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Second Department Finds Insurer Not Entitled To Recoupment Of Defense Costs For Uncovered Claims

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The Second Department has parted ways with other New York courts that have permitted insurers to recoup defense costs paid on behalf of an insured if there is ultimately no coverage for the underlying action, provided that the insurer reserved its rights to seek reimbursement. The Appellate Division, Second Department in *American W. Home Ins. Co. v. Gjonaj Realty & Mgt. Co.*, 192 A.D.3d 28 (2d Dep't Dec. 30, 2020) determined that an insurer with no obligation to defend or indemnify is *not* entitled to recover defense fees and costs incurred in the underlying action.

The underlying action commenced in January of 2011 when Viktor Gecaj ("Gecaj") sued Gjonaj Realty & Management Co. ("Gjonaj Realty") and 28-47 Webb Avenue Associates, LLC ("Webb") (collectively, the "insureds") after falling from a ladder at the premises owned or managed by the insureds. It was undisputed that American Western Home Insurance Company ("American") was obligated to defend the insureds for the claim under the American policy upon proper notice of the claim. However, it was also undisputed that the insureds did not give notice of the May 2010 accident to American until four years later. One week after receiving notice, American Western denied coverage based on untimely notice, but advised that if the $900,000 default judgment entered was set aside, it would reconsider its denial. In December 2015, the default judgment was vacated. However, the vacatur was reversed on April 25, 2017, and on May 2, 2017, American denied coverage and reserved its right to recover fees and costs incurred in defending the insureds.

In July 2017, American commenced a declaratory judgment action against the insureds for declaratory relief and moved for summary judgment declaring it (1) had no obligation to defend or provide coverage to the insureds; (2) had no obligation to pay any judgment in favor of plaintiff in the underlying action; and (3) could collect defense fees and costs incurred in defending the insureds from May 2, 2017 to date. The insureds and Gecaj cross-moved for summary judgment declaring they were entitled to coverage. On February 22, 2018, [1] the Supreme Court granted American Western's motion and denied the cross-motions.

On appeal, the Second Department agreed with the Supreme Court's determination that American Western had no obligation to indemnify the insureds. However, the Second Department disagreed with the award of defense costs, reasoning that to permit such recovery would be to erode the well-

established doctrine that an insurer has a broad duty to defend even if it is not ultimately required to provide coverage, and "effectively would make the duty to defend merely coextensive with the duty to indemnify." The Court noted that the New York state and federal cases cited by American, which affirmed orders allowing an insurer to recoup its defense costs upon a determination that no duty to indemnify exists, did not address the issue of whether recouping defense costs is appropriate or authorized. In certain of the cited cases, there was no opposition to the requests for defense costs like there was in this instance. Moreover, the Court agreed with the federal court for the Eastern District of New York finding against insurers' entitlement to recoupment of defense costs when there was no express contractual provision allowing the recoupment of defense costs.[2]

The Court concluded that American could have written entitlement to reimbursement into the insurance policy if it wanted to ensure recoupment of costs. The Court declined to adopt the approach taken in other jurisdictions where a new "implied" contract is created when an insurer includes in a letter that it reserves its right to recover costs. The Second Department held that a "unilateral reservation of rights letter cannot create rights not contained in the insurance policy." Finally, the Second Department noted that any reliance on an unjust enrichment argument is misplaced not only because New York law precludes claims for unjust enrichment where an insurance policy governs but also because the policies of equity and fairness do not permit an insurer to "hedge on its defense obligations by reserving its right to reimbursement while potentially controlling the defense and avoiding a bad faith claim from its insured."

New York's highest court has yet to weigh in on the right to recoupment of defense costs issue. This Second Department ruling confirms the split between the First and Second Departments on whether a specific reservation of rights is sufficient to successfully recover defense costs, which should be considered by insurers when seeking recoupment of defense costs. If you have any questions about the decision, please feel free to contact Karen H. Moriarty, kmoriarty@cmg.law) or Christa P. McLeod (cmcleod@cmg.law).

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[1] *Am. W. Home Ins. Co. v. Gjonaj Realty & Mgmt. Co.*, 2018 NY Slip Op 33899(U) (Sup. Ct.)

[2] *See Crescent Beach Club LLC v Indian Harbor Ins. Co.*, 468 F Supp 3d 515, 554 (E.D.N.Y. 2020); *Century Sur. Co. v Vas & Sons Corp.*, No. 17-CV-5392 (DLI), 2018 US Dist LEXIS 151209 (E.D.N.Y. Aug. 31, 2018).