NO. SCCQ-22-0000658

IN THE SUPREME COURT OF THE STATE OF HAWAI‘I

ST. PAUL FIRE AND MARINE INSURANCE COMPANY, a Connecticut corporation; THE TRAVELERS INDEMNITY COMPANY OF AMERICA, a Connecticut corporation; THE PHOENIX INSURANCE COMPANY, a Connecticut corporation; and TRAVELERS PROPERTY CASUALTY COMPANY OF AMERICA, a Connecticut corporation,

Plaintiffs-Appellants,

v.

BODELL CONSTRUCTION COMPANY, a Utah corporation; SUNSTONE REALTY PARTNERS X, LLC, a Hawaii limited liability company; and STEADFAST INSURANCE COMPANY, a Delaware corporation,

Defendants-Appellees.

AND RELATED CROSS-ACTIONS.

CIVIL NO. 20-cv-00288 DKW-WRP
(Certified Question)

RE: CERTIFIED QUESTIONS ON THE ISSUE OF EQUITABLE REIMBURSEMENT FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF HAWAI’I

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF HAWAI‘I

JUDGE: THE HONORABLE DERRICK K. WATSON

UNITED POLICYHOLDERS' MOTION FOR LEAVE TO FILE AMICUS CURIAE BRIEF IN SUPPORT OF DEFENDANTS-APPELLEES

DECLARATION OF ALAN VAN ETTEN

EXHIBIT "A"

CERTIFICATE OF SERVICE

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UNITED POLICYHOLDERS' MOTION FOR LEAVE TO FILE AMICUS CURIAE BRIEF IN SUPPORT OF DEFENDANTS-APPELLEES

Pursuant to Hawai'i Rule of Appellate Procedure 28(g), United Policyholders respectfully applies for the Court's permission to file the accompanying amicus curiae brief in support of Defendants-Appellees.

STATEMENT OF INTEREST OF *AMICI CURIAE*

United Policyholders is a non-profit 501(c)(3) organization founded in 1991 and is a respected voice and trusted information resource for insurance consumers in all 50 states. United Policyholders promotes fair claim and sales practices and integrity in the insurance marketplace. United Policyholders does not accept funding from insurance companies. Donations, foundation grants, and volunteer labor support the organization's work.

United Policyholders assists and advocates for individual and commercial policyholders regarding the full spectrum of insurance products, including home, automobile, health care, long-term care, and business owner's insurance. United Policyholders hosts a library of tips, sample forms, and articles on commercial and personal insurance products, coverage, and the claims process at its website, www.uphelp.org.

United Policyholders' work is divided into three program areas: Roadmap to Recovery (disaster recovery and claim help), Roadmap to Preparedness (insurance and financial literacy and disaster preparedness), and Advocacy and Action (advancing pro-consumer laws and public policy).

Under its Advocacy and Action program, United Policyholders analyzes trends, issues, and problems related to claims and the insurance marketplace. Commercial and individual insureds, claim professionals, and lawyers share information with United Policyholders about coverage and claim disputes every day. United Policyholders informs the public and the courts and assists

regulators and legislators in effectively overseeing business and personal insurance matters. United Policyholders' Executive Director, Amy Bach, has been an official consumer representative to the National Association of Insurance commissioners since 2009 and is in her second term as an appointed member of the Federal Advisory Committee on Insurance.

As part of its work, United Policyholders strives to assist courts throughout the country in resolving insurance disputes by filing "friend of the court" briefs in important cases such as this one. United Policyholders' amicus briefs have been cited in published decisions by the United States Supreme Court and numerous state and federal appellate courts. *See, e.g.*, *Humana, Inc. v. Forsyth*, 525 U.S. 299, 314, 119 S. Ct. 710, 142 L. Ed. 2d 753 (1999). This Court has previously accepted amicus brief submissions from United Policyholders in *Hart v. Ticor Title Ins. Co.*, 272 P.3d 1215 (Haw. 2012) and *Miller v. Hartford Life Ins. Co.*, 268 P.3d 418 (Haw. 2011). A list of amicus curiae briefs filed by United Policyholders can be found at https://www.uphelp.org/resources/amicus-briefs.

UNITED POLICYHOLDERS' AMICUS CURIAE BRIEF WILL ASSIST THE COURT

United Policyholders respectfully requests the Court grant it leave to file an amicus curiae brief in this matter because it will provide information, perspective, and argument that may help the Court beyond the help the parties' lawyers have provided.

The Hawai'i Supreme Court accepted the following certified questions from The United States District Court for the District of Hawai'i.

1. Under Hawai'i law, may an insurer seek equitable reimbursement from an insured for defense fees and costs when the applicable insurance policy contains no express provision for such reimbursement, but the insurer agrees to defend the insured subject to a reservation of rights, including reimbursement of defense fees and costs?

2. If an insurer may seek equitable reimbursement of defense fees and costs under Hawai'i law, (A) for what specific fees and costs may the insurer obtain reimbursement, (B) which party carries the burden of proof, and (C) what is the burden of proof?

The first certified question is the central issue in this case, and it has split state high courts around the country. United Policyholders respectfully submits that its national perspective will help this Court situate Hawai'i's special doctrines of insurance law within the trend of insurance recoupment cases from around the country and in so doing will assist this Court in determining whether Hawai'i law allows insurance companies to seek recoupment of defense costs when the policies they sell contain no express clause articulating such a right. In addition, while the certified questions are of course legal ones, United Policyholders' proposed amicus brief will provide this Court with important public policy considerations and will highlight the larger consequences for non-party insureds and insurers in relation to the important questions of insurance law raised by the certified questions.

For the foregoing reasons, United Policyholders respectfully requests that this motion be granted and that the amicus brief attached hereto may be filed.

DATED: Honolulu, Hawaii; March 31, 2023.

/s/ Alan Van Etten
ALAN VAN ETTEN
TRISTAN S.D. ANDRES
Attorneys for Amicus Curiae
United Policyholders

NO. SCCQ-22-0000658

IN THE SUPREME COURT OF THE STATE OF HAWAI‘I

ST. PAUL FIRE AND MARINE INSURANCE COMPANY, a Connecticut corporation; THE TRAVELERS INDEMNITY COMPANY OF AMERICA, a Connecticut corporation; THE PHOENIX INSURANCE COMPANY, a Connecticut corporation; and TRAVELERS PROPERTY CASUALTY COMPANY OF AMERICA, a Connecticut corporation, Plaintiffs-Appellants, v. BODELL CONSTRUCTION COMPANY, a Utah corporation; SUNSTONE REALTY PARTNERS X, LLC, a Hawaii limited liability company; and STEADFAST INSURANCE COMPANY, a Delaware corporation, Defendants-Appellees.	CIVIL NO. 20-cv-00288 DKW-WRP (Certified Question) RE: CERTIFIED QUESTIONS ON THE ISSUE OF EQUITABLE REIMBURSEMENT FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF HAWAI’I UNITED STATES DISTRICT COURT FOR THE DISTRICT OF HAWAI‘I JUDGE: THE HONORABLE DERRICK K. WATSON

DECLARATION OF ALAN VAN ETTEN

I, ALAN VAN ETTEN, declare as follows:

1. I am an attorney licensed to practice before the Courts of the State of Hawaii, and I represent United Policyholders in this matter.

2. United Policyholders is seeking participation as amicus curiae in the above-captioned action.

3. Attached hereto as Exhibit "A" is a true and correct copy of the Brief of *Amicus Curiae* United Policyholders in Support of Defendants-Appellees, which United Policyholders is requesting leave to file in this matter by way of this motion.

I declare under penalty of perjury that the foregoing is true and correct.

EXECUTED: March 31, 2023; Honolulu, Hawaii.

/s/ Alan Van Etten
ALAN VAN ETTEN

EXHIBIT A

NO. SCCQ-22-0000658

IN THE SUPREME COURT OF THE STATE OF HAWAI‘I

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BRIEF OF *AMICUS CURIAE* UNITED POLICYHOLDERS IN SUPPORT OF DEFENDANTS-APPELLEES

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STATEMENT OF INTEREST OF *AMICI CURIAE*

United Policyholders was founded in 1991 as a non-profit organization dedicated to educating the public on insurance issues and consumer rights. United Policyholders is funded by donations and grants from individuals, businesses and foundations. In addition to serving as a resource on insurance claims for disaster victims and commercial policyholders, United Policyholders receives frequent invitations to testify at legislative and other public hearings, and to participate in regulatory proceedings on rate and policy issues. A wide range of policyholders communicate on a regular basis with United Policyholders, which allows us to provide important and topical information to courts throughout the country via the submission of amicus briefs.

SUMMARY OF ARGUMENT

St. Paul Fire and Marine Insurance Company, The Travelers Indemnity Company of America, The Phoenix Insurance Company, and Travelers Property Casualty Company of America (collectively "Insurers") should not be permitted to "recoup" or obtain "reimbursement" of defense costs from Bodell Construction Company and Sunstone Realty Partners X, LLC.

This case follows a typical pattern. The policyholder, Bodell, was sued years ago related to a construction dispute and soon thereafter tendered the defense of the lawsuit to its insurers. Insurers relatively promptly issued a reservation of rights letter but otherwise paid for the defense of the underlying claims. After years of litigation and after well over a million dollars of defense costs were spent, the insurance companies surprise the policyholder with a second round of lawsuits, seeking to be paid back for the costs of defending the underlying claims.

When an insurance company undertakes the duty to defend, it assumes general control over the defense of the case, selecting and paying for its own choice of counsel. Its motivation in doing so is not altruistic. Instead, it is governed by contractual obligations, statutory rules of conduct,

well-established legal precedent recognizing a fiduciary duty of utmost good faith, and to a large degree, self-interest in ensuring that the defense is conducted cost-effectively to minimize the ultimate combined cost of the defense and settlement or judgment for which the insurance company could potentially be responsible.

An insurer can deny coverage when it concludes that the insurance it sold does not apply to the third-party claims asserted against its insured. But, if the claims are covered, or there is a remote possibility of coverage as to even a single claim, the insurer must provide a defense. An insurer that is uncertain whether a defense is owed can choose to defend under a reservation of rights, which takes the form of a formal letter stating the basis for the insurer's position that it is reserving the right to deny coverage at some later time. That in itself is fair. But, an insurer that has willingly assumed a defense should not be able to wait until the underlying litigation is over and then, years later, initiate a declaratory judgment action to retroactively claw back defense costs it already paid. Doing so is nothing more than an attempt to retroactively eliminate the initial uncertainty that validly gave rise to the insurer's duty to defend.

This Court should not create an extra-contractual right for an insurance company to recover defense costs, even if such costs were paid under the nominal form of protestation contained in a reservation of rights letter. Doing so would eviscerate decades of well-established jurisprudence concerning the broad duty to defend, in Hawai‘i and elsewhere, and would result in a windfall to insurers who have sold insurance policies in Hawai‘i for decades pursuant to this law.

ARGUMENT

I. INSURANCE POLICIES ARE A SPECIAL TYPE OF CONTRACT IMBUED WITH PUBLIC POLICY.

"[I]nsurance is an instrument of social policy…" *AVEMCO Ins. Co. v. Chung*, 388 F. Supp. 142, 151 (D. Hawai‘i. 1975) (citing *Cooper v. Government Employees Ins. Co.*, 237 A.2d

870, 873-874 (N.J. 1968)). By compensating entities that have suffered losses, it spreads risk and provides the financial security, peace of mind, and risk tolerance necessary for people and businesses to pursue all manner of beneficial activities. At the same time, insurance is woven into the fabric of our economy through mandatory purchase requirements, personal and business risk management, and the pricing of goods and services. In recognition of the important societal role of a well-functioning insurance marketplace, the Hawai‘i Legislature has stated:

> "The business of insurance is one affected by the public interest, requiring that all persons be actuated by good faith, abstain from deception and practice honesty and equity in all insurance matters."

Hawai‘i Revised Statutes ("HRS") § 431:1-102.

This statement is no mere preamble, devoid of substantive content. Rather, it provides the basis for special interpretive rules and public policy guardrails that: (1) distinguish insurance policies from other bilateral contracts; and (2) protect policyholders against the otherwise unchecked interests of large and sophisticated for-profit insurance companies. Insurers sell adhesion contracts in a marketplace characterized by inequality between seller and purchaser. Judicial oversight is essential for maintaining the purpose and value of insurance in this complex system. In accordance with the Legislature's instruction to give effect to the public purpose of insurance, courts have developed a number of policyholder protections and special rules for insurance policy interpretation.

For example, HRS § 431:1-102 was mentioned by this Court in *Best Place, Inc. v. Penn America Ins. Co.* in support of its decision to recognize the tort of insurer bad faith. 82 Hawai‘i 120, 125-26, 920 P.2d 334, 339-40 (1996). There are two notable things about the tort of insurer bad faith that provide insight into the way in which courts are to construe insurance contracts, specifically, in a manner that provides special and heightened protections to insurance policyholders. First, the bad faith tort runs only against insurance companies and is not available

for an insurer to bring against its insured. *See, e.g.*, *Wailua Associates v. Aetna Cas. Sur. Co.*, 183 F.R.D. 550, 561 (D. Haw. 1998) ("[I]t is the inequality between the insurer and the insured which gives rise to the insurer's 'heightened duty.' Consequently, the insured may recover for the insurer's bad faith in tort as well as contract, while the insurer, by contrast, has no such tort remedy."). Second, this Court declined to extend the tort of bad faith to contracts outside of the insurance context in *Francis v. Lee*, when it noted that *Best Place* was "grounded" in the "atypical relationship existing between the insured and the insurer" as well as "the adhesionary aspects of an insurance contract." 89 Hawai'i 234, 237-38, 971 P.2d 707, 710-11 (1999) (internal citations and quotations omitted).

In addition to the tort of insurer bad faith, Hawai'i law contains other rules that protect the integrity of the products that insurers sell. Insurance Code provisions are read into each insurance policy at the time of enactment and become a part of the contract with binding effect upon each party. *See Bowers v. Alamo Rent-A-Car, Inc.*, 88 Hawai'i 274, 281, 965 P.2d 1274, 1281 (1998). This Court often refuses to enforce insurance policy provisions that are contrary to public policy as set forth in the Insurance Code. *See Dawes v. First Ins. Co. of Hawaii LTD*, 77 Hawai'i 117, 121, 883 P.2d 38, 42 (1994). Outside of legislation and regulations, this Court has long recognized the rule of *contra proferentem*, that ambiguities in insurance policies are strictly construed against the insurer, and the related doctrine of reasonable expectations of the insured, which requires courts to construe insurance policies in a way that a reasonable person (not insurance company) would expect them to operate. *Id.* at 121, 883 P.2d at 42.

The above-discussed rules confirm that this Court understands the unique features of insurance policies that give rise to the need for special judicial handling. In the present case, this Court is called upon to decide an issue that has split state high courts around the country – whether

an insurer who sold an insurance policy without a recoupment clause can later recover defense costs based on a unilateral reservation of rights letter. United Policyholders respectfully urges the Court to keep in mind the special public policy considerations it has applied in other insurance cases and create a rule that is protective of policyholders' interests.

II. PERMITTING RECOUPMENT UPENDS NEARLY A HALF-CENTURY OF WELL-ESTABLISHED LAW CREATED TO PROTECT INSUREDS FROM THE IMBALANCE OF POWER INHERENT IN THE RELATIONSHIP BETWEEN THE INSURER AND ITS INSURED.

The duty to defend sits at the core of an insurance company's promise of protection. As stated by an insurance executive in a prominent publication covering the industry, "the liability system is the engine of the insurance industry." F. Nutter, *Search for Stability*, Bus. Ins., June 17, 1985, at 21. Within the liability context, "[t]he insurer's promise to defend a legal action provides litigation insurance that is at least as important as the insurer's promise to pay a judgment or settlement." Restatement of the Law of Liability Insurance §14, Comment (a). This is because the cost to defend lawsuits can often exceed the ultimate judgment. For many types of insurance, defense costs are not subject to policy limits. In line with its importance, courts have developed broad policyholder protections regarding an insurer's duty to defend.

It has been the law in this state for over forty years that an insurer's "duty to defend rests primarily on the possibility that coverage exists[,]" and that "possibility may be remote, but if it exists the [insurer] owes the insured a defense." *Standard Oil Co. v. Hawaiian Ins. & Guar. Co.*, 65 Haw. 521, 527, 654 P.2d 1345, 1349 (1982) (quoting *Spruill Motors, Inc. v. Universal Under. Ins. Co.*, 212 Kan. 681, 686, 512 P.2d 403, 407 (1973)). Not long after, this Court recognized additional bedrock principles concerning an insurer's duty to defend, which all tilt in favor of providing the insured with a defense:

> An insurer's duty to defend arises whenever there is a potential for indemnification liability of insurer to insured under the terms of the policy.

> Corollary to the above-stated rule is the proposition that where a suit raises a potential for indemnification liability of the insurer to the insured, the insurer has a duty to accept the defense of the entire suit even though other claims of the complaint fall outside the policy's coverage. The fact that the pleadings state a cause of action that is not covered by the policy does not excuse insurer if another ground for recovery is stated that is covered because the duty to defend has broader aspects than the duty to indemnify . . . . Accordingly, the insurer is obligated to provide a defense against the allegations of covered as well as the noncovered claims.
>
> . . .
>
> The duty to defend is determined at the time the suit is brought and not at the conclusion of litigation. Thus, an insurer's ultimate non-liability should not free it from its concurrent contractual duty to defend.

First Ins. Co. v. State, 66 Haw. 413, 417-18, 665 P.2d 648, 652 (1983) (citations and quotation marks omitted).[1] These principles are deeply entrenched in Hawai'i insurance law.

Much like the special rules of insurance policy construction that favor the insured, this Court bases the broad duty to defend and the defense of uncovered claims in the inherent special features of the insurer-insured relationship. For instance, in *Best Place*, this Court pointed to: (1) the "atypical" special relationship between insurer and insured, wherein the insured seeks peace of mind rather than commercial advantage; (2) the insurer's assumption of an "almost adjudicatory responsibility" in evaluating and handling the insured's needs and claims for relief under the contract; and (3) the "adhesionary aspects" of an insurance policy. *Best Place*, 82 Hawai'i at 130-32, 920 P.2d at 344-46.

[1] *First Insurance Co. v. State* has been cited by three other jurisdictions, in 2000, 2005 and 2010, in support of a finding that recoupment is not permissible. *See, Gen. Agents Ins. Co. of Am., Inc. v. Midwest Sporting Goods Co.*, 215 Ill. 2d 146, 161 (Ill. 2005); *Shoshone First Bank v. Pacific Employers Ins. Co.*, 2 P.3d 510, 515-516 (Wyo. 2000); *Am. & Foreign Ins. Co. v. Jerry's Sport Ctr., Inc.*, 606 Pa. 584, 615, 2 A.3d 526, 545 (Penn. 2010).

This imbalance of power and special relationship, underlie the public policy supporting the almost universal rule that requires the insurer to defend uncovered claims in a mixed action, even when there is only a remote possibility of coverage.[2]

The Insurers' contrary position here represents a radical departure from these long-established rules and undermines their very purpose and the rationale. For example, permitting recoupment of defense costs years after an insured is sued directly contradicts the requirement that the "duty to defend . . . must be determined at the onset of litigation using the complaint allegation rule." *Pancakes of Haw. v. Pomare Props. Corp.*, 85 Hawai'i 286, 292, 944 P.2d 83, 89 (App. 1997). Furthermore, an untimely attempt at recoupment exposes the analysis to the prejudice of hindsight, after the insurer's decision to provide a defense made "at the onset of litigation" as required, had earlier demonstrated the insurer's belief that at that time there had been a possibility – which possibility this Court has held may be "remote" – of coverage at the time of the lawsuit. *Id.*; *Tri-S Corp. v. W. World Ins. Co.*, 110 Haw. 473, 488, 135 P.3d 82, 97 (2006).

Perhaps worse, presenting an insured with a unilateral reservation of rights letter invoking a right to recoupment that was not provided for in the policy destroys the "peace of mind" referenced in *Best Place* by threatening recoupment at some unknown time in the future. *Best Place*, 82 Hawai'i at 130-31, 920 P.2d at 344-45 (quoting *Rawlings v. Apodaca*, 151 Ariz. 149, 726 P.2d 565, 570-71 (Ariz. 1986)). Additionally, the adhesionary concerns and imbalance of power are both amplified by a threat of recoupment, as the insured is at its most vulnerable when

[2] *See, e.g.*, 22-136 *Appleman on Insurance Law & Practice Archive* § 136.1 ("An insurer has a duty to defend whenever there is a possibility of coverage, even when that possibility is remote"); Restatement of the Law of Liability Insurance § 14 ("the insurer has a duty to provide a defense that . . . makes reasonable efforts to defend the insured from all causes of action and remedies sought in the action, including those not even potentially covered by the liability insurance policy.").

facing defense costs and liability. *Best Place*, 82 Hawai‘i at 128, 920 P.2d at 342 (“the insured is [often] in an especially vulnerable economic position when such a [] loss occurs”) (*quoting Noble v. National American Life Ins. Co.*, 128 Ariz. 188, 624 P.2d 866, 867-68 (Ariz. 1981)). Acceptance of a defense under a reservation of the right to recoupment is but a Hobson’s choice between either rejecting the insurer’s proposition and incurring the cost of the underlying defense along with initiating a lawsuit against the insurer or accepting the defense subject to the insurer’s unilateral revisions to the Policy essentially under the duress of a pending lawsuit.

Additionally, permitting unilateral recoupment retroactively obliterates the rule that “the insurer is obligated to provide a defense against the allegations of covered as well as the noncovered claims.” *First Ins. Co. v. State*, 66 Haw. at 418, 665 P.2d at 652 (citations omitted). If an insurer is truly in doubt about whether it has a duty to defend, current law and practice mandates that it bring a declaratory judgment action immediately, which renders the issue of recoupment moot.[3] Allowing an insurer to unilaterally claim a right to reimbursement that is non-existent in the contract of insurance completely contradicts Hawai‘i law and should not be permitted.

III. THE HAWAIʻI SUPREME COURT NEED NOT PROVIDE THE INSURANCE INDUSTRY AN UNFETTERED RIGHT TO SEEK REIMBURSEMENT OF DEFENSE COSTS

[3] If the insurer defended under a reservation of rights, it would cover the defense fees until such time that a Court determines it has no duty to defend. The insurer thereby acknowledged that a possibility of coverage existed until the Court foreclosed the possibility. Thus, there is nothing to recoup. Conversely, if the insurer outright denies coverage and files a declaratory judgment action, it would not be providing a defense, so there would be no fees to recoup. Either way, certainty is provided from the outset, the insured is not presented with an ultra-adhesionary choice between accepting a defense under a reservation of rights or getting no defense at all, the duty to defend analysis is conducted closest to the time of the complaint and not prejudiced by hindsight, and the insured is not saddled with the prospect of repaying defense fees years down the road, possibly arising from a case that it won.

A. THE INSURER'S DRAFTED THE POLICIES THEY SOLD TO BODELL AND COULD EASILY HAVE ADDED AN EXPRESS RIGHT OF RECOUPMENT, BUT THEY DID NOT, AND IF THEY HAD, BODELL MIGHT HAVE PATRONIZED A DIFFERENT INSURER.

The question before the Court is not whether recoupment of defense costs is ever permissible, but simply what the *default rule* should be when an insurance policy is silent on the issue. Many insurance policies speak clearly and include explicit recoupment clauses.[4] But here, Insurers chose to sell policies that were silent. The Court should not create a default rule that reads words into an insurance policy where they do not exist. *Strouss v. Simmons*, 66 Haw. 32, 40, 657 P.2d 1004, 1010 (1982) ("It is the function of courts to construe and enforce contracts made by the parties, not to make or alter them."). Moreover, when interpreting a contract that is silent on a disputed issue, the Court should keep in mind "the fundamental principle of construction of insurance contracts [which is] that where reasonable to do so such contracts are to be construed in favor of the insured so as to provide coverage." *State v. Bayly*, 118 Hawai'i 1, 14, 185 P.3d 186, 199 (2008) (citations omitted).

Placing the burden on the insurance company to explicitly articulate the right to reimbursement has other beneficial results. It forecloses disputes and avoids lawsuits such as this one by putting the right to recoupment beyond dispute; it allows for the contract itself to set out

[4] *See, e.g., See Liberty Mut. Fire Ins. Co. v. Ferrara Candy Co.*, 2019 IL App (1st) 181385, 18 (Ill. App. Ct. 2019) ("If we initially defend an insured ('insured') or pay for an insured's ('insured's') defense but later determine that the claim(s), is (are) not covered under this this insurance, we have the right to reimbursement for the defense costs we have incurred. The right to reimbursement for the defense costs under this provision will only apply to defense costs we have incurred after we notify you in writing that there may not be coverage, and that we are reserving our rights to terminate the defense and to seek reimbursement for defense costs."); *Liberty Ins. Underwriters v. Cocrystal Pharma Inc.*, 1:19-cv-02281-JDW-CJB, at *3 (D. Del. May 23, 2022) ("[i]f it is determined by ... litigation ... that any such Defense Costs are not covered under this Policy, the Insureds agree to repay the Insurer the amount of such Defense Costs not covered.").

the specific parameters for recoupment; and it provides clear notice to all parties and allows regulators and brokers to better evaluate the coverage that insurers intend to provide.

B. THE INSURANCE INDUSTRY'S UNJUST ENRICHMENT ANALYSIS IS STRAINED.

The unjust enrichment arguments put forward by the insurance industry in this and similar cases throughout the country regarding the right to recoupment are faulty. Unjust enrichment is an equitable remedy that should be used sparingly. It should not be employed where there are alternative ways for an insurance company to protect itself.

First, an unjust enrichment analysis is best suited if the parties involved have equal bargaining power, unlike the parties here, and the contract at issue does not implicate important public policy considerations, like an insurance policy does. This Court should disfavor a rule allowing for recoupment that relies on unjust enrichment when insurers have known for decades about recoupment disputes and are able to include specific language allowing for recoupment if they so choose.

Second, standard commercial general liability policies like the one sold to Bodell are not silent with regard to an insurance company's right to recoup defense costs, but rather negate that right through other policy language. For example, standard supplementary payment provisions state that the insurance company "will pay, with respect to any claim we investigate or settle, or any 'suit' against an insured we defend: All expenses we incur." The distinction in this clause between the claim-specific coverage for indemnification and complete coverage for the defense of a "suit" (crucially not written as "that part of a suit relating to covered claims") is illuminating as is the insurer's express promise to pay **all expenses we incur**. This explicit language has been identified by scholarly commentators:

> Allowing the insurer to shift defense costs back to the insured through reimbursement would contravene the clause's express promise that the insurer will

> pay them. Accordingly, contrary to what a reader may conclude from reviewing cases on both sides of the question, standard liability policies are not silent about allocation or recoupment. They expressly disclaim it.

A. Elbert & S. Nardoni, *Buss Stop: A Policy Language Based Analysis*, 13 Conn. Ins. L.J. 61 (2006/2007).

Third, unjust enrichment makes little sense in the context of coverage for litigation defense costs because it is never possible for the insured to have profited from being sued. Simply put, the insured here, Bodell, was not made any richer – was not "enriched" – through having certain of its defense costs covered by Insurers. Of course, an insurer may argue that its insured is technically "enriched" by receiving an insurance benefit for which it did not pay premiums. But this argument fails because it ignores the fact that insurance is a business. An insurance company sets premiums according to its estimate of expenses, which include not only judgments and settlement payments, but also defense costs. Hawaii has not had the recoupment rule urged by the insurer here for at least 40 years. In determining the premiums to charge insureds such as Bodell, then, the insurer examined decades of data containing, *inter alia*, defense costs for these kinds of policies issued to similar businesses in the region, with more weight given to data coming from policies and businesses in Hawai‘i. Thus, the insureds in Hawai‘i, including Bodell, have indeed been paying for the litigation defense at issue here. It would be the insurer, not the insured, who would be unjustly enriched if it obtains the relief it seeks in this action.

Put another way, the insurer's unjust enrichment argument contains a strained definition of "enrich" and approaches being circular: (1) it presupposes that the insurer has a right to recoupment in the first place, or stated differently, that the policyholder did not pay premiums for the right to be safe in the belief that coverage payments made to it by its insurer are not subject to retraction years later; and (2) the reality is that defense fees are costs to the insurers, which are added to their other costs, then balanced against income, of which premiums are a primary source. It is basic

business logic that premiums set by insurance companies reflect the history of past costs, including defense costs, including, sometimes, defense costs for claims that are later determined not to be covered.

IV. RELEVANT CASE LAW FROM HAWAI'I AND OTHER STATES

A. HAWAI'I SHOULD JOIN THE RANKS OF OTHER STATE HIGH COURTS THAT REQUIRE AN INSURER TO CLEARLY ARTICULATE A RIGHT TO REIMBURSEMENT IN THE POLICY

There is a true nationwide split of authority regarding whether an insurer can seek reimbursement of costs spent to defend against uncovered claims.[5] Notable state high court decisions on the pro-insurer side are led by California's *Buss v. Super. Ct.*, 939 P.2d 766 (Cal. 1997). Other state high court decisions include: Colorado, *Hecla Mining Co. v. New Hampshire Ins. Co.*, 811 P.2d 1083, 1089 (Colo. 1991), Montana, *Travelers Cas. & Sur. Co. v. Ribi Immunochem Research, Inc.*, 326 Mont. 174, 189 (Mont. 2005), Connecticut, *Sec. Ins. Co. of Hartford v. Lumbermens Mut. Cas. Co.*, 264 Conn. 688, 699 (Conn. 2003), and most recently Nevada, *Nautilus Ins. Co. v. Access Med., LLC*, 482 P.3d 683 (Nev. 2021).

While these cases are certainly relevant authority and cannot be ignored, United Policyholders respectfully suggests that they are, on the whole, less well reasoned than the pro-policyholder set of cases (to be discussed second), and importantly, a number of them only devote limited attention to the relevant issue of recoupment.

For example, in *Hecla Mining*, the Colorado Supreme Court stated that an insurance company can "provide a defense to the insured under a reservation of its rights to seek reimbursement should the facts at trial prove that the incident resulting in liability was not covered

[5] While the Insurers' brief cites a list of states for the pro-recoupment rule, not all of them include state high court decisions, and a number of the cited cases are from federal courts sitting in diversity and predicting state law. This brief limits its discussion of out-of-jurisdiction authority to states in which high courts have addressed the issue.

by the policy." 811 P.2d at 1089. But this statement (1) was dicta and reads almost as if it were an off-hand comment, (2) did not address the issue of whether the right to seek reimbursement ought to be limited to insurers who sold policies expressly providing for such a right, and (3) provided no substantive analysis of the issue and only cited to two cases for support (*Reliance v. Martin*, 126 Ill. App.3d 94, 97, 467 N.E.2d 287, 290 (Ill. Ct. App. 1984) and *City of Willoughby Hills v. Cincinnati Ins. Co.*, 459 N.E.2d 555, 558 (Ohio 1984)), neither of which are relevant to an insurer's right to seek reimbursement. Moreover, one of the cited cases came from the Illinois Court of Appeals, a jurisdiction in which the state's Supreme Court later held that insurers cannot seek reimbursement of defense costs. *General Agents Insurance Co. of America, Inc. v. Midwest Sporting Goods Co.*, 215 Ill. 2d 146, 160-161 (Ill. 2005).

Though its discussion was not dicta nor as cursory as *Hecla Mining*, the Montana Supreme Court's reimbursement-related holding in *Ribi Immunochem* was only one of many issues addressed by the court and as a consequence did not receive in-depth treatment. The court in *Ribi Immunochem* mostly relied on an Illinois federal district court, *Grinnell Mut. Reinsurance Co. v. Shierk*, 996 F. Supp. 836 (S.D. Ill. 1998), for the position favoring recoupment. But as noted above, that federal court got it wrong given the Illinois Supreme Court's extensively reasoned and opposite opinion issued seven years later in *Midwest Sporting Goods.* The only other decisions discussed or cited by the Montana Supreme court were: (1) another federal court predicting state law for a state that had not yet ultimately decided the issue, *United National Insurance v. SST Fitness Corp.*, 309 F.3d 914 (6th Cir. 2002); and (2) a single Florida court of appeals case, *Colony Insurance Co v. GE Tires Service, Inc.*, 777 So.2d 1034, 1039 (Fla. Cir. 2000).

A similar story appears in Connecticut with *Lumbermens*, which permitted recoupment of defense costs for a long-tail environmental pollution insurance claim in which the policyholder

was self-insured for part of the triggered period. There, the Connecticut Supreme Court cited to only a single case, *Buss*, for support of its "implied in law" and "quasi-contractual" holding allowing for recoupment when the policy is silent. *See Lumbermens*, 264 Conn. at 716-717.

Finally, in *Nautilus Ins. Co. v. Access Med., LLC*, 482 P.3d 683 (Nev. 2021), while the Nevada Supreme did devote significant attention to the precise question of whether an insurer can seek recoupment in the absence of express contractual language allowing for such, the decision was a close 4-3 vote and included an extensive and well-reasoned dissent. Moreover, the insurer in *Nautilus v. Access Med.*, unlike Insurers in this case, immediately initiated a declaratory action when it reserved its right to later seek reimbursement. Though the Nevada Supreme Court's analysis did not turn on this issue, an insurer who initiates a declaratory action to establish a complete lack of coverage concurrently with issuing a reservation of rights letter is a different factual matter than a case where the insurer waits years to begin contesting coverage.

Ultimately, of the above-discussed notable pro-insurer state high court cases, only *Buss* and *Nautilus v. Access Med.* truly delved into the issue, and both included spirited and persuasive dissents championing the no-reimbursement position. Taken as a whole, the pro-insurance industry cases can hardly be considered a national trend.

On the other hand, based on United Policyholders' research, there appears to be significantly more state high court decisions adopting the pro-policyholder approach. The pro-policyholder cases generally involve a much deeper analysis of the issue.

State high courts denying insurance companies the right to seek reimbursement based solely on a unilateral reservation of rights letter include Pennsylvania, *American and Foreign Ins. Co. v. Jerry's Sport Center*, 606 Pa. 584 (Pa. 2010), Illinois, *Gen. Agents Ins. Co. of Am. v. Midwest Sporting Goods Co.*, 215 Ill. 2d 146 (Ill. 2005), Utah, *United States Fid. & Guarantee Co. v. United*

States Sports Specialty Ass'n, 270 P.3d 464 (Utah 2012), Washington, *Nat'l Sur. Corp. v. Immunex Corp.*, 297 P.3d 688, 695 (Wash. 2013), Alaska, *Attorneys Liab. Prot. Soc'y, Inc. v. Ingaldson Fitzgerald, P.C.*, 370 P.3d 1101 (Alaska 2016), Wyoming, *Shoshone First Bank v. Pac. Emp'rs Ins. Co.*, 2 P.3d 510, 514 (Wyo. 2000), Arkansas *Med. Liab. Mut. Ins. Co. v. Alan Curtis Enters. Inc.*, 285 S.W.3d 233, 235-237 (Ark. 2008), and Texas, *Excess Underwriters at Lloyd's v. Frank's Casing Crew & Rental Tools, Inc.*, 246 S.W.3d 42, 54 (Tex. 2008).

Each of these cases contain significant discussions of the relative merits of the pro-insurer and pro-insured sides of the argument. Together, they provide the basis for the American Law Institute's lawyers and professors to conclude, in the Restatement of the Law of Liability Insurance adopted in 2018, that non-recoupment is the more soundly and reasoned default position, consistent with good public policy. *See,* Restatement of Liability Insurance § 21.

For example, *Jerry's Sport Center* includes an in-depth analysis of the history and development of recoupment case law, largely beginning with *Buss* in 1997, which as the Pennsylvania Supreme Court pointed out, "arose following a lawsuit in which only one of 27 claims was potentially covered." 606 Pa. at 602. Surveying the case law and rationale in favor and against reimbursement, the Pennsylvania Supreme Court noted numerous reasons other courts around the country have considered but declined to follow *Buss* including: "reimbursement is inconsistent with the broad duty to defend" *id.* at 605; in many instances, the "insurer voluntarily undertook the defense for its own interest, even though the payments were made under some rudimentary form of protestation" *id.* at 605-606; "a unilateral reservation of rights letter cannot create rights not contained in the insurance policy itself" *id.* at 606; and "concerns of equity and fairness weigh against reimbursement, because an insurer benefits unfairly if it can hedge on its defense obligations by reserving its right to reimbursement while potentially controlling the

defense and avoiding a bad faith claim." *Id.* at 605-606 (collecting and citing cases for each proposition).

A similarly detailed analysis can be found in the decisions from other supreme courts, listed above. In each decision, the various courts review extensive case law from around the country, balance arguments and public policy considerations, and ultimately conclude that reimbursement should not be allowed absent an express provision in the policy.

B. *NAUTILUS V. LEXINGTON* DOES NOT REQUIRE ADOPTION OF A PRO-INSURANCE COMPANY RULE.

This Court's statement in *Nautilus Ins. Co. v. Lexington Ins. Co.*, 132 Hawai'i 283, 293, 321 P.3d 634, 644 (2014) that an insurer that defends under a reservation of rights "may recoup its expenses from the insured" if "it is later determined that the insurer had no duty to defend" was non-binding *dicta*. More importantly and substantively, the position advanced by Bodell and United Policyholders does not strictly prevent an insurer from seeking recoupment, and therefore does not contradict *Nautilus v. Lexington*. An insurer has ample ability to include an express right to seek reimbursement in the contract of insurance, and many insurance carriers do this. Of course, this Court in *Nautilus v. Lexington* was not squarely presented with the issue of whether an insurer can seek reimbursement of defense costs based *solely* on a unilaterally issued reservation of rights letter and as such, this case provides the Court the ability to clarify without contradicting its previous statement.

The Washington Supreme Court's decision in *Nat'l Sur. Corp. v. Immunex Corp.*, 176 Wash. 2d 872 (Wash. 2013) is instructive. There, the court was presented with a similar situation in which a Washington appellate court had posited without significant analysis that reimbursement would be allowed subject to later discovery that there was not duty to defend. In disaffirming that previous statement to the extent it related to a "unilateral reservation of rights," the Washington

Supreme Court noted that it was dicta and inconsistent with other principles of Washington insurance law. *Nat'l Sur. Corp. v. Immunex Corp.*, 176 Wash. 2d 872, 888 n.2 (Wash. 2013). This Court should take the same view here.

C. OTHER PRECEDENT FROM THIS AND OTHER HAWAI'I COURTS SUPPORT ADOPTION OF THE PRO-POLICYHOLDER POSITION.

In *First Ins. Co. v. State*, 66 Haw. 413, 422, 665 P.2d 648, 654 (1983) this Court stated:

> Thus, affording an insured a defense under a reservation of rights agreement merely retains any defenses the insurer has under its policy; it does not relieve the insurer of the costs incurred in defending its insured where the insurer was obligated, in the first instance, to provide such a defense.

Id.

In addition to this being a clear articulation of the principles disallowing recoupment, in the same paragraph, this Court cited with approval to *Crawford v. Ranger Insurance Co.* for the definition of a reservation of rights: "A reservation of rights agreement is a notice by the insurer to the insured that the insurer will defend the insured but that the insurer is not waiving any defenses . . . it may have under the policy." 653 F.2d 1248, 1252 (9th Cir. 1981). *Crawford* in turn cited to *Yuen v. London Guarantee Accident Co.*, 40 Haw. 213 (1953) which, while admittedly relating to a slightly different issue, illustrates Hawai'i's longstanding adoption of rules generated to protect policyholder interests against inconsistent positions taken by insurers, such as the rule in question here which would allow an insurer to both undertake the defense and later seek reimbursement for such an undertaking. *Id.* at 233. In *Yuen*, this Court stated, "[i]t is apparent from the record before us that [the insurer] was in fact continuing to defend successive suits, in favor of its insured, and simultaneously disclaiming liability under the policy without the consent of their insured. That course of conduct is precisely what an insurer should be foreclosed from pursuing. It may elect to do either, but is precluded from doing both." *Id*. Taken together, these

cases and others confirm Hawai‘i’s commitment, for at least the last seventy years, to upholding the interests of policyholders and requiring insurers to live up to their broad duty to defend.

V. CERTIFIED QUESTION NUMBER 2

If the Court answers the first certified question against the policyholder, it is respectfully urged to restrict reimbursement to cases in which there is not even one potentially covered claim. Allowing an insurance company to seek reimbursement of uncovered claims in a mixed action would eviscerate the longstanding one-claim all claim rule, which requires carriers to provide a defense so long as one claim in an underlying complaint triggers coverage.

Moreover, the current law is that if there is any chance that an insurance company might pay (remote possibility) then they must provide a defense. This means that an insurance company must decide at the *beginning* of a lawsuit whether there is a remote possibility of coverage. If there is not, it is free to deny the claim. But if there is a remote possibility of coverage, it must provide a defense. Though an insurer can bring a declaratory judgment action to eliminate the uncertainty and prove that there is no coverage, it should not also be able to retroactively recoup defense costs expended when there had been such an uncertainty.

CONCLUSION

For the foregoing reasons, *amicus curiae* United Policyholders respectfully requests that the Court answer the first certified question in the negative, finding that an insurer may not seek equitable reimbursement from an insured for defense fees and costs when the applicable insurance policy contains no express provision for such reimbursement.

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NO. SCCQ-22-0000658

IN THE SUPREME COURT OF THE STATE OF HAWAI‘I

ST. PAUL FIRE AND MARINE INSURANCE COMPANY, a Connecticut corporation; THE TRAVELERS INDEMNITY COMPANY OF AMERICA, a Connecticut corporation; THE PHOENIX INSURANCE COMPANY, a Connecticut corporation; and TRAVELERS PROPERTY CASUALTY COMPANY OF AMERICA, a Connecticut corporation, Plaintiffs-Appellants, v. BODELL CONSTRUCTION COMPANY, a Utah corporation; SUNSTONE REALTY PARTNERS X, LLC, a Hawaii limited liability company; and STEADFAST INSURANCE COMPANY, a Delaware corporation, Defendants-Appellees.	CIVIL NO. 20-cv-00288 DKW-WRP (Certified Question) RE: CERTIFIED QUESTIONS ON THE ISSUE OF EQUITABLE REIMBURSEMENT FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF HAWAI’I UNITED STATES DISTRICT COURT FOR THE DISTRICT OF HAWAI‘I JUDGE: THE HONORABLE DERRICK K. WATSON

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing document was served upon the parties listed below, by JEFS and/or via U.S. Mail at their last known address as referenced below, on the following date.

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