the argument relied upon in Buss and its progeny that to deny recovery of defense costs will give insureds more than they bargained for, i.e., partial payment for the cost of defending claims that were not covered by the policies that they purchased. The court finds the reasoning of Jerry's more persuasive: 'In some circumstances, an insurance company may face a difficult decision as to whether a claim falls, or potentially falls, within the scope of the insurance policy. However, it is a decision the insurer must make.'..

"In this case, if the Insurers had refused to provide a defense, they would have incurred no liability to Vibram because the claims in the Underlying Action were not within the coverage provided. However, they determined in the exercise of their considered judgment that it was better to provide a defense and file an action for declaratory judgment. 'It is undisputed that the [the Policies] did not contain a provision providing for reimbursement of defense costs under any circumstances. Thus, the right [the Insurers] attempt[] to assert in this case, the right to reimbursement, is not a right to which [they are] entitled based on the [Policies].' … Knowing that there is a risk that they would decide to provide a defense in cases in which they were uncertain as to whether a claim was covered because the claim was novel or the law unclear, the Insurers could have addressed the right of recoupment in their Policies; they didn't. The court ought not insert a policy provision that the parties did not agree upon."

While this decision will not be mandatory authority for future Superior Court Judges, Judge Kaplan's decision is well-reasoned and supported and will likely provide guidance should this issue arise in the future.

