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Mass. Case May Lead Policyholders To Limit Litigation Costs

By **Jeff Sistrunk**

Law360, Los Angeles (September 22, 2017, 8:49 PM EDT) -- Massachusetts' highest court recently agreed to review a ruling that shoe maker Vibram's insurance companies can't recoup the sums they paid to defend the company in a trademark dispute, and attorneys say a ruling that the insurers do have a right to reimbursement could lead policyholders to try to limit their litigation costs.

The case concerns Vibram USA Inc.'s battle with its insurers, Country Mutual Insurance Co. and Maryland Casualty Co., over coverage for an underlying lawsuit alleging the company unlawfully obtained a trademark for a shoe named after the late Olympic marathon champion Abebe Bikila.

On Sept. 15, the Massachusetts Supreme Judicial Court granted a joint request for direct appellate review lodged by Vibram and the insurers, which had initially agreed to defend Vibram in the action by Bikila's family subject to a reservation of rights to later challenge coverage.

The state justices will review both Judge Mitchell H. Kaplan's determination that the Bikila suit didn't trigger Country Mutual's and Maryland Casualty's defense obligations, and his subsequent holding that the insurers couldn't recoup defense costs they had already paid to Vibram. The dispute raises multiple issues of first impression under Massachusetts law, including whether an insurer has a right to recover defense costs paid under a unilateral reservation of rights.

Lawyers who represent insurance carriers say there is ample precedent supporting insurers' right to reimbursement in situations like Vibram's, under a theory of unjust enrichment. If the Massachusetts high court decides to follow that case law and rules in favor of the insurance companies, policyholders in the state will likely start taking more steps to keep their litigation costs in check, given the possibility that insurers may be able to demand reimbursement for those sums down the road, attorneys say.

"These types of commercial cases can be incredibly expensive," said Morrison Mahoney LLP partner Michael Aylward. "I have to think that, if the [Supreme Judicial Court] found a right to recoupment, policyholders would be more cognizant of the legal fees their independent counsel are charging and would make greater efforts to control the cost of these cases."

In the now-settled underlying federal court action, Bikila's widow and children accused Vibram of creating a false designation of origin by obtaining a trademark for a shoe named after the two-time Olympic champion from Ethiopia, who famously won a 1960 gold medal in Rome while running barefoot.

Country Mutual and Maryland Casualty agreed to pay Vibram's defense costs in the Bikila action while reserving their rights to later deny coverage and to recoup any defense costs they paid if a court ultimately ruled the underlying suit didn't trigger their defense obligations.

The insurance companies secured just such a ruling from Judge Kaplan in August 2016, with the judge finding that none of the claims in the underlying suit fell within the scope of offenses outlined in the policies' personal and advertising injury coverage. At the time that decision was rendered, Vibram had sent Country Mutual and Maryland Casualty invoices for nearly $1.3 million in defense costs, and the insurers had collectively reimbursed the company about $668,000.

In a subsequent decision issued in March, Judge Kaplan refused the insurers' bid to recoup the defense costs they had previously paid to Vibram. Citing heavily to the Pennsylvania Supreme Court's 2010 decision in American & Foreign Insurance Co. v. Jerry's Sport Center Inc., the judge held that, because the insurers' policies didn't expressly provide for a right to reimbursement, they could not manufacture such a right via their reservation of rights letters.

The trial court noted the deep judicial divide on whether insurers are entitled to recoup defense costs paid under a reservation of rights. The Jerry's ruling and other decisions that have gone against insurers on the issue have tended to focus on policy language, while decisions finding a right to reimbursement — exemplified by the California Supreme Court's 1997 ruling in Buss v. Superior Court — have largely done so based on unjust enrichment principles.

Crowell & Moring LLP partner Laura Foggan, who represents insurers, said the trial court's reliance on the policy language was misplaced. By definition, if a court rules that a claim against a policyholder isn't covered, any defense costs advanced by the insurer were paid outside the terms of the policy, she said.

"If there is no coverage in the first place, and insurers advance funds with notice they will seek reimbursement, it seems only fair that they should be able to recover those funds," Foggan said.

In Buss, the California high court found that, if insurance carriers didn't have a right to reimbursement of defense costs paid for uncovered claims, the policyholder "would receive a windfall and would be unjustly enriched," and insurers would be tempted to refuse to defend certain claims outright.

But many attorneys said that, regardless of whether the Massachusetts high court adopts the reasoning in Buss, insurers in the state will likely continue to err on the side of defending their policyholders. As Pierce Atwood LLP partner Michael J. Daly explained, insurance companies in Massachusetts "have been conditioned" to avoid the consequences of an incorrect refusal to defend, which can include massive bad faith and other penalties.

According to Aylward, that will hold true even if the Massachusetts justices hold that insurers have a right to reimbursement.

"Even with a right to recoupment, insurers will likely undertake their insured's defense to try to maintain some control over the outcome of the case and to avoid the insured from assigning its claims or entering into a consent judgment, and to protect against allegations of extracontractual liability and bad faith," Aylward said.

However, some attorneys say a ruling endorsing a right to recoupment would have the effect of making

policyholders that retain independent defense counsel at their insurers' expense more vigilant about ensuring that defense fees are reasonable and necessary.

"When independent counsel is representing the policyholder, the policyholder has particular leverage to ensure the costs are reasonable and necessary," Foggan said. "Recognition that costs advanced by an insurer may have to be reimbursed gives the policyholder a strong incentive to use its leverage to control costs that are incurred."

Not all attorneys agreed with the notion that policyholders will look to reduce litigation costs if the Massachusetts high court rules in favor of Vibram's insurers. According to Pillsbury Winthrop Shaw Pittman LLP partner David Klein, a policyholder's choice of counsel is not tethered to whether the insurer has a right to reimbursement.

In high-stakes matters, a company may opt to pay some of its own defense costs out of pocket if the insurer wants to pay a lower rate, he said.

"When an insurance company agrees to defend the claim, one of two things happen: The policyholder reluctantly accepts the insurer's choice of counsel at rates that are lower, or alternatively, the policyholder simply pays the difference between what the insurer will pay and what the firm charges," Klein said.

But many policyholders will be more conscious of lawyers' rates if faced with the prospect of later having to repay their insurers, Aylward said.

"Allowing your chosen counsel to charge $800 or more per hour is a lot less attractive if a policyholder knows there is a possibility it will later have to reimburse the insurer for what its lawyers were billing," he said.

--Editing by Katherine Rautenberg and Aaron Pelc.
