wiley

NEWSLETTER

Restitution of Defense Costs Available When Insurer, As a Matter of Law, Owed No Duty to Defend

July 2007

An Illinois appellate court has held that an insurer may seek restitution for defense costs after a determination that it had no duty to defend as a matter of law and where it had paid defense costs only after it had been ordered to do so by a trial court in a decision that was subsequently reversed. *Steadfast Ins. Co. v. Caremark Rx, Inc.*, 2007 WL 1485900 (Ill. App. Ct. May 22, 2007).

In 2001, the insurer issued a managed care professional liability policy to a pharmacy services provider. This policy provided coverage for claims alleging negligent acts, errors, or omissions arising out of the provider's professional services. The policy excluded coverage for intentional, criminal, or fraudulent acts. The insurer had a duty to defend any claim seeking damages payable under the policy.

In 2002, the pharmacy services provider faced two lawsuits alleging that it breached fiduciary duty under ERISA, conspired with drug manufacturers for kickbacks for preferring certain drugs, made misrepresentations, and failed to disclose material information. The plaintiffs also sought an accounting. The insurer denied coverage and filed a declaratory judgment action seeking a declaration that it had no duty to defend or indemnify. The provider counterclaimed and sought a declaration of coverage under the policy.

The court held that the underlying complaints against the pharmacy services provider did not contain allegations of negligent acts, errors, or omissions and entered summary judgment in favor of the insurer.

The insurer then filed a motion for restitution to recover the defense costs it had paid the provider during the pendency of its appeal. The trial court denied this motion and relied on *General Agents Insurance Co. v. Midwest Sporting Goods Co.*, 215 Ill. 2d 146 (Ill. 2005), which had held that "an insurer cannot recover defense costs paid pursuant to a reservation of rights absent a provision entitling it to such relief . . . ." The policy at issue did not contain such a provision, and the trial court concluded that the insurer's declaratory judgment action was effectively an agreement to defend the provider under a reservation of rights. The insurer argued on appeal that it had paid the defense costs "solely to comply with the circuit court's order."

The appellate court concluded that the lack of a provision allowing the recoupment of defense costs was not relevant in this case.

In *General Agents*, the court had concluded that the insurer sought to modify its policy, which did not provide for recoupment of defense costs, with its reservation of rights letter. By contrast, the insurer in this case, which had not defended under a reservation of rights, did not attempt a similar policy revision. In addition, on appeal of the declaratory judgment, the court had held that the insurer had no duty to defend or indemnify as a matter of law. "[B]ecause no factual issues existed . . . no uncertainty concerning coverage ever existed at the time [the pharmacy services provider] tendered the defense of the underlying actions to [the insurer]." The duty to defend, therefore, "arose out of the circuit court's erroneous order," for which the insurer should receive restitution.

The court treated the motion for restitution as a motion for summary judgment. The insurer had not pled a claim for unjust enrichment, which was necessary for the remedy of restitution. The court upheld the trial court's denial of the motion, because summary judgment could not be entered on a theory of recovery not pled. The court overruled, however, the trial court's denial of the insurer's leave to amend its complaint to cure this insufficiency and remanded the action.