"Freedom to Contract"

Gives Rise to Big Recovery Opportunities from Policyholders for Self-Insured Retentions, Deductible Reimbursements, Retrospective Premiums and Loss Adjustment Expenses

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"I am bound because I intend to be bound."
'Contracts,' Calamari and Perillo (2nd Ed. 1977)

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MANY INSURANCE POLICIES CONTAIN ENDORSEMENTS OR OTHER PROVISIONS PROVIDING AN INSURER RECOVERY RIGHTS FOR MONIES ADVANCED ON BEHALF OF ITS INSURED. THESE ENDORSEMENTS AND PROVISIONS OFTEN ARISE OUT OF SELF-INSURED RETENTIONS (SIR), DEDUCTIBLE AMOUNTS ADVANCED, UNPAID PREMIUMS UNDER RETROSPECTIVE PREMIUM PAYMENT PLANS, AND LOSS ADJUSTMENT EXPENSES INCURRED BY THE INSURER. TYPICALLY THESE TYPES OF REIMBURSEMENT PROVISIONS ARE INCLUDED IN COMMERCIAL LIABILITY, PROFESSIONAL MALPRACTICE, AUTOMOBILE, AND WORKERS' COMPENSATION POLICIES, ESPECIALLY INVOLVING HIGH-RISK OR SPECIALTY RISK INSUREDS. BELOW IS A DISCUSSION ON PURSUING THESE LARGELY UNTAPPED CONTRACTUAL RECOVERY OPPORTUNITIES AGAINST ONE'S POLICY HOLDER.

Common Policy Provisions

Insurance policies often include language that allows insurers to recover amounts they have advanced for the insured's benefit. For instance, if the insured's policy has a SIR, the policy may contain a provision similar to the following:

> We shall have the right but no obligation, in all cases, to assume charge of the defense and/or settlement of any claim, and, upon our written request, you shall tender such portion of the SIR as we may deem necessary to complete the settlement of such claim.

Upon payment, the insurer is entitled to recover the SIR's full amount, and courts have found that allowing the insured to avoid its SIR obligation would "yield a result at substantial variance with actuarial reality and the premium paid for the policy." *Harbor Ins. Co. v. City of Ontario,* 231 Cal. App. 3d 927, 935 (Cal. App. 1991).

Similarly, policies with a deductible often include language to the effect that if the insurer pays any part of the deductible in order to settle a claim, the insured has to promptly reimburse the insurer for the deductible amount that was paid. In these instances, once the insurer settles an underlying claim, its right to reimbursement will be broadly applied. *See Casualty Ins. v. Town & Country Pre-School Nursery, Inc.,* 498 N.E.2d 1177, 1178 (Ill. App. 1986).

Recovery opportunities can also arise under retrospective premium plans and claim service agreements. Specifically, under a retrospective premium plan, the insured's annual premium is estimated at the beginning of the policy period and then adjusted at the end of the policy period based on the number of losses. If the final premium is more than the original premium paid, the insured is required to pay the balance.

Recovery Entitlements Derive From Basic Contract Rights

Generally, courts interpret reimbursement provisions the same way they interpret any other contract, by applying general contract law. In applying contract law to reimbursement provisions, most courts uphold these provisions by finding that they do not contravene public policy or violate state statutes.

In applying these basic principles,

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courts have allowed insurers to recover unpaid deductibles for a variety of insurance policies. For commercial liability policies, courts assume that contracting parties have sufficiently equal bargaining power, so insurers and insureds are afforded substantial latitude in drafting and policy terms are enforced as contracted. "Liability insurance policies with deductibles are written for commercial risks" and "business persons should recognize that when they accept a liability policy with a deductible they may be called on to pay it." *American Home Assume Co., Inc. v. Hermann's Warehouse Corp.*, 521 A.2d 903, 905-906 (N.J. Super. 1987).

Professional malpractice policies are treated similarly. Courts have found that "[s]o long as coverage required by law is not omitted and policy provisions do not contravene applicable statutes, the extent of the insurer's liability is governed by the contract entered into." *London, Anderson & Hoeft, Ltd. v. Minn. Layers Mutual Ins. Co.,* 530 N.W.2d 576, 577 (Minn. App. 1995). Unless there is a specific "consent to settle" requirement in the policy (often included in professional policies for accountants, engineers, medical and legal malpractice, etc.), even when dealing with workers' compensation policies or automobile policies, courts have allowed the insurer to be reimbursed even where the insurer committed the insured's deductible without the insured's consent. *American Protection Ins. Co. v. Airborne, Inc.*, 476 F.Supp.2d 985 (N.D. Ill. 2007); *Maryland Casualty Co. v. American Lumber & Wrecking Company, Inc.,* 282 N.W. 806, 809 (Minn. 1938).

Regardless of the type of policy involved, courts have confirmed that an insurer's right to be reimbursed is broad, based soundly on principals of equity and contract law. Consequently, broad recovery opportunities for insurers to pursue amounts owed from their insureds and add value back to their otherwise worthless collectibles.

Strategies to Maximize Recovery Potential

While the litigation process is always available to an insurer when an insured refuses to pay amounts owed, there are number of steps insurers can take prior to issuing a policy to protect themselves. One of the simplest and most effective ways for an insurer to offer itself additional protection is to insert language into the policy stating that all insureds, including the insured appearing on the declaration page and any additional named insureds, are jointly and severally liable for the failure of any named insured to reimburse the insurer. Adding language to this effect may provide an insurer with the ability to pursue those named insureds that are more economically viable and able to make payment, rather than chasing a company that may be going out of business or have limited collectable assets.

Another option for insurers to consider when issuing policies with a SIR,

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deductible or other reimbursement provision is to require the insured to post collateral securing the future obligation. One of the best ways for an insurer to procure sufficient collateral is by requiring the insured to provide a letter of credit from a recognized bank or financial institution that the insurer can draw on in the event the insured fails to make payments. Alternatively, the insurer could require the insured to deposit funds into a collateral trust account, but this method can involve additional steps and responsibilities, such as the creation of a separate trust agreement, that make it more onerous than a letter of credit.

Where an insurer does not take such affirmative steps to protect itself from an insured defaulting on its duty to reimburse steps prior to issuing the policy, there are still a number of remedies available to effectuate recovery. First and foremost, an insurer should invest resources to have a comprehensive investigation into the insured's financials. Since the insured has already failed to pay monies owed, it is possible, if not likely, that the insured is having financial difficulties. There are a number of third-party vendors that specialize in investigating corporate assets and financials which can provide invaluable information early the process. If the insured is in a precarious financial condition, the insured may not have the assets to pay a judgment or may have a number of secured creditors with superior claims. By completing a comprehensive pre-suit investigation, the insurer and its counsel will be able identify viable recovery opportunities early on without incurring significant costs.

In the event recovery potential exists, an insurer should have outside counsel issue a demand letter for payment. While an insurer can issue the demand letter directly, using outside counsel is generally more effective and the letter is less likely to be ignored by the insured. If litigation is ultimately required, it is essential to pursue early and detailed discovery into the insured's finances and assets. This information will provide both the details the insurer will need to recover its judgment and likely make the insured uncomfortable in having to disclose its normally confidential financials.

Often, since an insured has no defense to its failure to pay, the insured will not present any defense and an early default judgment can be pursued. To the extent the insured does attempt to defend itself, an insurer's claims for reimbursement are well suited for resolution by summary judgment as the interpretation of the insurance policy is a question of law that is determined by the court. As a consequence, litigation against insureds for recovery of amounts owed may be resolved early on, avoiding a trial.

Defenses to Overcome

When faced with an insurer's claims for reimbursement, an insured may attempt to assert claims of bad faith in an effort protect itself and put the insurer on guard. However, an insured's bad faith claims in the context of its duty to reimburse an insurer are quite limited. Most often, the insured will claim that the insurer's adjustment or settlement of a claim was done in bad faith. However, courts have taken a skeptical view of such claims and place a high burden on the insured "to show that the insurer recklessly ignored and disregarded important facts in adjusting the claim." *United Capitol*

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Insurance Co. v. Bartolotta's Firework's Co., Inc., 546 N.W.2d 198 (Wis. Ct. App. 1996). Some courts have found that an insurer cannot be charged with bad faith if the settlement was arguably prudent and, in order to prove bad faith, an insured must show that "no reasonable observer could have viewed the situation" as the insurer did. *Orion Insurance Company, Ltd. v. General Electric Company,* 492 N.Y.S.2d 397, 403 (N.Y.Sup., 1985).

In considering an insured's claims of the insurer settling in bad faith, courts are reluctant to find bad faith even where the insurer did not investigate the claim as long as the settlement was within the limits of the deductible. *Marginian v. Allstate Insurance Co.,* 481 N.E.2d 600 (Ohio, 1985). The strong resistance in finding bad faith is rooted in the preference for settlements over litigation and to encourage insurers to make payments on claims. *American Home Assume Company, Inc. v. Hermann's Warehouse Corp.,* 521 A.2d 903 (N.J. Super. 1987).

As an alternative defense, an insured may attempt to argue that the insurer settled a third party's claim over the insured's objections or without the insured's consent. This sometimes happens when the insured believes it should not be liable for the claim or that it can succeed in litigating the claim. However, unless the policy wording calls for it, courts will generally not read a consent requirement into an insurance policy. As such, an insurer not obtaining an insured's consent before settling case within the SIR or deductible will generally not preclude an insurer's recovery. *American Protection Insurance Company,* 476 F.Supp.2d at 990. See *Orion Insurance Company, Ltd.,* 492 N.Y.S.2d at 403 (holding that "as a general rule, the insurer has the right to settle with or without the insured's consent … thereby obliging the insured to repay a deductible").

As these cases illustrate, while an insured may attempt to raise issues related to the insurer's conduct, such attempts are generally unsuccessful and should not deter an insurer from pursuing its contractual rights. Unlike traditional bad faith litigation where the insurer has either not provided coverage or failed to settle a claim, in the reimbursement context, it is the insured who has failed to hold up its end of the bargain and courts will generally not be sympathetic to its defense.

Effective Strategies for Enforcing and Collecting On A Judgment

In most cases, obtaining a judgment against the other side is the most difficult part of the litigation. Collecting on a judgment is often routine, especially if the defendant has sufficient insurance coverage or other assets. However, in the context of recovering from an insured who has failed to pay deductibles owed, obtaining a judgment is often only the first step in a long and winding road towards achieving the ultimate goal: recovering from the insured what it legally owes. Remember, the insured has already failed once to live up to its contractual obligations, so forcing it to pay a judgment may not be easy.

But there is hope. While the entire universe of the means and methods available to enforce a judgment is beyond the scope of this article, following are a few practical tips to keep in mind.

First, always record the judgment immediately. This will offer the insurer some protection from, and priority above, other creditors. While there are always exceptions, in general, "first in time, first in line" is a good rule to follow.

Second, do not forget the easy ways to enforce a judgment. As noted gangster Willie Sutton once (allegedly) said: "Why do I rob banks? Because that's where the money is." Most jurisdictions authorize the use of the local sheriff to garnish or levy bank accounts or personal property. While attaching an insured's personal property may not be feasible or advisable, garnishing a bank account is a relatively expeditious process. While there may not be enough money in the account to cover

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the entire judgment, few insureds are able to operate without using legitimate bank accounts. Garnishing a bank account will get an insured's attention, and may even provide enough funds to cover the cost of the litigation and satisfy a portion of the judgment.

What if the insurer does not know where the insured keeps its money? No problem, issue a Citation to Discover Assets to either the insured or its suspected banker to determine where its assets lie. Most jurisdictions have some sort of post-judgment procedure to allow a judgment creditor to obtain documents or even take depositions in furtherance of enforcement of a judgment to discover the whereabouts of the insured's assets and finances.

If garnishing a bank account does not do the trick, you can always take more drastic measures, such as foreclosing on the insured's unencumbered real property, or using turnover orders or court-appointed receivers to sell or auction personal property of the debtor. There are auction companies which specialize in this work and can be a valuable resource. For example, if the insured runs a trucking business and owns dozens of tractor trailers, the Court can order those trucks be turned over to a public auctioneer for sale.

Further recovery opportunities potentially exist to the extent circumstances warrant for alter ego liability via successor liability or piercing the corporate veil. Thorough investigation of the insured's related entities and evidence of direct participation and "control" are key. Further keys to establishing personal or successor liability involve violations of public policy, sham entities designed to perpetuate a fraud, undercapitalization, failure to follow corporate formalities, lack of separateness between corporations and controlling individuals resulting in a "unity of interest," and overall improper corporate conduct. Taking a closer look for deep pockets is vital to uncover the necessary evidence. Once the dots are connected, the recovery payoff can potentially be quite large.

Conclusion

The genesis of recovery claims against policyholders for failure to perform as promised is basic contract law. For centuries, the law recognizes and enforces private agreements between parties. Unless there are viable contract defenses, insurers are no different than any other contracting party – they are entitled to achieve the benefit of the bargain. Freedom of contract is deeply rooted in contract law. The underpinnings derive from various societal values: the promisor's responsibility to do what the promisor promised; freedom of contract; reliance by, and fairness, to the policy issuing insurer; and basic notions of fairness and justice.

With these principles of fundamental contract law, insurers hold significant subrogation opportunities from their policyholder insureds for recovery of self-insured retentions, deductible reimbursements, retrospective premiums and loss adjustment expenses.

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