

THE RIGHT TO REIMBURSEMENT: NEVADA COURTS SHOULD FOLLOW THE TREND AND FORBID INSURERS FROM SEEKING RECOUPMENT OF DEFENSE COSTS

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I. AN INTRODUCTION TO THE DUTY TO DEFEND AND AN INSURER'S RIGHT TO REIMBURSEMENT OF DEFENSE COSTS

Over the last twenty years, a battle has emerged between insurers and policyholders concerning which party should bear the burden of defense costs. This issue, which has yet to be settled in many jurisdictions, focuses on whether commercial general liability (“CGL”) policies allow for insurers to be reimbursed for the costs of defending claims that are later found not to be covered under the insurance policy.¹ Logically, insurance companies argue that because the claims were found not to be covered by the policy, they should not bear the costs of their defense. However, the arguments that policyholders make are equally logical. Policyholders argue that insurance companies have significantly more bargaining power than policyholders and that principles of equity and fairness should prohibit insurers from determining at some later date that the policyholder should pay defense costs. In response to such claims, policyholders typically argue that insurers are attempting to add new terms to the insurance contract and thus are seeking payment for benefits that were not bargained for or agreed to in the original policy.

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¹ Benjamin D. Morgan, *Courts Are Now Rejecting Insurers' Reimbursement for Defending Non-covered Claims*, A.B.A. (Sept. 12, 2012), <http://apps.americanbar.org/litigation/committees/insurance/articles/julyaug2012-courts-rejecting-reimbursement2.html> [https://perma.cc/HP36-PDR3].

Unlike personal liability insurance, CGL insurance is provided to protect companies and other business organizations.² CGL insurance protects the assets of a company and typically covers “the cost of [the company’s] legal defense and any settlement or award should [the company] be successfully sued.”³ Accordingly, under a standard CGL policy, when the policyholder is sued, the claim or claims are covered by the insurance policy, and the insurer steps in and pays for both the defense costs and any settlement or awarded monies. However, at the beginning of litigation, it is often difficult to determine where each of the individual claims stand. This difficulty arises three different ways: (1) some claims appear covered while others do not; (2) no claims appear covered; or (3) in the majority of situations, it is unknown which, if any, claims are covered. Therefore, while the issue of which party should bear the burden of defense costs arises very early in litigation, the answer is often not determined until the very end of litigation—placing both the policyholder and insurer in a difficult position.

Policyholders and insurers are placed in a tenuous situation because the total expenditures spent on defending claims have become an increasingly large portion of the total costs of a lawsuit. Due to these ever-increasing defense costs, it is understandable that insurers are looking for ways to recoup some of those expenses. One such attempt at recoupment has been through claims to the right to reimbursement.

It was not until the 1997 California Supreme Court *Buss v. Superior Court* decision that the insurer’s right to reimbursement was given any serious consideration.⁴ The *Buss* decision, which remains the seminal case on this topic, is discussed at length below. In the aftermath of the ruling in *Buss*, it was inevitable that other jurisdictions would soon have to decide whether to allow or forbid insurers from seeking reimbursement of defense costs. It should be noted that because each state maintains its own insurance laws, inconsistent rulings on the right to reimbursement have been handed down across the United States.

A. *An Overview of the Duty to Defend: The “Four Corners” Rule v. The “Extrinsic Evidence” Rule*

As a general rule, modern CGL insurance agreements contain two overarching promises to the insured: (1) the duty to defend, and (2) the duty to indemnify. The duty to defend is a promise by the insurer to defend the insured in

² *Commercial General Liability (CGL) Policy*, INT’L RISK MGMT. INST., <https://www.irmi.com/online/insurance-glossary/terms/c/commercial-general-liability-cgl-policy.aspx> [https://perma.cc/L33Z-VDJ6] (last visited Sept. 1, 2016).

³ Caron Beesley, *General Business Liability Insurance—How It Works and What Coverage Is Right for You*, U.S. SMALL BUS. ADMIN. (Sep. 26, 2016), <https://www.sba.gov/blogs/general-business-liability-insurance-how-it-works-and-what-coverage-right-you> [https://perma.cc/A82R-679Z].

⁴ *Buss v. Superior Court*, 939 P.2d 766 (Cal. 1997).

a legal action.⁵ The duty to indemnify is “the insurer’s agreement to pay for the insured’s legal liability up to the stated policy limits.”⁶ The duty to defend is broader than the duty to indemnify.⁷ Unlike the duty to indemnify, the duty to defend extends to frivolous, false, and even fraudulent claims.⁸ If an insurance policy contains an obligation to defend, the insurer is required to defend *any claim* that *potentially* falls within the scope of the insurance policy.⁹ Thus, to determine whether an insurer has a duty to defend, the court must first determine whether there is a single claim potentially covered under the policy.¹⁰

The duty to defend seems absolute. However, courts differ on whether or not information outside the complaint can be considered when determining if an insurer’s duty to defend has been activated.¹¹ Courts—that do not allow extrinsic evidence to be considered when evaluating an insurer’s obligations—abide by the “four corners” rule, indicating that these courts will only analyze what appears within the four corners of the document.¹² “While many states adhere to the ‘four corners’ rule, about twice as many do not and have concluded that extrinsic evidence can be considered by a court in its duty to defend determination.”¹³ This second approach is commonly known as the “extrinsic evidence” rule.¹⁴ Under this rule, the information the court can draw from when making decisions is significantly greater, although the duty to defend still turns on whether there are any *potentially* covered claims.¹⁵

An argument could be made that Nevada traditionally adopted the extrinsic evidence rule. The Nevada Supreme Court previously held that:

[A]n insurer . . . bears a duty to defend its insured *whenever it ascertains facts* which give rise to the potential of liability under the policy. Once the duty to defend arises, this duty continues throughout the course of the litigation. If there is any doubt about whether the duty to defend arises, this doubt must be resolved in favor of the insured. The purpose behind construing the duty to defend so broadly is to prevent an insurer from evading its obligation to provide a defense for an insured without at least investigating the facts behind a complaint.¹⁶

⁵ Eliot M. Harris, *The Duty to Defend: What Insurers, Insureds and Their Counsel Need to Know When Faced with a Liability Coverage Dispute*, A.B.A., http://www.americanbar.org/groups/young_lawyers/publications/the_101_201_practice_series/duty.html [<https://perma.cc/P4BD-RYAD>] (last visited Aug. 27, 2016).

⁶ *Id.*

⁷ *Id.*

⁸ RANDY J. MANILOFF & JEFFREY W. STEMPER, *GENERAL LIABILITY INSURANCE COVERAGE: KEY ISSUES IN EVERY STATE* 111 (3d ed. 2015).

⁹ *See id.*

¹⁰ *Id.*

¹¹ *Id.* at 111–12.

¹² *Id.* at 112.

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *United Nat’l Ins. Co. v. Frontier Ins. Co.*, 99 P.3d 1153, 1158 (Nev. 2004) (emphasis added) (internal citations omitted) (internal quotations omitted).

However, in 2014, the United States District Court for the District of Nevada, looking to *United National Insurance Co. v. Frontier Insurance Co.* in its ruling, came to “[t]he logical conclusion [] that Nevada has adopted the four corners doctrine even though the Nevada Supreme Court has yet to explicitly state that.”¹⁷ By this implication, in Nevada, an insurer has a duty to defend the insured “whenever it ascertains facts which give rise to the potential of liability under the policy.”¹⁸ However, there is no duty to defend where claims are proven to be outside the policy.¹⁹ The universal test for determining whether an insurer has a duty to defend rests solely on whether any claim alleged in the complaint is potentially covered under the insurance policy.²⁰

B. Situations in Which the Right to Reimbursement Arises: Uncertain and “Mixed Action” Claims

Because an insurer has a duty to defend all potentially covered claims, the right to reimbursement typically arises in two instances. The first is when coverage is uncertain, meaning an insurer cannot determine at the early stages of litigation whether or not a claim is covered by the policy.²¹ The second is known as a “mixed action” suit.²² A mixed action claim contains two types of claims: some that are covered by the policy and others that are not.²³ Mixed action suits are commonly associated with right to reimbursement issues because insurers acknowledge that a duty to defend exists but reserve the right to seek payment for non-covered claims or settlements.²⁴

Accordingly, in mixed action cases where the duty to defend exists, an insurer is obligated to pay for the policyholders’ defense costs, subject to a reservation of rights that may disclaim coverage at a later date.²⁵ Assuming that it can be shown that defense costs were paid for non-covered claims, the issue arises as to whether the insurer can seek reimbursement from the policyholder

¹⁷ *Andrew v. Century Sur. Co.*, No. 2:12-cv-00978-APG-PAL, 2014 WL 1764740, at *5 (D. Nev. Apr. 29, 2014).

¹⁸ *United Nat’l Ins. Co.*, 99 P.3d at 1158.

¹⁹ *Id.*

²⁰ James W. Carbin & Alissa M. Christie, *An Insured’s Obligation to Reimburse Its Insurer for Costs Expended in the Defense of Non-Covered Claims*, 16 MEALEY’S EMERGING INS. DISPUTES, Nov. 3, 2011, at 24; see *Erie Ins. Exch. v. Transamerica Ins. Co.*, 533 A.2d 1363, 1368 (Pa. 1987).

²¹ Bob Allen et al., *Reversing Course: Can an Insurer Seek Reimbursement from Its Policyholder for Amounts Related to Noncovered Claims?*, in 2011 INSURANCE COVERAGE LITIGATION COMMITTEE CLE SEMINAR, MARCH 3–5, 2011: INSURER REIMBURSEMENT FROM A POLICYHOLDER 1 (2011), <https://apps.americanbar.org/litigation/committees/insurance/docs/2011-cle-materials/11-ReimbursementPaymentClaims/11aReversingCourseCanInsurer.pdf> [<https://perma.cc/YEX8-JXNV>].

²² *Id.* at 2.

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*

for those defense costs.²⁶ “In most jurisdictions an insurer must defend a mixed action in its entirety.”²⁷ Under this rule, an insurer will often pay to defend non-covered claims.²⁸ It is from these situations that claims by insurers to the right to reimbursement emerged.

On one side of the argument, insurers claim that allowing for reimbursement “promotes early settlements and avoids a windfall to the insured in the form of indemnity for uncovered claims.”²⁹ Insurers reason that forbidding recoupment of defense costs of non-covered claims would grant the insured a windfall benefit, which was neither stipulated to in the policy nor included in the premium.³⁰ On the other side, policyholders argue that the right to reimbursement is not an express term of the policy and thus is not considered binding on the policyholder.³¹ Policyholders contend that allowing additional terms to be added to the policy agreement, which was originally drafted by the insurer, would provide the insurer with additional benefits that were not bargained for by the parties.³²

Courts across the country have reached different conclusions concerning whether insurers maintain a right to seek reimbursement for defense costs. Part II of this note analyzes the California Supreme Court’s ruling in *Buss v. Superior Court* and the shift in determining whether an insurer has the right to seek reimbursement if the right has been properly reserved. Part III of this note discusses the holding of two Texas Supreme Court rulings in *Texas Association of Counties County Government Risk Management Pool v. Matagorda County* and *Excess Underwriters at Lloyd’s v. Frank’s Casing Crew & Rental Tools, Inc.*, as well as the Pennsylvania Supreme Court’s ruling in *American & Foreign Insurance Co. v. Jerry’s Sports Center, Inc.* The latter two decisions from 2008 and 2010, respectively, reject the *Buss* holding. Part IV of this note reviews the limited case law in Nevada and briefly analyzes the questions left unanswered by the existing cases. Part V creates a “what if” situation for Nevada and analyzes a best-case scenario moving forward.

²⁶ *Id.*

²⁷ Randall L. Smith & Fred A. Simpson, *The Mixed Action Rule and Apportionment/Allocation of Defense Costs and Indemnity Dollars*, 29 T. MARSHALL L. REV. 97, 100 (2003).

²⁸ Allen et al., *supra* note 21, at 2.

²⁹ *Id.*

³⁰ Carbin & Christie, *supra* note 20, at 23–24.

³¹ See Allen et al., *supra* note 21, at 3.

³² *Id.* (“Policyholders have also argued that the potential for insurance coverage drives up the settlement value of a case, which should not be borne by the policyholder if there is no coverage.”).

II. ALLOWING INSURERS THE RIGHT TO SEEK REIMBURSEMENT FOR NON-COVERED CLAIMS: A STUDY OF *BUSS V. SUPERIOR COURT*

Imagine a lawsuit that alleges twenty-seven separate causes of action. Of those twenty-seven causes of action, only a single claim is potentially covered under the policyholder's insurance agreement.³³ However, because one of the claims is potentially covered, the insurer agrees to defend the entire suit but conditions the defense on a reservation of rights.³⁴ Ultimately, the parties agreed to the terms, and the insurer undertook the defense costs of the policyholder.³⁵ Such was the situation that led to the seminal case of *Buss v. Superior Court* in 1997. In *Buss*, the ultimate settlement was for a total of \$8.5 million, and defense counsel was paid out just over \$1 million.³⁶ Of the incurred costs, an expert for Transamerica, the insurer, determined that approximately \$21,720.00 to \$55,767.50 was related to defending the sole claim that was potentially covered by the insurance policy.³⁷

Transamerica later refused to contribute to the \$8.5 million settlement, and therefore, Buss, the policyholder, sued Transamerica.³⁸ Buss claimed that Transamerica breached its contract by denying that it had a duty to defend the suit in its entirety and to contribute to the settlement.³⁹ The California Supreme Court first expressed that the duty to defend is absolute and that the insurer cannot seek a recoupment for claims that are potentially covered because those costs were bargained for and premiums were paid for this obligation.⁴⁰ Despite this reasoning, the *Buss* court went on to rule that CGL insurers (like Transamerica) have a right to reimbursement of defense costs for claims not potentially covered under the insurance policy.⁴¹

The court reasoned that the insurer had not bargained for these costs nor had it been paid premiums for the costs, and, therefore, it had a right to seek reimbursement for defense costs.⁴² In a footnote, the *Buss* court further reasoned that the right of reimbursement need not be an express term of the policy but rather is implied-in-law.⁴³ However, in mixed action suits, the court stated that an insurer seeking reimbursement has the burden of proving, by a prepon-

³³ *Buss v. Superior Court*, 939 P.2d 766, 770 (Cal. 1997).

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Id.* at 771.

⁴⁰ *Id.* at 774-75.

⁴¹ *Id.* at 776.

⁴² *Id.*

⁴³ *Id.* at 776 n.13.

derance of the evidence, which claims are not potentially covered and thus which costs can be allotted to the non-covered claims.⁴⁴

A. *Reaffirming the Buss Decision: Other Cases That Permit Insurers to Seek Recoupment of Defense Costs for Uncovered Claims*

The California Supreme Court has affirmed the *Buss* holding on multiple occasions. For example, in *Blue Ridge Insurance Co. v. Jacobsen*, despite an insured's adamant refusal to accept the insurer's right to reimbursement at the time of the settlement, the court applied the *Buss* rationale in favor of the insurer seeking recoupment for the settlement costs.⁴⁵ Similarly, in *United National Insurance Co. v. SST Fitness Corp.*, the Sixth Circuit Court of Appeals held that a newly formed implied-in-fact contract established the insurer's right to reimbursement.⁴⁶ In *SST Fitness*, the court reasoned that because the insurer undertook the defense only on the express and specific condition of a reservation of rights, an implied-in-fact contract was created upon the policyholder's acceptance of the defense.⁴⁷ Additionally, in *Scottsdale Insurance Co. v. MV Transportation*, the Supreme Court of California held that the right to reimbursement applied to all non-covered claims and not merely those within the context of mixed action suits.⁴⁸

The rationales from *Buss*, *Blue Ridge*, *SST Fitness*, and *MV Transportation* were melded in the United States District Court for the District of Hawaii decision, *Scottsdale Insurance Co. v. Sullivan Properties, Inc.*⁴⁹ In *Sullivan*, the court first determined that the right to seek reimbursement was implied within the terms of the insurance policy.⁵⁰ While the court relied heavily on contract principles, it went further by stating that the reservation of rights letters that explicitly reserved the right to seek reimbursement (despite the fact that they were never accepted by the policyholder) created a new contract.⁵¹ The court also relied heavily on equity principles and claims that public policy strongly favored the insurer's right to reimbursement.⁵²

⁴⁴ *Id.* at 778. An analysis of the burden of proof in right to reimbursement matters is outside the scope of this article.

⁴⁵ *See Blue Ridge Ins. Co. v. Jacobsen*, 22 P.3d 313, 231 (Cal. 2001).

⁴⁶ *See United Nat'l Ins. Co. v. SST Fitness Corp.*, 309 F.3d 914, 921 (6th Cir. 2002).

⁴⁷ *See id.*

⁴⁸ *See Scottsdale Ins. Co. v. MV Transp.*, 115 P.3d 460, 471 (Cal. 2005).

⁴⁹ *Scottsdale Ins. Co. v. Sullivan Props. Inc.*, No. 04-00550-HG-BMK, 2007 WL 2247795, at *5-6 (D. Haw. Aug. 2, 2007).

⁵⁰ *Id.* at *3.

⁵¹ *See id.*

⁵² *Id.* at *19-20.

B. The Rationale Behind Why Courts Have Allowed Insurers to Seek Recoupment of Defense Costs for Uncovered Claims

Following the decision in *Buss* and the related cases, insurers across the country began reserving the right to seek reimbursement for defense costs. For a brief period, it appeared that *Buss* would carry the day and that all jurisdictions would adopt the *Buss* reasoning. The courts that have followed the *Buss* line of reasoning typically based such holdings on principles of equity, contract, or both.⁵³ Of the courts that rely on equity principles, the concepts of unjust enrichment and restitution are most often cited. As such, some courts reason that allowing policyholders to experience a windfall benefit by having the insurer pay for defense costs of non-covered claims would violate basic understanding of fairness.⁵⁴

There are many courts that rely on contract principles such as quasi-contract or implied-in-fact contract to uphold the right of reimbursement. So long as an insurer properly reserves the right to seek reimbursement and a policyholder accepted payment of defense costs without protest, a handful of courts have allowed insurers the right to seek reimbursement.⁵⁵ The courts that have allowed the right to reimbursement have rationalized that a reservation of rights letter establishes an offer to form a new contract.⁵⁶ This new contract is determined to be binding upon the acceptance of the defense by policyholder.⁵⁷ However, as discussed in Part III, this line of thinking is not absolute, and numerous courts have rejected this reasoning.

Generally, courts that allow insurers to seek the right to reimbursement maintain that insurers and policyholders are equals in terms of finances and bargaining power. Policyholders may: (1) decline the defense and seek recovery under the insurance policy; (2) decline the defense and file a declaratory judgment action; or (3) accept the defense under a reservation of rights.⁵⁸ Based on this rationale, the concept that public policy favors the insurer is stronger because the insurer's expectations in relation to protection of the policyholder are placed on more level footing.

⁵³ Morgan, *supra* note 1.

⁵⁴ See, e.g., *Cincinnati Ins. Co. v. Grand Pointe, LLC*, 501 F. Supp. 2d 1145, 1169 (E.D. Tenn. 2007); *St. Paul Fire & Marine Ins. Co. v. Compaq Comput. Corp.*, 377 F. Supp. 2d 719, 723 (D. Minn. 2005), *aff'd*, 457 F.3d 766 (8th Cir. 2006); *Blue Ridge Ins. Co. v. Jacobsen*, 22 P.3d 313, 321 (Cal. 2001).

⁵⁵ See *Grinnell Mut. Reinsurance Co. v. Shierk*, 996 F. Supp. 836, 839 (S.D. Ill. 1998); *Travelers Cas. & Sur. Co. v. Ribl Immunochem Research, Inc.*, 108 P.3d 469, 480 (Mont. 2005).

⁵⁶ Morgan, *supra* note 1.

⁵⁷ See *id.*

⁵⁸ *United Nat'l Ins. Co. v. SST Fitness Corp.*, 309 F.3d 914, 921 (6th Cir. 2002) ("When faced with a reservation of rights, the insured can choose to: 1) decline the offer, pay for the defense, and seek to recover on the policy; 2) decline the offer and file a declaratory judgment action; or 3) accept the offer subject to the reservation of rights.").

Although for a short time it appeared as if all courts would follow the *Buss* line of reasoning concerning the right to reimbursement of non-covered claims, such a majority opinion has dissipated over time. While rejection of the *Buss* viewpoint was previously seen as a minority position, it is now equal to or even surpasses the *Buss* viewpoint in many states. The next part demonstrates this shift away from *Buss* and the rationale behind it.

III. A SHIFT IN THINKING: THE MOVEMENT AWAY FROM *BUSS* AND THE RATIONALE BEHIND DENYING INSURERS THE RIGHT TO REIMBURSEMENT

Courts have rejected the *Buss* holding for a wide variety of reasons. Many courts find that the right to reimbursement is inconsistent with the duty to defend while others note the imbalance of power between the insurer and the policyholder. Other courts maintain that the express terms of the contract prohibit the addition of new terms. Woven throughout each of these analyses floats the issue of reservation of rights letters. Overall, courts rejecting the idea that insurers may seek recoupment of defense costs hold that reservation of rights letters fail to create express or implied contract terms. Thus, insurers are unable to enforce these new, unaccepted, and unbargained-for terms. In particular, Texas has delved into the scope of insurers' rights to reimbursement concerning non-covered claims.

A. *Texas's Approach to Denying Insurers the Right to Reimbursement*

In *Texas Association of Counties County Government Risk Management Pool v. Matagorda County*, decided in 2000, the Texas Supreme Court held that a CGL insurer was not entitled to reimbursement from its policyholder for settlement costs paid by the insurer, despite a reservation of rights.⁵⁹ In *Matagorda County*, the plaintiffs were three prisoners who were assaulted by other inmates; they subsequently sued the inmates and the sheriff of the Matagorda County prison.⁶⁰ The inmates and the sheriff demanded that Texas Association of Counties County Government Risk Management Pool ("TAC") defend and indemnify them under the insurance policy maintained by the jail.⁶¹ Initially, TAC refused.⁶² However, TAC later agreed to undertake the defense costs, subject to a reservation of rights.⁶³ TAC eventually settled the claim for \$300,000 and sought reimbursement.⁶⁴ The Texas Supreme Court held that because there was no express agreement between the policyholder and TAC allowing for the

⁵⁹ *Tex. Ass'n of Ctys. Cty. Gov't Risk Mgmt. Pool v. Matagorda Cty.*, 52 S.W.3d 128, 136 (Tex. 2000).

⁶⁰ *Id.* at 129.

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.*

⁶⁴ *Id.* at 130.

insurer to seek recoupment, TAC was not entitled to reimbursement.⁶⁵ The court further stated that unless the policy expressly provides that the insurer is entitled to reimbursement or that the policyholder clearly and unequivocally agrees to the terms, a reservation of rights letter is ineffective.⁶⁶

The *Matagorda County* court further suggested that TAC's reservation of rights letter was an attempt to unilaterally amend the insurance contract and add additional rights, making the letter invalid.⁶⁷ The court acknowledged that its decision to deny reimbursement could possibly place insurers in a difficult position.⁶⁸ However, the court held that "insurers are better positioned to handle this risk, either by drafting policies to specifically provide for reimbursement or by accounting for the possibility that they may occasionally pay uncovered claims in their rate structure."⁶⁹ Additionally, in response to TAC's argument that denying reimbursement allowed the insurer to be unjustly enriched, the court stated that clear and unequivocal consent to reimbursement is required, "[o]therwise, the [policyholder] is forced to choose between rejecting a settlement within policy limits or accepting a possible financial obligation to pay an amount that may be beyond its means, at a time when the [policyholder] is most vulnerable."⁷⁰

Eight years later, in *Excess Underwriters at Lloyd's v. Frank's Casing Crew & Rental Tools, Inc.*, Texas addressed and clarified the standard of "clear and unequivocal" agreement by the policyholder, as originally expressed in *Matagorda County*.⁷¹ The court again acknowledged the difficult position that insurers may sometimes face through the denial of the right to reimbursement but maintained that the insurer is "in the best position to assess the viability of its coverage dispute."⁷² *Frank's Casing* differed from *Matagorda County* in that the policyholder acknowledged from the outset that that settlement offer was reasonable and demanded that the insurer accept it.⁷³

The insurer in *Frank's Casing* argued that an implied agreement to the right to reimbursement was created when the policyholder demanded that the insurer accept the settlement.⁷⁴ The court upheld the *Matagorda County* reasoning and further held that because there was no clear and unequivocal consent between the parties, no implied-in-fact agreement had been reached.⁷⁵ The court specifically stated:

⁶⁵ *Id.* at 136.

⁶⁶ *Id.* at 135–36.

⁶⁷ *Id.* at 131–32.

⁶⁸ *Id.* at 135.

⁶⁹ *Id.* at 136.

⁷⁰ *Id.* at 134–35.

⁷¹ *Excess Underwriters at Lloyd's v. Frank's Casing Crew & Rental Tools, Inc.*, 246 S.W.3d 42, 43 (Tex. 2008).

⁷² *Id.* at 46 (quoting *Tex. Ass'n of Ctys.*, 52 S.W.3d at 135).

⁷³ *Id.* at 43–44.

⁷⁴ *Id.* at 48.

⁷⁵ *Id.* at 48–49.

This is a far cry from impliedly consenting to reimbursement. . . . Given the parties' explicit efforts to preserve their positions, it makes no more sense to say that Frank's Casing impliedly agreed to reimburse the carriers than it would to say that the carriers impliedly agreed to waive their coverage position.⁷⁶

The court similarly rejected the insurer's right to reimbursement under equity and public policy principles, focusing instead on the forcing of an insured "to choose between rejecting a settlement within policy limits or accepting a possible financial obligation to pay an amount that may be beyond [the insured's] means."⁷⁷

B. Pennsylvania's Line of Attack Against Insurers Seeking the Right to Reimbursement

In 2010, Pennsylvania similarly held that insurers lacked the right to seek reimbursement of non-covered claims. In *American & Foreign Insurance Co. v. Jerry's Sport Center, Inc.*, the National Association of Colored People ("NAACP") sued a company selling firearms in an attempt to hold the firearms industry liable for injuries, deaths, and damages for distributing firearms in a negligent manner.⁷⁸ The firearms vendor demanded that its insurer defend and indemnify it as the policyholder under its CGL policy.⁷⁹ The insurer undertook representation under a full reservation of rights and sent the firearms vendor multiple reservation of rights letters.⁸⁰

The Pennsylvania Supreme Court subsequently held that reservation of rights letters could not be used to reserve a right that was not in the original CGL policy.⁸¹ The court stated that to allow such a reservation of rights would be "tantamount to allowing the insurer to extract a unilateral amendment to the insurance contract."⁸² Moreover, the court emphasized that the *Buss* holding was inconsistent with Pennsylvania's broad duty to defend because the right and duty to defend would become contingent upon the court's determination that covered claims had been alleged.⁸³

Pennsylvania's highest court also rejected the insurer's equity arguments. The court reasoned that because the insurer has not only a duty to defend but also the *right* to defend, both the insurer and policyholder benefit.⁸⁴ The policyholder is spared the costs of defense, but the insurer is able to control the de-

⁷⁶ *Id.* at 48.

⁷⁷ *Id.* at 46 (quoting *Tex. Ass'n of Cty's.*, 52 S.W.3d at 134); see Allen et al., *supra* note 21, at 11.

⁷⁸ *Am. & Foreign Ins. Co. v. Jerry's Sport Ctr., Inc.*, 2 A.3d 526, 529 (Pa. 2010).

⁷⁹ *Id.*

⁸⁰ *Id.* at 530.

⁸¹ *Id.* at 544.

⁸² *Id.*

⁸³ *Id.* at 536–39.

⁸⁴ *Id.* at 545.

fense and is able to protect itself from the risk of indemnity.⁸⁵ Finally, the court expressed concerns that allowing insurers to seek reimbursement outside of the express CGL policy would place the policyholder at the mercy of the insurer.⁸⁶ “The court was concerned that allowing the insurer to ‘design’ its own right of reimbursement would open the door to unjustified maneuverings by insurance companies at their policyholders’ expense.”⁸⁷ Accordingly, the Pennsylvania Supreme Court held that even when an insurer sends a reservation of rights letter, the insurer cannot recoup defense costs from the policyholder absent a clear agreement.⁸⁸

C. New York’s Recent Decision Rejecting an Insurer’s Claims of Reimbursement of Defense Costs

More recently, New York courts were faced with the same dilemma as that of Texas and Pennsylvania: Would the state allow insurers to seek reimbursement of non-covered claims and, if so, under what reasoning? While the issue has been largely ignored by many state courts, New York courts have addressed this issue on four occasions, generally appearing to favor the insurers and approve of the right to reimbursement.⁸⁹ However, the most current and detailed opinion, from the Eastern District of New York, follows the recent trend prohibiting insurers from seeking recoupment of defense costs.⁹⁰

In *General Star Indemnity Co. v. Driven Sports, Inc.*, the insurer of Driven Sports, a manufacturer and seller of an energy supplement titled “Craze,” sought reimbursement for defense costs.⁹¹ The Court summarized the opinion as follows:

In 2013, defendant was sued in three separate actions . . . alleging that Craze contains an illegal and potentially dangerous methamphetamine analog, and defendant sought coverage under the Policy. Both parties have moved for summary judgment, asking the Court to declare the extent of plaintiff’s obligation to

⁸⁵ *Id.*

⁸⁶ *Id.* at 545–46.

⁸⁷ Morgan, *supra* note 1.

⁸⁸ *Am. & Foreign Ins. Co.*, 2 A.3d at 546; *see* Morgan, *supra* note 1.

⁸⁹ *See* *Certain Underwriters at Lloyd’s London v. Lacher & Lovell-Taylor, P.C.*, 975 N.Y.S.2d 870 (N.Y. App. Div. 2013); *Am. Family Home Ins. Co. v. Delia*, No. 12-CV-5380-ADS-WDW, 2013 WL 6061937, at *1 (E.D.N.Y. Nov. 15, 2013); *Max Specialty Ins. Co. v. WSG Inv., LLC*, No. 09-CV-05237-CBA-JMA, 2012 WL 3150579, at *9 (E.D.N.Y. Apr. 20, 2012) (report and recommendation), *adopted by* 2012 WL 3150577 (E.D.N.Y. Aug. 2, 2012); *Gotham Ins. Co. v. GLNX, Inc.*, No. 92 Civ. 6415 (TPG), 1993 WL 312243, at *5 (S.D.N.Y. Aug. 6, 1993).

⁹⁰ *See* *Gen. Star Indem. Co. v. Driven Sports, Inc.*, 80 F. Supp. 3d 442, 445–46 (E.D.N.Y. 2015).

⁹¹ *Id.* at 445; Randy J. Maniloff, *New York Court Says N-O to Reimbursement of Defense Costs: Most Extensive N.Y. Case to Address the Issue*, LEXISNEXIS LEGAL NEWSROOM INS. L. (Mar. 5, 2015, 2:16 PM), <http://www.lexisnexis.com/legalnewsroom/insurance/b/insurance-law/archive/2015/03/05/new-york-court-says-n-o-to-reimbursement-of-defense-costs-most-extensive-n-y-case-to-address-the-issue.aspx> [<https://perma.cc/8TAN-UQD8>].

defend the underlying lawsuits. The Court concludes that the underlying lawsuits are excluded from coverage by a [the Failure to Conform Exclusion] provision in the Policy.⁹²

Once it was determined that the claims were not covered by the insurance policy, the insurer sought reimbursement for defense costs of these uncovered claims.⁹³ However, the court found that reimbursement would be inappropriate in this case.⁹⁴ This was a somewhat surprising decision as four previous decisions in New York had allowed for recoupment of defense costs.⁹⁵ Nonetheless, the *Driven Sports* court determined that because the policyholder had “effectively resisted the idea of recoupment from the very beginning by rejecting plaintiff’s offer of a separate recoupment agreement” that this case differed from precedent.⁹⁶

The New York court cited nearly every reason, as stated by every other court, as to why recoupment was inappropriate.⁹⁷ The list included much of the reasoning discussed above—namely unjust enrichment, the broad duty to defend, and principles of equity and fairness.⁹⁸ Additionally, the *Driven Sports* court stated that failure to contract for the right to reimbursement from the outset is a fault that lies with the insurer.⁹⁹ The court addressed implied-in-fact contracts and reservation of rights letters in one sentence by stating that the insurer “bears the risk of not providing for recoupment in the Policy itself, and [the insurer] is not saved by its later, unilateral reservation of rights.”¹⁰⁰

Finally, the New York court made a public policy argument, asserting that the rule currently encourages policyholders to seek out coverage.¹⁰¹ But, if insurers could later threaten to seek recoupment of defense costs, policyholders would lose substantial incentives to seeking CGL coverage and “would be faced with a ‘Hobson’s choice’ in any close case.”¹⁰² Put simply, policyholders with claims that may potentially be covered would be deterred from seeking coverage out of fear and unease that the defense costs would be unreasonably prohibitive, and the policyholder would be unable to repay them if the court

⁹² *Gen. Star Indem. Co.*, 80 F. Supp. 3d at 445.

⁹³ *Id.* at 445.

⁹⁴ *Id.*

⁹⁵ See *Certain Underwriters at Lloyd’s London v. Lacher & Lovell-Taylor, P.C.*, 975 N.Y.S.2d 870 (N.Y. App. Div. 2013); *Am. Family Home Ins. Co. v. Delia*, No. 12-CV-5380-ADS-WDW, 2013 WL 6061937, at *1 (E.D.N.Y. Nov. 15, 2013); *Max Specialty Ins. Co. v. WSG Inv., LLC*, No. 09-CV-05237-CBA-JMA, 2012 WL 3150579, at *9 (E.D.N.Y. Apr. 20, 2012) (report and recommendation), *adopted by* 2012 WL 3150577 (E.D.N.Y. Aug. 2, 2012); *Gotham Ins. Co. v. GLNX, Inc.*, No. 92 Civ. 6415 (TPG), 1993 WL 312243, at *5 (S.D.N.Y. Aug. 6, 1993).

⁹⁶ *Gen. Star Indem. Co.*, 80 F. Supp. 3d at 460.

⁹⁷ See generally *id.* at 460–63.

⁹⁸ *Id.* at 460–63.

⁹⁹ *Id.* at 461.

¹⁰⁰ *Id.*

¹⁰¹ *Id.* at 462.

¹⁰² *Id.*

later ruled in favor of the insurer.¹⁰³ By ruling against the right to reimbursement and concisely combining the rationales of several courts throughout the United States, the New York court struck a blow for insurers.

D. The Reasoning Behind the Decisions That Have Rejected the Right to Reimbursement: Contract Principles, Imbalances of Power, the Duty to Defend, and Equity and Fairness

While many jurisdictions have yet to address whether an insurer may seek reimbursement for defense costs of non-covered claims, the courts that have elected to reject *Buss* maintain that such a reasoning is the more equitable approach. First, these jurisdictions point to general contract principles contained in the express language of the CGL policy. The terms of the contracts state that the insurer has a duty to defend the policyholder and has no authority to issue a unilateral modification of the contract.¹⁰⁴

Furthermore, the insurance company is the original drafter of the CGL policy.¹⁰⁵ This severely weakens the insurer's argument for why it should be allowed to create new contract terms to which the policyholder never agreed and often, expressly rejected. The insurer had the opportunity, at the time of drafting, to include language in the policy concerning the right to reimbursement. However, if language that would provide for a right to reimbursement is absent from a CGL policy, then a unilateral imposition of such terms, at a later date, would unfairly burden the policyholder. "Moreover, by defending the insured, the carrier also benefits its own self-interests by controlling the defense with the hope of avoiding or minimizing its indemnity obligation."¹⁰⁶

Courts that have rejected the *Buss* line of reasoning also assert that a right to reimbursement is wholly inconsistent with the duty to defend.¹⁰⁷ Any claim that is even potentially covered by the applicable insurance policy prompts the duty to defend.¹⁰⁸ However, a court may determine at a later date that there are no covered claims, and thus, there is no duty to indemnify. Remembering that the duty to indemnify is narrower than the duty to defend, "[t]o allow the insurer to be reimbursed for defense costs would improperly place those two contractual rights on the same level—yet, they have historically always been con-

¹⁰³ *Id.* ("As it operates now, this rule incentivizes an insured to seek coverage, but if insurers can threaten the later collection of costs, an insured's incentives would change drastically, and he would be faced with a 'Hobson's choice' in any close case. In other words, an insured whose claim *might* be covered could be dissuaded from seeking coverage out of concern that the legal costs would be so prohibitive that the insured could never pay them if a court later disagreed.") (emphasis in original).

¹⁰⁴ Morgan, *supra* note 1.

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

¹⁰⁷ See Am. & Foreign Ins. Co. v. Jerry's Sport Ctr., Inc., 2 A.3d 526, 543–44 (Pa. 2010).

¹⁰⁸ Harris, *supra* note 5.

sidered separate and apart.”¹⁰⁹ Therefore, by rejecting the right to reimbursement, the line that separates the duty to defend and the duty to indemnify is never blurred.

Finally, the *Buss* court heavily relied on the concept of fairness, specifically lack of fairness to the insurer in paying defense costs for non-covered claims.¹¹⁰ However, the courts that have elected not to follow the *Buss* reasoning reiterate that the insurer is in a far superior position to know the nature and extent of claims that could potentially be covered.¹¹¹ Moreover, insurers control the defense and are able to position themselves in a way so as to minimize the risk of indemnifications. Thus, if the courts were to allow insurers to unilaterally amend CGL policies through reservation of rights letters, then the “unfairness” would burden the policyholder in a significantly greater manner than the insurer. The insurer is in a better position to take such risks and therefore should be the party to carry that burden.

Accordingly, the recent shift has been a departure from *Buss* and a move toward denying the right of reimbursement for defense costs. The express language of a CGL policy, the broad duty to defend, and the increased burden that would be placed on the policyholder have provided the basis for rejecting insurers’ rights to reimbursement. For these reasons, many courts have rejected *Buss* and denied insurers the right to reimbursement, either completely or unless the right is properly reserved. The next part discusses two cases addressing the right to reimbursement of defense costs that apply Nevada law as well as the questions and possible solutions that these cases left unanswered.

IV. AN ANALYSIS OF *FORUM INSURANCE* AND *BLAZER*: DO THESE CASES CARRY THE DAY IN NEVADA, OR ARE THEY APPROPRIATE ONLY IN LIMITED CIRCUMSTANCES?

The Nevada Supreme Court has been silent with regard to the right to reimbursement, either as a strategic choice or merely by chance. The Ninth Circuit Court of Appeals, applying Nevada law, and the Nevada District Court have each issued a single ruling on the issue of the right to reimbursement. This part analyzes whether the Ninth Circuit and Nevada District Courts’ limited rulings are appropriate outside the specific facts of those decisions. This part also considers and evaluates the questions these cases left in their wake.

¹⁰⁹ Morgan, *supra* note 1.

¹¹⁰ See generally *Buss v. Superior Court*, 939 P.2d 766 (Cal. 1997).

¹¹¹ *Tex. Ass’n of Ctys. Cty. Gov’t Risk Mgmt. Pool v. Matagorda Cty.*, 52 S.W.3d 128, 135–36 (Tex. 2000) (“Requiring the insurer, rather than the insured, to choose a course of action is appropriate because the insurer is in the business of analyzing and allocating risk and is in the best position to assess the viability of its coverage dispute. . . . On balance, insurers are better positioned to handle this risk, either by drafting policies to specifically provide for reimbursement or by accounting for the possibility that they may occasionally pay uncovered claims in their rate structure.”).

As the previous sections have illustrated, there is no majority position in United States' courts concerning whether insurers may seek reimbursement for defense costs of non-covered claims. While some jurisdictions, such as those in California, Texas, Pennsylvania, and New York, have expressly ruled on this issue, the majority of jurisdictions, including Nevada, have yet to determine this matter. Moving forward, this will be a pressing issue for Nevada courts, both federal and state, as insurers and policyholders continue to be at odds over who should pay for defense costs when claims are later determined to be uncovered by insurance policies.

A. The Ninth Circuit Court of Appeals is the First to Apply Nevada Law to the Right to Reimbursement

Federal diversity courts must apply state law when construing insurance policies.¹¹² “Accordingly, [federal courts] must construe the policy as a Nevada state court would if presented with the same question.”¹¹³ Under Nevada law, the duty to defend is extended to all potentially covered claims, however there is “no duty to defend where there is no coverage.”¹¹⁴

The first case applying Nevada law to the right to reimbursement, *Forum Insurance Co. v. County of Nye*, was decided in an unpublished opinion by the Ninth Circuit Court of Appeals. In *Forum*, Nye County breached a hospital management agreement and was in violation of a reservation of rights letter sent by the insurer on January 28, 1988.¹¹⁵ Under the insurance policy, coverage did not extend to contractual obligations.¹¹⁶ However, Nye County argued that there were possible tort claims, and the insurer agreed to undertake the defense but mailed a reservation of rights letter stating that it would seek recoupment should it later be found that the duty to defend did not exist at the time the management agreement was breached.¹¹⁷

Nye County never agreed to the terms contained in the reservation of rights letter and, in fact, objected to such terms.¹¹⁸ However, Nye County “continued to accept a defense valued at hundreds of thousands of dollars. The court ordered the County to reimburse [the insurer] for the costs of the defense that the County accepted after the January letter.”¹¹⁹ The court emphasized that the in-

¹¹² *Fortis Benefits Ins. Co. v. Johnson*, 966 F. Supp. 987, 989 (D. Nev. 1997).

¹¹³ *Capitol Indem. Corp. v. Blazer*, 51 F. Supp. 2d 1080, 1084 (D. Nev. 1999); see *Fortis Benefits Ins. Co.*, 966 F. Supp. at 989–90.

¹¹⁴ *Bidart v. Am. Title Ins. Co.*, 734 P.2d 732, 734 (Nev. 1987) (citing *Snow v. Pioneer Title Ins. Co.*, 444 P.2d 125, 128 (1968)); see also *Forum Ins. Co. v. Cty. of Nye*, No. 91-16724, 1994 WL 241384, at *2 (9th Cir. June 3, 1994); *Rockwood Ins. Co. v. Federated Capital Corp.*, 694 F. Supp. 772, 776 (D. Nev. 1988).

¹¹⁵ *Forum Ins. Co.*, 1994 WL 241384, at *1–2.

¹¹⁶ *Id.* at *1.

¹¹⁷ *Id.* at *2.

¹¹⁸ *Id.*

¹¹⁹ *Id.*

surer was put at a severe disadvantage in this case and was denied the ability to recoup substantial costs.¹²⁰ In such a situation, the court feared that “[t]he insurer would be forced to withhold the defense in order to get the requisite agreement and reserve its right to seek a later adjudication. Such a result would benefit no one.”¹²¹ The court believed it to be a better solution all around to allow insurers to seek recoupment through a reservation of rights, so long as it is done in a “manner least damaging to both parties” and the policyholder “has unambiguous notice that it may later be held responsible for costs incurred.”¹²²

Further, the court, citing a California case, held that “[a]cceptance of monies constitutes an implied agreement to the reservation’ of the right to seek reimbursement.”¹²³ The Ninth Circuit specifically relied on principles of equity and fairness, finding fault with the county for refusing to accept the new terms in the reservation of rights letter yet accepting the insured’s significant payments for the defense.¹²⁴ *Forum* is a unique case due to its fact pattern. The county asserted that there were potential tort claims, but, in the end, there were no potentially covered claims under the policy.¹²⁵ Thus, as a non-mixed action suit that was decided over a decade ago, it provides limited guidance for other Nevada courts in regard to mixed action suits.

B. The Nevada District Court Weighs in on the Right to Reimbursement

Five years after the Ninth Circuit’s ruling in *Forum*, a Nevada federal court was again faced with the issue of insurers’ seeking the right to reimbursement. *Capitol Indemnity Corporation v. Blazer* involved three men, Peter Banach, Buddy Simpson, and David Lawrence Shaw.¹²⁶ On January 23, 1997, the three men were customers at a local tavern called Bird Off Paradise Lounge.¹²⁷ Robert Blazer, Jr. owned and operated the tavern.¹²⁸ While at the tavern, Banach and Simpson assaulted and battered Shaw, from which Shaw suffered bodily harm, including a complete loss of vision in his left eye.¹²⁹

While Banach and Simpson were found guilty on criminal charges, Shaw later filed a civil suit as well, naming Blazer, his tavern, and the bartender on duty the night of January 23, 1997, as defendants.¹³⁰ At the time of the assault, Blazer had a CGL insurance policy with Capitol Indemnity Corporation (“Capi-

¹²⁰ *Id.* at *3.

¹²¹ *Id.*

¹²² *Id.*

¹²³ *Id.* (quoting *Walbrook Ins. Co. v. Goshgarian*, 726 F. Supp. 777, 784 (C.D. Cal. 1989)).

¹²⁴ *Id.*

¹²⁵ *Id.* at *2.

¹²⁶ *Capitol Indem. Corp. v. Blazer*, 51 F. Supp. 2d 1080, 1082 (D. Nev. 1999).

¹²⁷ *Id.*

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ *Id.*

tol Indemnity”).¹³¹ “The policy provides coverage for bodily injury only if it is caused by an ‘occurrence.’”¹³² Additionally, the CGL policy encompassed multiple exclusionary provisions that barred coverage even for qualifying “occurrence[s].”¹³³ One of the exceptions contained in the CGL policy was for assault and battery.¹³⁴ Accordingly, on July 13, 1998, Capitol Indemnity filed a claim for declaratory relief, alleging it had no duty to defend and seeking compensation for all expenditures sustained in the defense of Shaw’s claims.¹³⁵

The *Blazer* court analyzed this matter and reached specific findings and conclusions. First, the court determined that the assault and battery claims were barred from coverage under the exclusionary provisions of the CGL policy.¹³⁶ Second, the court addressed Capitol Indemnity’s reimbursement claim. The ultimate issue in this case was whether the insurer was “required to reserve its rights before it [could] pursue reimbursement.”¹³⁷ The court held that Capitol Indemnity could not seek reimbursement for defense costs.¹³⁸ However, the court did not ban insurers outright from seeking recoupment. Instead, the court maintained: “The right to reimbursement does not arise unless there is an understanding between the parties that the insured would be required to reimburse the insurer for monies expended in providing a defense. . . . The insured must have ‘unambiguous notice that it may later be held responsible for costs incurred.’”¹³⁹

In order to seek recoupment, the court required “a clear understanding between the parties that [the insurer] reserved the right to reimbursement.”¹⁴⁰ Here, no evidence was presented that Capitol Indemnity had an understanding with *Blazer*, and thus, reimbursement was denied.¹⁴¹ In its opinion, the court called on additional Nevada case law and further elaborated that efforts to limit insurance policies must be clear and explicit and that any insurer seeking to limit coverage should utilize language that clearly and expressly communicates such limitations to the policyholder.¹⁴²

The *Blazer* opinion represents only a narrow portion of the right to reimbursement. The *Blazer* court chose not to elaborate further on the issues of reimbursement outside of the facts of this case. The *Blazer* opinion may show that in order to seek recoupment of defense costs, the policyholder must essen-

¹³¹ *Id.*

¹³² *Id.*

¹³³ *Id.*

¹³⁴ *Id.*

¹³⁵ *Id.* at 1083.

¹³⁶ *Id.* at 1091.

¹³⁷ *Id.* at 1090.

¹³⁸ *Id.* at 1091.

¹³⁹ *Id.* at 1090 (internal citations omitted) (internal quotations omitted).

¹⁴⁰ *Id.*

¹⁴¹ *Id.* at 1090–91.

¹⁴² *Id.* at 1084 (citing *Nat’l Union Fire Ins. v. Reno’s Exec. Air Inc.*, 682 P.2d 1380, 1382 (Nev. 1984); *Sullivan v. Dairyland Ins. Co.*, 649 P.2d 1357, 1358 (Nev. 1982)).

tially agree to the insurer's seeking reimbursement, however whether this is actually what the court desired is not clear.¹⁴³ To others, most likely insurers in Nevada, the *Blazer* opinion stands for the proposition that insurers may seek reimbursement so long as the reservation of the right is clearly communicated. No Nevada court, neither federal or state, has specifically addressed the right to reimbursement since *Blazer*. Therefore, many questions remain unanswered.

C. Questions Left Unanswered in Nevada: Will Future Decisions Follow Precedent, or Will the Courts Deviate?

While the Nevada District Court made a limited ruling on the right to reimbursement, many issues remain unaddressed in Nevada. Did the decision in *Blazer* prohibit insurers from seeking the right to reimbursement? Does *Blazer* allow for reimbursement so long as "unambiguous notice" of the possibility of recoupment is given to the policyholder?¹⁴⁴ Or instead, does *Blazer* require the insurer to receive unequivocal agreement from the policyholder in order seek recoupment? These are just a few of the many questions the *Blazer* decision left unanswered.

The analysis is further complicated by the *Forum* decision, which was decided five years prior to *Blazer* and expressly addressed reservation of rights letters.¹⁴⁵ Does continued acceptance of defense equate to acceptance of new contract terms? Does the express refusal to accept the terms contained in a reservation of rights letter count for nothing? Does *Forum* apply in mixed action cases, or is its ruling applicable only when it is later determined that there are no causes of action covered by the CGL insurance policy? And most importantly, moving forward, will Nevada Courts look to these two decisions at all, or will they instead look to other states, such as California, Texas, Pennsylvania, and New York, which have defined decisions concerning the right to reimbursement more clearly? All these questions, and more, remain undecided and are likely to be issues before both the Nevada Supreme Court and the Nevada District Court in the near future.

Taking these questions in turn, Nevada courts will need to look to the two limited decisions applying Nevada law, as well as the case law of other jurisdictions that have ruled on recoupment of defense costs.¹⁴⁶ While the *Blazer*

¹⁴³ See *Capitol Indem. Corp.*, 51 F. Supp. 2d at 1090; Allen et al., *supra* note 21, at 14 ("[A]n insurer may be reimbursed for costs incurred in defending against 'claims not potentially covered under the insurance policy *only* if there was a clear understanding between the parties that [the insurer] reserved the right to reimbursement for the costs of the investigation and/or defense'[]). The apparent requirement of agreement by the policyholder effectively disallows reimbursement.") (emphasis in original) (quoting *Capitol Indem. Corp.*, 51 F. Supp. 2d at 1090).

¹⁴⁴ *Capitol Indem. Corp.*, 51 F. Supp. 2d at 1090.

¹⁴⁵ See *Forum Ins. Co. v. Cty. of Nye*, No. 91-16724, 1994 WL 241384, at *2 (9th Cir. June 3, 1994).

¹⁴⁶ See *Capitol Indem. Corp.*, 51 F. Supp. 2d. at 1082; *Forum Ins. Co.*, 1994 WL 241384, at *3.

court held that the insurer, Capitol Indemnity, could not seek reimbursement, it did not ban insurers outright from seeking recoupment.¹⁴⁷ Instead, the court focused on the “clear understanding” between the insurer and the policyholder that the insurer may seek reimbursement of defense costs.¹⁴⁸ Additionally, from *Forum*, it is unclear whether the court’s holding that reservation of rights letters or new contract terms are recognized upon the acceptance of defense costs in mixed action claims or only when a case involves non-covered claims.

Therefore, the next scenario examines these hypothetical questions and lays out a possible “best-case” situation for Nevada. These questions are assessed in a way that demonstrates which position favors insurers and the ability to freely seek the right to reimbursement while also clearly identifying when the policyholder is better served such that the right to reimbursement should be outright denied or, alternatively, heavily restricted. These possible answers will be scrutinized based on case law from both Nevada and the other jurisdictions previously discussed.¹⁴⁹

V. A “WHAT IF” SITUATION AS APPLIED TO NEVADA: WHAT IS THE BEST OPTION?

When analyzing situations that present the possibility of the right to reimbursement, the vast majority of states have been indecisive in determining how best to rule. Given the same set of facts, one court may rule one way while another rules the exact opposite. Or, in some cases, a court may simply refuse to address the right to reimbursement at all. However, with the right to reimbursement being pushed into the court system by insurance companies, this is an issue that ultimately cannot be avoided. In Nevada, a clear, sustainable analysis has to be developed to avoid unnecessary confusion by insurers and policyholders alike.

A. *The “Best Case” Situation for Nevada: Allow Insurers to Seek Limited Rights to Reimbursement*

Moving forward, it is proposed that the best plan for Nevada would be to implement a mix of the California and Texas approaches: respectively, free allowance of and adamant refusal of the right to reimbursement. On one hand, if Nevada forbids insurers from seeking the right to reimbursement in all situations, insurers may get saddled with exorbitant defense costs for claims that are not and were never covered by the insurance policies; such was the situation in *Buss v. Superior Court*. Alternatively, adopting a plan that allows insurers to seek the right to reimbursement without express restrictions can and easily will lead to situations in which policyholders are stuck with a bill for defense costs

¹⁴⁷ *Capitol Indem. Corp.*, 51 F. Supp. 2d. at 1090–91.

¹⁴⁸ *Id.* at 1090.

¹⁴⁹ California, Texas, Pennsylvania, and New York are the previously mentioned jurisdictions.

they never bargained for and frankly never imagined would be theirs to bear. Therefore, the argument can be made that the “best-case” situation would be for Nevada to adopt a plan that favors neither insurers nor policyholders too heavily but instead creates a workable middle-ground policy under which all future CGL right to reimbursement issues can be adjudicated.

First and foremost, insurers in Nevada should not be permitted to recover defense costs paid to settle non-covered claims unless the insurer timely reserves the right to reimbursement. One can imagine a situation in which, on the eve of trial or settlement, an insurer attempts to execute a reservation of rights against a policyholder. In such a situation, the policyholder may very well accept the insurer’s terms as a way to end what is likely to be a tedious, prohibitively expensive lawsuit. Thus, Nevada must adopt a policy that seeks to avoid such a situation.

To resolve the issue of timeliness, Nevada should look to adopt one of two rules. Under the first, which is likely to be favored by policyholders, Nevada could require insurers to add express language to all CGL insurance policies notifying the policyholder, before they ever sign an insurance agreement, that the insurer maintains the right to seek reimbursement of uncovered defense costs. While this seems like an easy solution to many of the problems discussed herein, insurers are incredibly hesitant to adopt such language. Part of this fear may stem from stiff competition in the insurance market. Alternatively, this resistance may arise from the general refusal by the insurance industry to adopt such new and restrictive express language. Whatever the reasoning, this option is likely to be highly disfavored by insurers but would resolve issues involving equity and fairness.

A second option with regard to timeliness would be to allow insurers to seek a reservation of rights, most likely through express reservation of rights letters, but to put strict time constraints on such letters. Under such a policy, insurers would be prohibited from reserving reimbursement rights close to trials and settlements. In fact, a more equitable solution would be to require insurers to reserve the right to reimbursement from the moment they agree to defend a claim that may potentially be uncovered by the policy. With the adoption of such a policy, both insurers and policyholders would have knowledge of clear guidelines, and neither party would be too heavily favored. Whether this option is viable in practice is yet to be determined.

Next, even a timely reservation of rights should be deemed invalid within Nevada should there not be an express agreement between the insurer and the policyholder concerning the reservation of rights. Under this rule, if a policyholder does not have clear knowledge that the insurer may seek reimbursement of defense costs in the future and the claims are found to be uncovered, then the timely reservation of rights is void. This position likely favors the policyholder; however, there is incredibly high probative value for such favoritism. The insurer inherently possesses more power in an insurer-policyholder relationship. Because of this power inequity, the policyholder has a high probability of never

knowing or understanding that the insurer may seek reimbursement of defense costs absent express acknowledgment by the policyholder. Thus, requiring express policy terms, as well as a clear acknowledgement of the right to reimbursement by the policyholder, is an equitable and just solution.

An additional option would be merely to require insurers to allow reservation of rights via properly executed reservation of rights letters, even without agreement on the part of the policyholder. This plan heavily favors the insurer and is highly inequitable in regard to power balancing. It is nearly indisputable that during the early stage of litigation, insurers have the lion's share of bargaining power in the insurer/policyholder relationship. As such, allowing an insurer to unilaterally amend insurance policies by adding new terms where there has never been precedent to do so would lead to issues of fairness and would result in significant litigation. Conversely, from the insurer's perspective, it is arguable that the insurer is taking a huge risk by undertaking the defense of potentially uncovered claims. Thus, equity heavily favors the opportunity of the insurer to seek recoupment once a reservation of rights letter has been issued. Accordingly, although this option also has the potential to be adopted by the Nevada court system, unilateral amendment of contract terms is generally disfavored.

Third, Nevada courts must make a clear rule regarding the acceptance of defense costs. Merely because a policyholder accepts payment of defense costs from the insurer does not mean that new contract terms reserving the right to reimbursement have been established. Unlike some previously discussed jurisdictions, it is inequitable to allow insurers to state that an implied reservation of rights was created due to the power imbalance discussed herein. Conversely, should a timely and express understanding between parties already be established, a policyholder should be forbidden from accepting defense costs and then later attempting to argue that reimbursement rights were not formed. Such was the case in *Forum*.

Finally, Nevada should impose strong regulation concerning reservation of rights letters. However, the rule established by Nevada must not be so strict as to deny that rights were reserved solely because a policyholder objects to the reservation. If such a rule were adopted, policyholders (or more likely attorneys on their behalf) would merely reply with a rejection letter in response to all insurers' reservation of rights letters and arguably leave insurers in situations such as that of *Buss*. Alternatively, the validity and extent of reservation of rights letters will require a factual determination by the court. The timing, language, and understanding of each letter will likely determine its validity. Accordingly, the preferred adaptation for Nevada would be to implement a policy that requires policyholders to have clear and express knowledge that the insurer is reserving the right to seek reimbursement of non-covered claims in the future. Thus, to avoid issues with implied contract terms and to resolve several of the issues surrounding reservation of rights letters, insurers and policyholders

must have clear understanding before a reservation of rights letter is deemed valid.

In summary, Nevada should look to adopt a policy that balances the desire to protect both insurers and policyholders. Insurers need protection from astronomically high and unjust defense costs while policyholders require shielding from insurers who maintain the vast majority of the bargaining power and are seeking to unilaterally and inequitably amend policy terms for their own benefit. Thus, Nevada should attempt to implement a plan that requires at least these three requirements: (1) timely reservation of rights; (2) express reservation of rights that results in a clear understanding between the insurer and the policyholder; and (3) clear guidelines concerning acceptance of defense costs and reservation of rights letters.

CONCLUSION

Courts faced with deciding between allowing or denying insurers the right to recoup defense costs must always consider the express language of the underlying insurance policy itself as well as general legal principles. It is equitable to require that an insurer stay true to the language of the policy that it drafted or to require that insurers include express language within the CGL policy itself reserving the right to seek reimbursement. Additionally, courts must continue to look to concepts including unjust enrichment, the duty to defend, other contract principles, and public policy concerns in making decisions concerning the right to reimbursement. Policyholders, while not completely helpless, are at a severe disadvantage in regard to bargaining with their insurers. It will be interesting to see which position the many jurisdictions that have yet to decide the issue will favor. Yet even more interesting will be the decision reached by the Nevada courts and their rationale for such a decision.