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Sixth Circuit Court of Appeals Holds Insurer Entitled to Recoup Defense Costs From Insured After Finding of No Coverage

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Recently, the Sixth Circuit Court of Appeals addressed whether an insurer may recoup defense costs from its insured after a finding that the insurer did not owe a duty to defend. In *Great American Fidelity Insurance Co. v. Stout Risius Ross, Inc.*, 2024 U.S. App. LEXIS 8576 (6th Cir. Apr. 8, 2024), the Sixth Circuit affirmed the United States District Court for the Eastern District of Michigan's decision, holding that an insurer is entitled to reimbursement for costs expended after the insurer's duty to defend ends, even in the absence of a policy provision purporting to allow recoupment.

By way of background, Stout was hired by the Trustees of the Appvion Retirement Savings and Employee Stock Ownership Plan ("Appvion ESOP") as its financial advisor and provided valuations of the stock for Appvion's parent company, PDC. Stout allegedly overvalued the stock, encouraging Appvion employees to invest their retirement savings in the Appvion ESOP. Appvion then went bankrupt, collapsing PDC's stock price, which resulted in hundreds of millions of dollars in losses of funds invested in the ESOP. The Appvion ESOP believed that Stout negligently or fraudulently appraised or overstated the value of the ESOP's stock in PDC, contributing to Appvion's bankruptcy and losses sustained by the ESOP, and filed a complaint against Stout in the United States District Court for the Eastern District of Wisconsin.

Great American agreed to defend Stout, subject to a full reservation of rights, and relevant here, reserved "the right to seek reimbursement from Stout if it were determined that Great American had no obligation to defend them, to pay indemnity, or to defend or indemnify them against certain claims."

Great American subsequently brought suit against Stout in the United States District Court for the Eastern District of Michigan seeking a judicial declaration that Stout's policy did not obligate Great American to defend or indemnify Stout. Ultimately, the District Court determined that an exclusion precluded coverage for claims brought in ESOP's amended complaint, and further, that Great American could recover defense expenses from its insured from the date of the amended (non-covered) claims under an implied-in-fact contract theory. The District Court, however, concluded that the insurer could not recover amounts expended in defense prior to the filing of the second amended complaint in the underlying action.

On appeal, the Sixth Circuit, applying Michigan law, affirmed the District Court's decision. First, the court affirmed that there was an initial duty to defend the original fraud and negligent misrepresentation claims, but that there was no duty to defend amended claims later filed in the action, which were precluded by an exclusion. The District Court then considered whether Great American could recover the costs it had expended during the pendency of the underlying litigation.

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The Sixth Circuit found, as did the District Court, that the insurer could be reimbursed for expenses incurred defending claims for which it had no duty to defend, namely, the amended claims precluded by an exclusion. Notably, the subject policy *did not* include a specific provision providing for reimbursement of defense costs. Instead, the Sixth Circuit reasoned that where the insurer "explicitly reserves its right to reimbursement and notifies the insured of the specific possibility of reimbursement, the parties form an implied-in-fact contract for the reimbursement of costs expended by the insurer for claims that it had no duty to defend." According to the Sixth Circuit, Michigan law generally recognizes implied-in-fact contracts, and it failed to find any indication that the Michigan Supreme Court would decline to recognize implied-in-fact contracts in the insurance context. The Sixth Circuit rejected Stout's contentions that there was no consideration to support a contract because Great American had a pre-existing legal duty to tender a defense, or that mutual assent was lacking. The Sixth Circuit found these arguments unpersuasive, reasoning that Great American had no pre-existing duty to tender a defense after Stout filed the second amended complaint, and that Stout accepted the defense after being timely notified that Great American might seek reimbursement. This, according to the Court, was sufficient manifestation of assent under Michigan law.

Thus, the Sixth Circuit affirmed the District Court's determination that the insured must reimburse Great American for costs defending it in the underlying lawsuit under an implied-in-fact contract theory, at least after filing of the amended (uncovered) complaint.

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