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September 2010

Pennsylvania Rushes to the Defense of Policyholders

*American and Foreign Insurance Company
v. Jerry's Sport Center, Inc.*

By Pamela D. Hans and Darin J. McMullen

On August 17, 2010, the Supreme Court of Pennsylvania joined a growing number of courts throughout the country in holding that policyholders are not required to reimburse their insurance companies for amounts paid by the insurance company to defend potentially covered claims — even if a court subsequently determines that the insurance company had no obligation to defend its policyholder. The Court's decision in *American and Foreign Insurance Company v. Jerry's Sport Center, Inc.*, 2010 PA. LEXIS 1803 (No. 88 MAP 2008)(August 17, 2010) ("*Jerry's Sport Center*"), provides policyholders with the critical assurance that, even when a defense is provided pursuant to a reservation of rights letter, Pennsylvania law does not require subsequent reimbursement if there is an ultimate determination that the insurance company is not obligated to defend. The decision also reaffirmed Pennsylvania law maintaining the integrity of the parties' intent, as well as the express terms of an insurance policy, by rejecting an insurance company's efforts to unilaterally alter or rewrite the terms of its policy through its reservation of rights letter.

In *Jerry's Sport Center*, Royal Insurance Company ("*Royal*") selected and paid defense counsel to defend its policyholder, Jerry's Sport Center, Inc. Royal provided this defense pursuant to a reservation of rights letter in which Royal attempted to "reserve its right" to be reimbursed for amounts that it paid to defense counsel.

The trial court granted summary judgment in Royal's favor, holding that it had no duty to defend Jerry's Sport Center, Inc., which the Superior Court of Pennsylvania subsequently affirmed. The Superior Court, however, later reversed the trial court's decision that Royal was entitled to reimbursement.

No Right to Reimbursement Unless the Policy Expressly Says So

Affirming the Superior Court, the Supreme Court of Pennsylvania held that an insurance company is not entitled to reimbursement of defense costs simply because it attempts, in a reservation of rights letter, to "reserve the right" to reimbursement. The Court noted that in a reservation of rights letter, the insurance company may only assert defenses and exclusions that are already set forth in the policy, and, therefore, an insurance company

ANDERSON KILL & OLICK, P.C.
1251 Avenue of the Americas
New York, NY 10020
(212) 278-1000 Fax: (212) 278-1733

ANDERSON KILL & OLICK, P.C.
One Gateway Center, Suite 1510
Newark, NJ 07102
(973) 642-5858 Fax: (973) 621-6361

ANDERSON KILL & OLICK, P.C.
1600 Market Street, Suite 2500
Philadelphia, PA 19103
(267) 216-2700 Fax: (215) 568-4573

Anderson Kill Wood & Bender, P.C.
864 East Santa Clara Street
Ventura, CA 93001
(805) 288-1300 Fax: (805) 288-1301

ANDERSON KILL & OLICK, L.L.P.
1717 Pennsylvania Avenue, Suite 200
Washington, DC 20006
(202) 416-6500 Fax: (202) 416-6555

ANDERSON KILL & OLICK, P.C.
Two Sound View Drive, Suite 100
Greenwich, CT 06830
(203) 622-7668 Fax: (203) 622-0321

www.andersonkill.com





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who

Pamela D. Hans is managing shareholder and **Darin J. McMullen** is of counsel in the Philadelphia office of Anderson Kill & Olick, P.C. Ms. Hans and Mr. McMullen regularly represent policyholders in insurance coverage disputes.



phans@andersonkill.com
(267) 216-2720

dmcullen@andersonkill.com
(267) 216-2708

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cannot assert a "right to reimbursement" that is not expressly contained within the policy.

The Court rejected Royal's contention that the reservation of rights letter created a "contract implied-in-fact" that provided Royal with a right to reimbursement. Highlighting the importance of "preserving the intent of the parties as reflected in the agreed-upon policy terms," the Court stated that allowing an insurance company to assert new rights that are not contained within the policy by simply sending a reservation of rights letter including such purported new rights, "is tantamount to allowing the insurer to extract a unilateral amendment to the insurance contract."

The Court thus held that "where the insurance contract is silent about the insurer's right reimbursement of defense costs, permitting reimbursement of cost the insurer spent exercising its right and duty to defend potentially covered claims prior to a court's determination would be inconsistent with Pennsylvania law."

A Court's Determination that No Defense Obligation Exists Does Not Entitle an Insurance Company to Reimbursement

Squarely rejecting Royal's assertion that its duty to defend was not triggered until the court determined whether or not the duty existed, the Court unequivocally stated that it is the insurance company's job at the outset to determine whether the allegations in the complaint trigger its duty to defend under the policy. Once the insurance company made such a decision, any subsequent resolution of coverage questions would not "retroactively eliminate the insurer's duty to defend the insured during the period of uncertainty."

The Court further stated that to relieve the insurance company of its responsibility of determining whether it has a duty to defend and make that duty contingent upon a court's determination, "would amount to a retroactive erosion of the broad duty to defend in Pennsylvania by making the right and duty to defend contingent upon a court's determination that a complaint alleged covered claims." Consequently, because an insurance company's duty to defend is not contingent upon a court's prior determination that a complaint alleged covered claims, the insurance company is not entitled to be reimbursed for defense costs that it pays while awaiting a court's ruling on a declaratory judgment.

Insurance Companies Benefit From Defending Policyholders Even if a Court Later Determines that the Duty to Defend Was Not Triggered

In rejecting Royal's claims that its policyholder would be unjustly enriched if it could enjoy the benefits of a free defense to claims, the Court stated that, to the contrary, it "would be unjust to require [Jerry's Sport Center] to pay for the cost of the defense where Royal invoked its right to defend in part to protect its own interest." The Court then enumerated the various ways that Royal benefited by defending its policyholder, including protecting itself against potential indemnity exposure, selecting defense counsel, monitoring and reviewing costs



and fees, and protecting itself from the potential of a bad faith claim. Accordingly, the Court held that, “by providing a defense to its Insured, therefore, Royal acted as much in its own interest as it did in the Insured’s.” The Court further illuminated the fallacy in Royal’s equitable arguments by stating that “if the insurer could recover defense costs from its insured, then the insured would be paying for the insurer to protect itself.”

The *Jerry’s Sport Center* decision is a significant victory for policyholders. The Supreme Court’s

decision clearly establishes that, because an insurance company can only reserve rights that it has in the insurance policy, absent an express policy provision requiring reimbursement of defense costs a policyholder is not obligated to reimburse the company for the defense of claims that are not covered by the policy. Moreover, the decision further restricts an insurance company’s efforts to unilaterally alter the express terms of an insurance policy through correspondence and reservation of rights letters. ▲



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