Holyoke

COMMONWEALTH OF MASSACHUSETTS

SUFFOLK, ss.

SUPERIOR COURT
CIVIL ACTION
NO. 15-2321 BLS1

HOLYOKE MUTUAL INSURANCE COMPANY IN SALEM and MARYLAND CASUALTY COMPANY

vs.

VIBRAM USA, INC.

MEMORANDUM OF DECISION AND ORDER ON CROSS-MOTIONS FOR SUMMARY JUDGMENT ON RECOUPMENT AND RECOVERY OF DEFENSE COSTS

INTRODUCTION

This action arises out of a coverage dispute between the plaintiff insurance companies, Holyoke Mutual Insurance Company in Salem (Holyoke)[1] and Maryland Casualty Company (Maryland) (individually an Insurer, and collectively the Insurers), and the defendant, Vibram USA, Inc. (Vibram). Each of the insurers issued commercial general liability policies to Vibram (or its affiliate) (the Policies).[2] An action was filed against Vibram in the United States District Court for the Western District of Washington at Tacoma captioned: *Tefere Abebe Bikila, and others, v. Vibram*, case no. 3:15-cv-05082-RBL (the Underlying Action). Vibram asserted coverage under the Policies and tendered defense of the Underlying Action to the Insurers. The

[1] Holyoke has been replaced as a plaintiff in this action by its successor, Country Mutual Insurance Company. For consistency, the court will continue to refer to it as Holyoke in this Memorandum of Decision and Order.
[2] Holyoke issued policies to Vibram for several years, while Maryland issued policies to an affiliate of Vibram, Vibram Five Fingers, LLC. It is not necessary to distinguish between Vibram and its affiliate for the purposes of this motion, and the court will refer to them collectively as Vibram. Additionally, for purposes of this motion the relevant policy language in all of the policies is identical, and is it also unnecessary to distinguish among policy years. The court will therefore simply refer to the Holyoke and Maryland policies collectively as the Policies.

Insurers each sent a "reservation of rights" letter to Vibram in which they agreed to provide its defense to the claims asserted in the Underlying Action, but also maintained that coverage did not exist under the Policies and reserved their rights to bring a declaratory judgment action and seek reimbursement for defense costs advanced. The Insurers then filed this declaratory judgment action seeking a declaration that the claims asserted against Vibram in the Underlying Action are not covered under the Policies; Vibram counterclaimed for a declaration that they are. In a Memorandum of Decision and Order on Cross-Motions for Summary Judgment and Partial Summary Judgment originally issued on August 17, 2016 (the Decision), this court held that the Policies do not provide coverage for the claims asserted against Vibram in the Underlying Action and, accordingly, there is no duty to defend.

The case is now before the court on cross-motions for summary judgment addressing the issues of recoupment of defense costs advanced or, conversely, recovery of defense costs incurred before the court rendered the Decision but left unpaid—issues of first impression in Massachusetts. The Insurers contend that since the claims asserted in the Underlying Action were not insured under the Policies, they are entitled to recoup the defense costs that they previously paid Vibram. Vibram, in turn, maintains that it is entitled to recover defense costs already incurred, but still unpaid, as of the date the Decision issued. For the reasons that follow, each party's motion is allowed, in part, and denied, in part.

ADDITIONAL BACKGROUND

None of the facts necessary to resolve these cross-motions are in dispute.

Because the Insurers sent reservation of rights letters to Vibram, Vibram exercised its right to control its defense of the Underlying Action and retained its own counsel.[3] Vibram's counsel kept the Insurers informed concerning the status of the Underlying Action and forwarded copies of pleadings to them. By August 17, 2016, the date the Decision issued, Vibram had sent the Insurers invoices for defense costs totaling $1,272,212.57 and the Insurers had collectively reimbursed Vibram $667,901.71—$472,216.80 from Holyoke and $195,684.91 from Maryland. Vibram last received a payment from the Insurers on July 18, 2016. Neither Insurer informed Vibram why it did not pay the full amount of the invoices.[4]

As relevant to the issues raised by the pending motions, the Policies provide that the Insurers "will pay those sums that the insured becomes legally obligated to pay as damages because of 'personal and advertising injury' to which this insurance applies. We have the right and duty to defend the insured against any 'suit' seeking those damages. However, we will have no duty to defend the insured against any 'suit' seeking damages for personal and advertising injury' to which this insurance does not apply." The Policies also state that the Insurers "will pay, with respect to any claim we investigate or settle, or any 'suit' against any insured we defend: . . . All expenses we incur . . . ."

DISCUSSION

Recoupment

In *Metro. Life Ins. Co. v. Cotter,* 464 Mass. 623 (2013) (*Cotter*), the Supreme Judicial Court (SJC) was called upon to decide if a disability insurer could recoup from its insured benefit

[3] See, e.g., *Northern Sec. Ins. Co. Inc. v. Another 1*, 78 Mass. App. Ct. 691, 694-695 (2011).
[4] At oral argument, counsel for the Insurers stated that invoices were still being processed for payment when the Decision issued, and the Insurers elected to withhold payment.

payments made under a reservation of rights after a court determined that the insured's benefits claim was not covered. In considering that claim for recoupment, the SJC noted that, with respect to liability policies:

> We have not addressed whether an insurer may seek reimbursement for the costs of a defense undertaken pursuant to a unilateral reservation of rights. We note that other jurisdictions are split as to the validity of such claims. See *Perdue Farms, Inc. v. Travelers Cas. & Sur. Co.*, 448 F.3d 252, 258 (4th Cir.2006), and cases cited ("jurisdictions differ on the soundness of an insurer's right to reimbursement of defense costs").
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> Based on the theory that insurers are in the business of analyzing and allocating risk, and thus in a better position to do so, courts in some jurisdictions have declined to allow liability insurers to bring reimbursement claims for the costs of defense. See *Texas Ass'n of Counties County Gov't Risk Mgt. Pool v. Matagorda County*, 52 S.W.3d 128, 135 (Tex.2000). See, e.g., *Excess Underwriters at Lloyd's, London v. Frank's Casing Crew & Rental Tools, Inc.*, 246 S.W.3d 42, 45–47 (Tex.2008) ("imposing an extra-contractual reimbursement obligation places the insured in a highly untenable position"); *United States Fid. v. United States Sports Specialty*, 270 P.3d 464, 470–471 (Utah 2012) ("The right of an insurer to recover reimbursement from its insured distorts the allocation of risk unless it has been specifically bargained for").

Id. at 641 n.21. This question is squarely before this court in this case.

While acknowledging that there are divergent views on the right of recoupment in cases such as this, in which a court has entered a declaratory judgment that none of the claims alleged in the complaint are covered under the Policies, the Insurers maintain that the majority of jurisdictions permit recoupment. Perhaps, the most frequently cited case for the proposition that defense costs advanced under a reservation of rights may be recovered is *Buss v. Superior Court*, 16 Cal. 4th 35 (Cal.App. 1997). In a more recent decision, the California Supreme Court reaffirmed its holding in *Buss* with the following comments:

> As *Buss* explained, the duty to defend, and the extent of that duty, are rooted in basic contract principles. The insured pays for, and can reasonably expect, a defense against third party claims that are potentially covered by its policy, but no more. Conversely, the insurer does not bargain to assume the cost of defense of claims that are not even potentially covered. To shift these costs to the insured does not upset the contractual

> arrangement between the parties. Thus, where the insurer, acting under a reservation of rights, has prophylactically financed the defense of claims as to which it owed no duty of defense, it is entitled to restitution. Otherwise, the insured, who did not bargain for a defense of noncovered claims, would receive a windfall and would be unjustly enriched.
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> . . .
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> As *Buss* further noted, "[n]ot only is it good law that the insurer may seek reimbursement for defense costs as to the claims that are not even potentially covered, but it also makes good sense. Without a right of reimbursement, an insurer might be tempted to refuse to defend an action in any part — especially an action with many claims that are not even potentially covered and only a few that are — lest the insurer give, and the insured get, more than they agreed. With such a right, the insurer would not be so tempted, knowing that, if defense of the claims that are not even potentially covered should necessitate any additional costs, it would be able to seek reimbursement."
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> Though these comments were made in the context of "mixed" actions [including covered and uncovered claims], they apply equally here. An insurer facing unsettled law concerning its policies' potential coverage of the third party's claims should not be forced either to deny a defense outright, and risk a bad faith suit by the insured, or to provide a defense where it owes none without any recourse against the insured for costs thus expended. The insurer should be free, in an abundance of caution, to afford the insured a defense under a reservation of rights, with the understanding that reimbursement is available if it is later established, as a matter of law, that no duty to defend ever arose.

Scottsdale Ins. Co. v. MV Transportation, 36 Cal. 4th 643, 655 (Cal.App. 2005) (Internal citations and quotations omitted). In this case, the Insurers make the same arguments that the California Supreme Court describes in *Scottsdale*.

Vibram, however, points the court to a recent, unreported decision of the United States District Court in Massachusetts that reaches an opposite conclusion: *Welch Foods Inc. v. Nat'l Union Fire Ins. Co.*, No. 09-12087-RWZ 2011 WL 576600 (D. Mass. Feb. 9, 2011). In that case, like this one, the District Court found that claims in an underlying action were not covered by the liability policy and then addressed the insurer's claim for recoupment of defense costs paid under a reservation of rights. The District Court acknowledged the holding and reasoning of *Buss*, but rejected the California Supreme Court's opinion in favor of a more recent decision by the

Pennsylvania Supreme Court, *American & Foreign Ins. Co. v. Jerry's Sport Center, Inc.*, 2 A.3d 526 (2010) (*Jerry's*), which appears to be the most frequently cited case by those courts that have recently held that under these circumstances there is no right to recoup.

In *Jerry's*, the Pennsylvania Supreme Court began with an exhaustive review of the competing lines of cases permitting and rejecting claims for recoupment of defense costs by liability insurers. *Id.* at 536-537. It then reflected on the very broad duty to defend (broader than the duty to indemnify) that exists under Pennsylvania, a duty that it describes in very much the same way as Massachusetts appellate courts describe the duty that liability carriers owe their insureds under Massachusetts law. See *Id.* at 540-541, compare Decision at 5-6. The Court then found that the answer to the question before it: is the insurer entitled to recover defense costs advanced before it obtained a declaratory judgment of no coverage, lay in the language of the policy itself:

> We agree with Insured that whether a complaint raises a claim against an insured that is potentially covered is a question to be answered by the insurer in the first instance, upon receiving notice of the complaint by the insured. Although the question of whether the claim is covered (and therefore triggers the insurer's duty to defend) may be difficult, it is the insurer's duty to make that decision. See *Shoshone First Bank*, 2 P.3d at 516 (holding that the insurer must make the decision about whether there is a duty to defend). Insurers are in the business of making this decision. The insurer's duty to defend exists until the claim is confined to a recovery that the policy does not cover. . . .Where a claim potentially may become one which is within the scope of the policy, the insurance company's refusal to defend at the outset of the controversy is a decision it makes at its own peril. . . .
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> In some circumstances, an insurance company may face a difficult decision as to whether a claim falls, or potentially falls, within the scope of the insurance policy. However, it is a decision the insurer must make. If it believes there is no possibility of coverage, then it should deny its insured a defense because the insurer will never be liable for any settlement or judgment. See *Shoshone*, 2 P.3d at 510 (stating that where an insurer believes there is no coverage, it should deny a defense at the beginning). This would allow the insured to control its own defense without breaching its contractual obligation to be defended by the insurer. If, on the other hand, the insurer is uncertain about coverage, then it should provide a defense and seek declaratory judgment about coverage. *Id.*

In a declaratory judgment action to determine whether a claim is covered, the court resolves the question of coverage. . . . The court's role in the declaratory judgment action is to resolve the question of coverage to eliminate uncertainty. If the insurer is successful in the declaratory judgment action, it is relieved of the continuing obligation to defend. The court's resolution of the question of coverage does not, however, retroactively eliminate the insurer's duty to defend the insured during the period of uncertainty.

. . .

An examination of the insurance contract between the parties reveals that under the policy, [the Insurer] was obliged to pay damages because of bodily injury, and had the "right and duty to defend the insured against any 'suit' seeking those damages." . . . . The policy further provided that it had no duty to defend the insured against any suit seeking damages for bodily injury to which the insurance does not apply. Pursuant to the contractual language, therefore, [the Insurer] had the right and the duty to defend covered claims for bodily injury against Insured, and no duty to defend non-covered claims.

It was not immediately apparent whether the claim against Insured for bodily injury was or was not covered. It was immediately apparent, however, that the claim might potentially be covered. . . . Facing uncertainty about coverage, [the Insurer] appropriately activated its right and met its duty to defend under the policy when it was presented with a claim that may or may not have been covered. At the same time, [the Insurer] appropriately exercised its right to seek a declaration that it had no duty to defend.

The trial court's subsequent declaratory judgment determination that the claim was not covered relieved [the Insurer] of having to defend the case going forward, but did not somehow nullify its initial determination that the claim was potentially covered. . . .

We therefore reject [the Insurer's] attempt to define its duty to defend based on the outcome of the declaratory judgment action. The broad duty to defend that exists in Pennsylvania encourages insurance companies to construe their insurance contract broadly and to defend all actions where there is any potential coverage. . . .

Where the insurance contract is silent about the insurer's right to reimbursement of defense costs, permitting reimbursement for costs the insurer spent exercising its right and duty to defend potentially covered claims prior to a court's determination of coverage would be inconsistent with Pennsylvania law. It would amount to a retroactive erosion of the broad duty to defend in Pennsylvania by making the right and duty to defend contingent upon a court's determination that a complaint alleged covered claims, and would therefore narrow Pennsylvania's long-standing view that the duty to defend is broader than the duty to indemnify.

. . .

> Moreover, [the Insurer's] contractual obligation to pay for the defense arose as a consequence of the rules of contract interpretation. It is undisputed that the policy did not contain a provision providing for reimbursement of defense costs under any circumstances. Thus, the right [the Insurer] attempts to assert in this case, the right to reimbursement, is not a right to which it is entitled based on the policy

Id. at 541-544.

This court, like the District Court in *Welch*, finds that the Pennsylvania Supreme Court's decision in *Jerry's* comports with Massachusetts law. In Massachusetts, the insurer's duty to defend arises when the underlying complaint "show[s] only a possibility that the liability claim falls within the insurance coverage. There is no requirement that the facts alleged in the complaint specifically and unequivocally make out a claim within the coverage." *Sterilite Corp. v. Continental Cas. Co.*, 17 Mass.App.Ct. 316, 319 (1983). Even in cases in which the insurer may believe that coverage is unlikely under the terms of the policy, it has financial incentives to provide a defense. If it is determined in a separate action brought by the insured (or the insurer) that coverage existed, the insurer will be responsible for paying the insured's costs of establishing a right to a defense, even if the denial of coverage was made in good faith. See *Hanover Ins. Co. v. Golden*, 436 Mass. 584, 588 (Mass. 2002). Of course, a bad faith refusal to provide a defense could constitute a violation of chapter 93A and expose the insurer to multiple damages. See *Boston Symphony Orchestra, Inc. v. Commercial Union Ins. Co.*, 406 Mass. 7 (Mass. 1989) and *Boyle v. Zurich American Ins. Co.*, 472 Mass. 649, 661 (2015). In consequence, when in doubt, an insurer has an economically sound and self-interested reason to provide a defense under a reservation of right until the coverage issue can be resolved.

With those basic tenets of Massachusetts law in mind, we turn to the language of the contracts that define the parties rights and obligations, in this case the Policies. See, e.g., *Hakim v. Massachusetts Insurers' Insolvency Fund*, 424 Mass. 275, 280 (1997) ("The interpretation of

an insurance contract is no different from the interpretation of any other contract, and we must construe the words of the policy in their usual and ordinary sense.") There is simply nothing in the Policies that provides a right to recoup defense costs that the Insurers have advanced because they concluded that it was in their economic interest to do so. The court rejects the argument relied upon in *Buss* and its progeny that to deny recovery of defense costs will give insureds more than they bargained for, i.e., partial payment for the cost of defending claims that were not covered by the policies that they purchased. The court finds the reasoning of *Jerry's* more persuasive: "In some circumstances, an insurance company may face a difficult decision as to whether a claim falls, or potentially falls, within the scope of the insurance policy. However, it is a decision the insurer must make." *Jerry's*, 2 A.3d at 543.

In this case, if the Insurers had refused to provide a defense, they would have incurred no liability to Vibram because the claims in the Underlying Action were not within the coverage provided. However, they determined in the exercise of their considered judgment that it was better to provide a defense and file an action for declaratory judgment. "It is undisputed that the [the Policies] did not contain a provision providing for reimbursement of defense costs under any circumstances. Thus, the right [the Insurers] attempt[] to assert in this case, the right to reimbursement, is not a right to which [they are] entitled based on the [Policies]." *Id.* at 544. Knowing that there is a risk that they would decide to provide a defense in cases in which they were uncertain as to whether a claim was covered because the claim was novel or the law unclear, the Insurers could have addressed the right of recoupment in their Policies; they didn't. The court ought not insert a policy provision that the parties did not agree upon.

In *Jerry's*, the Pennsylvania Court addressed two other arguments advanced by the Insured in this case. First, a reservation of rights letter cannot create additional rights for the

Insurer not found in the contract. "[P]ermitting reimbursement by reservation of rights, absent an insurance policy provision authorizing the right in the first place, is tantamount to allowing the insurer to extract a unilateral amendment to the insurance contract." *Id.* and cases there cited. The court finds this reasoning consistent with existing Massachusetts precedent.

In *Joint Underwriting Ass'n v. Goldberg*, 425 Mass. 46 (1997), the insurer defended its insured under a reservation of rights. After a jury returned an adverse verdict against the insured in the underlying action and while appeals were pending, the insurer settled the underlying action. It then sought reimbursement for the cost of the settlement. The SJC held that even if the claims asserted against its insured in the underlying action were not covered, the insurer had no right to recover. The reservation of rights letter did not provide a right of recovery, it only permitted the insurer to defend without waiving its right to deny an obligation to cover an adverse judgment. While the insured's personal counsel had urged the insurer to settle, no agreement was ever reached that the insured would reimburse the insurer. The SJC noted that the insurer had settled the claims to protect its own interests, as it was concerned about liability under chapter 93A that could, in theory, treble damages, if its refusal to settle were found unreasonable. As the insurer had no contractual right to reimbursement, it had no basis to demand it.

The instant case obviously does not involve a claim to recover an amount paid by an insurer in settlement of a claim, but *Goldberg* does stand for the general proposition that when an insurer provides payments that benefit the insured, but also avoid a perceived risk of exposure to even greater loss to the insurer, the reservation of rights letter does not support a claim for reimbursement. A right to reimbursement must be found in a contract.

In *Jerry's*, the Pennsylvania Supreme Court also rejected the insurer's claim that it was entitled to recoupment under a theory of unjust enrichment. 2 A.2d at 545. In this case, the Insurers point to the SJC's decision in *Cotter* and the careful consideration that the SJC gave to the disability insurer's argument that it could recover benefit payments under an equitable claim for restitution. Although, in *Cotter*, the SJC rejected the disability insurer's claim, the Insurers argue that liability policies are different and the Restatement (Third) of Restitution and Unjust Enrichment, § 35(1) supports their right of recovery.[5]

In *Cotter*, the SJC addressed the insurer's equitable claim as follows:

> "A quasi contract or a contract implied in law is an obligation created by law 'for reasons of justice, without any expression of assent and sometimes even against a clear expression of dissent.' " *Salamon v. Terra*, 394 Mass. 857, 859 (1985), quoting 1 A. Corbin, Contracts § 19 (1963). "Restitution is an equitable remedy by which a person who has been unjustly enriched at the expense of another is required to repay the injured party." *Keller v. O'Brien*, 425 Mass. 774, 778 (1997), citing *Salamon v. Terra*, supra. "The fact that a person has benefited from another 'is not of itself sufficient to require the other to make restitution therefor.' ... Restitution is appropriate 'only if the circumstances of its receipt or retention are such that, as between the two persons, it is unjust for [one] to retain it.' " *Keller v. O'Brien*, supra, quoting Restatement of Restitution § 1 comment c (1937), and citing *National Shawmut Bank v. Fidelity Mut. Life Ins. Co.*, 318 Mass. 142, 146 (1945).
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> A determination of unjust enrichment is one in which "[c]onsiderations of equity and morality play a large part." *Salamon v. Terra*, supra. A plaintiff asserting a claim for unjust enrichment must establish not only that the defendant received a benefit, but also that such a benefit was unjust, "a quality that turns on the reasonable expectations of the parties." Global *Investors Agent Corp. v. National Fire Ins. Co.*, 76 Mass.App.Ct. 812, 826 (2010), quoting *Community Builders, Inc. v. Indian Motorcycle Assocs.*, Inc., 44 Mass.App.Ct. 537, 560 (1998). "The injustice of the enrichment or detriment in quasi-contract equates with the defeat of someone's reasonable expectations." *Salamon v. Terra*, supra. The party seeking restitution has the burden of proving its entitlement thereto. *J.A. Sullivan Corp. v. Commonwealth*, 397 Mass. 789, 796 (1986); *Hayeck Bldg. & Realty Co. v. Turcotte*, 361 Mass. 785, 789 (1972), citing *Andre v. Maguire*, 305 Mass. 515, 516 (1940).

[5] In *Cotter*, the SJC appeared to adopt the principles set out in Restatement (Third) of Restitution and Unjust Enrichment, § 35(1) and found that *Goldberg* did not preclude the possibility that an insurer could recover payments made under a reservation of right, but as explained below held that the insurer must still prove that retention of the payments would be unjust.

> We have allowed claims for restitution in circumstances involving fraud, bad faith, violation of a trust, or breach of a duty; in "business torts" such as unfair competition and claims for infringement of trademark or copyright; and in some circumstances, as here, in disputes arising from quasicontractual relations. See *Keller v. O'Brien*, supra at 778–779. In order to prevail on its claim for reimbursement of disability insurance benefits it paid to Cotter under a reservation of rights, MetLife must establish not only that Cotter received a benefit, which is not disputed, but also that such a benefit was unjust.

Cotter, 464 Mass. at 644. The court found that Cotter's retention of the disability benefit payments was not unjust.

Clearly, the facts of *Cotter*, in which the insurer sought to recover benefit payments made to an individual, were more compelling for the insured than those of the present case, which involves a commercial dispute between an insurer and a large company. Nonetheless, liability policies are also sold to individuals (e.g., auto and homeowners policies) and small family businesses, as well as to manufacturing companies like Vibram. In order to prove that it is *unjust* for an insured to retain defense costs advanced in respect of a third-party claim under a reservation of rights, an insurer must do more than prove that a court ultimately held that the claims were uncovered. Otherwise, the insurer is, in effect, using equitable principles to insert a reimbursement provision into the liability policy that does not exist. If a policy holder demands coverage of a third-party claim that is clearly not covered under the policy, the insurer can reject it. If a policy holder engaged in misrepresentations or other wrongful conduct (for example, acting in concert with a third-party claimant to make an uncovered claim appear covered), retention of defense costs might well be "unjust." However, a good faith demand for a defense under a liability policy, which the insurer decides is likely enough to be valid that it will tender a defense under a reservation of rights, does not make retention of those defense costs unjust. Claims of unjust enrichment ought not be used to imply rights that the parties have not included

in the written contract that defines their relationship and covers the subject matter in dispute. See *Kennedy v. B.A. Gardetto, Inc.* 306 Mass. 212 (1940).

Recovery of Unpaid Defense Costs

Vibram seeks to recover expenses for defense of the Underlying Action incurred up to the date that the court held that the claims asserted in the Underlying Action were not covered by the Policies. It argues that in all cases in which a defense is provided under a reservation of rights, the duty to defend continues "until a declaratory judgment of no coverage is entered and that it does not retroactively disappear, even if no coverage is found." Vibram asserts that *Metropolitan Property & Casualty Ins. Co. v. Morrison*, 460 Mass.352 (2011) *(Morrison)* established this principle. The court disagrees. Rather, *Morrison* teaches that the duty to defend ends when there is no longer any chance that the facts alleged in an underlying action can support a covered claim. That will often, but certainly not always, be when a declaratory judgment resolves a coverage dispute.

Morrison involved claims allegedly covered by a homeowner's insurance policy. Briefly stated, the policy holders' son (covered under the policy) had injured a police officer while resisting arrest. The son pled guilty to various criminal charges, and the police officer filed suit against the son alleging negligent and reckless conduct. The insurer, Metropolitan, disclaimed any obligation to provide indemnity or a defense, but did bring a declaratory judgment action seeking to establish no coverage. The son did not answer the police officer's complaint, and a default judgment entered against him in the underlying personal injury action. On appeal, the coverage issue turned on (1) an interpretation of a policy provision that excluded coverage for

bodily injury resulting from intentional and criminal acts and (2)whether the entry of a default judgment in the underlying personal injury action, before a judgment of no coverage entered in the declaratory judgment action, established that the police officer's injury was the result of negligence, as alleged in the complaint, and therefore a covered claim.

The SJC began by restating the well-established principle that the "insurer's duty to defend is independent from, and broader than, its duty to indemnify." *Id.* at 351. It then went on to explain that "the duty to defend is determined based on the facts alleged in the complaint, and on facts known or readily knowable by the insurer . . . . However, when the allegations in the underlying complaint lie expressly outside the policy coverage and its purpose, the insurer is relieved of the duty to investigate or defend the claimant." *Id.* (internal quotations and citations omitted). Or, stated somewhat differently, when the allegations of the complaint do not "roughly sketch a claim covered by a liability policy," there is no duty to defend. Id.

In support of its position, Vibram quotes the following statement from *Morrison*: "'a declaratory judgment of no coverage, either by summary judgment or after trial, does not retroactively relieve the primary insurer of the duty to defend; it only relieves the insurer of the obligation to continue to defend after the declaration.' 14 G. Couch, Insurance, supra at s. 200: 48, at 200-65 to 200-66." *Id.* at 352. Vibram, however, omits the very next sentence in the opinion: "Where material facts as to the duty to indemnify are in dispute, an insurer has a duty to defend until the insurer establishes that no potential for coverage exists. Id. at 200-21." *Id.* In other words, where it can be established that there is no coverage under the policy because there are no material facts necessary to determine the coverage issue in dispute, or because, even assuming all of the allegations in the underlying complaint are true, no coverage exists, there is no duty to defend. Indeed, in *Morrison*, the SJC remanded the case to the Superior Court to

determine whether Metropolitan owed its insured "a duty to defend at the time of the default judgment." The SJC instructed the trial judge to determine whether *by that point* the facts establishing no coverage were already known and undisputed. Clearly, the SJC was teaching that this was the time at which the duty to defend terminated, even if Metropolitan did not obtain its declaratory judgment until later.

Moreover, the rationale underlying the decision in *Jerry's,* and other similar cases, would be impaired if a duty to defend arose whenever an insured asserted a disputed right to coverage. In those cases, the courts held that the insurer had no right to recoup defense costs when a declaratory judgment entered that established that a third-party complaint did not assert a covered claim, because it was initially up to the insurer to decide whether to, in effect, hedge its bets and provide a defense when it was unsure of coverage: "In some circumstances, an insurance company may face a difficult decision as to whether a claim falls, or potentially falls, within the scope of the insurance policy. However, it is a decision the insurer must make. If it believes there is no possibility of coverage, then it should deny its insured a defense because the insurer will never be liable for any settlement or judgment." *Jerry's,* 3 A.2d at 542. If an insurer is bound to provide a defense whenever there is any chance that a policy might be interpreted to provide coverage, because of a dispute about policy term not alleged facts, the predicate for following the principle outlined in *Jerry's* is missing.

The court has found a single case in which a court ruled that a dispute concerning a question of law, resolved in favor of the insured, could nonetheless give rise to a duty to defend. In *Hugo Boss Fashions, Inc. v. Federal Ins. Co.*, 252 F.3d 608 (2001), the insurer rejected its insured's claims of coverage for a trademark infringement case filed against it and declined to provide a defense. The insured brought a declaratory judgment action seeking to establish

coverage and, while it was pending, settled the underlying trademark suit. The coverage case preceded to trial before a jury, which returned a verdict for the insured, both as to coverage and a duty to defend, and judgment entered for the insured. On appeal, the Second Circuit Court of Appeals reversed the District Court's judgment that the trademark suit was a covered claim. It held that the policy was unambiguous, as the term "trademarked slogans" had a specific meaning and, in consequence, the policy did not cover the underlying claim.

In a split decision the Court of Appeals, nonetheless, found a duty to defend. It held that "there are situations in which a *legal* uncertainty as to insurance coverage gives rise to (an at least temporary) duty to defend." *Id.* at 622. (Emphasis in original) The majority explained that there was sufficient "legal uncertainty (what does "trademarked slogan" mean)" to require the insurer "to undertake a defense of Hugo Boss until the uncertainty surrounding the term was resolved." *Id.* In other words, although it concluded that the term "trademarked slogan" had only one reasonable meaning, the possibility that a court might find it ambiguous gave rise to a duty to defend.

Justice Sotomayor (then an associate justice of the Second Circuit) dissented from this latter holding. She concluded that the majority's discussion of the duty to defend "finds no basis in New York law." Id. at 626. She went on to explain that:

> The majority errs in confusing two types of uncertainty. The first is cognizable under New York law, the second is not. The first concerns the period during which the underlying action is pending when the insurer must defend the insured against any allegations that, if proven, would result in indemnification. This type of uncertainty is a well-established element of New York insurance law and is unquestioned here. The majority attempts to read a second category of "uncertainty" into New York law, however, concerning how a court might rule on the scope of policy terms. No such "uncertainty" is recognized under New York law apart from that arising from an "ambiguous" policy term.

Id. at 627. Anticipating to some extent the reasoning that the Pennsylvania Supreme Court adopted in *Jerry's*, Justice Sotomayor's dissent went on to point out:

> In order to determine its duties under a policy, insurers are, as a matter of course, called upon to survey the relevant law and scrutinize the language of the policy to judge whether its terms are unambiguous. Insurers may err in their judgment concerning the unambiguity of a policy term but are given strong incentives to decide these questions correctly. If they do not, they can be forced to defend a costly coverage action or, if the finding of unambiguity was so far off the mark that "no reasonable [insurance] carrier would, under the given facts, be expected to assert it," *Sukup v. State*, 227 N.E.2d 842, 844 (N.Y. 1967), insurers can face even greater liabilities for breaching their duty of good faith.
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> *All of this assumes that we entrust insurers with the initial decision concerning whether policy terms are unambiguous.* In the case of a policy that uses a legal term of art, this inquiry requires a determination of whether that term of art is unambiguous. . . . And yet, the majority wants to deny Federal the opportunity to reach the same conclusion we have reached. It is difficult to understand why we should discourage Federal or any other insurer from making such determinations that are, in any case, subject to review and even sanction if erroneous.

Id. at 628-629 (Emphasis supplied).

Turning to the present case, first, this court's coverage Decision did not turn on whether some term of art used in the Policies was potentially ambiguous. The precise question before the court: would a liability policy providing coverage for an Advertising Injury cover a claim based on the unauthorized use of a famous person's name to sell a product, in this case a shoe, had not previously been decided in Massachusetts, or very many other courts. However, this court's Decision did not turn on whether any particular term of art used in the Policies was potentially ambiguous, but rather applied legal precedent to the interpretation of a series of policy provisions.

Additionally, the reasoning of Justice Sotomayer's dissent appears far more compelling with respect to the issues raised here than the majority opinion. In the first instance, it is for the insurer to decide whether any of the allegations in the complaint, if proved, could support a claim

covered by the policy. If it declines to provide a defense, it faces potential liabilities that will likely exceed the cost of the defense. However, if it elects not to defend the third-party claim, and its decision was correct as a matter of law, how could there ever have been a duty to defend?

The case now before the court does provide an additional confounding fact. The Insurers initially did agree to advance defense costs, but had not paid all outstanding invoices when the Declaratory Judgment of no coverage issued. Whether the insurer stopped paying because it became more convinced of the validity of its coverage position or because it was just slow in processing invoices does not appear to raise a disputed issue of fact material to this case. The relevant question is whether having initially agreed to pay for Vibram's defense, while prosecuting this declaratory judgment action, the Insurers are bound to continue to advance defense costs until this case is resolved. On the record before this court, it concludes that they are not.

While not perfectly analogous, the court notes that in *Herbert A Sullivan, Inc. v. Utica Mutual Ins. Co.*, 439 Mass. 387, 395 (2003), the insurer initially provided a defense to its insured under a general liability policy because one count of a multicount complaint alleged negligence. However, after the plaintiff in the underlying action amended its complaint and eliminated the negligence count, the insurer no longer had a duty to defend. The court finds that there is nothing inherent in an insurer's initial decision to provide a defense that precludes it from changing its mind, even while the declaratory judgment action is still pending.

The court can envision cases in which an insured may have relied on the insurer's initial decision and adopted a course of action in responding to the third-party claim such that it would suffer damage if the insurer discontinued the defense before the declaratory judgment action was resolved. For example, this might arise in situations in which the insurer is not only advancing

defense costs but actively providing the defense. However, this is not such a case. Upon receipt of the reservation of rights letter, Vibram exercised its right to retain its counsel of choice and to control its own defense, which given the amount of fees generated in a rather brief time was robust. There are no facts in the summary judgment record suggesting that the Insurers should be equitably estopped from discontinuing the advancement of defense costs, if the Policies permit them to do so. The court finds that, on these facts, the Insurers were permitted to change their mind with respect to advancing defense costs, as they were under no contractual obligation to pay them. The insured has neither a contractual or equitable claim for payment of unpaid costs of defense incurred up to the date the Decision issued.[6]

ORDER

For the foregoing reasons, the Insurers' motion for summary judgment is DENIED, to the extent that it seeks to establish a right to recoup defense costs previously advanced,and otherwise ALLOWED; and Vibram's motion for summary judgment is DENIED, to the extent it seeks to establish a right to recover any additional defense costs from the Insurers, and otherwise ALLOWED. Final judgment shall enter dismissing the counterclaims and declaring that the plaintiff insurance companies do not have a duty to defend the defendant Vibram in the

[6] Vibram argues that the provision in the Policies that states "[the Insurers] will pay, with respect to any claim we investigate or settle, or any 'suit' against any insured we defend: . . . All expenses we incur . . . ." requires payment of all defense costs through the date the Decision issued. Clearly, this policy term only provides that when the Insurers defend a claim they have to pay all costs that they incur. Presumably, when an insured receives a reservation of rights letter and elects to control its own defense, that provision requires reimbursement of all defense expenses incurred by the insured, at least all reasonable expenses. But, it does not create an independent duty to defend a claim, or pay for the defense of a claim, that the Insurers have decided not to defend. The duty to defend is determined under other policy provisions.

Underlying Action or indemnify it for any loss sustained in respect thereto. No party shall recover damages, and each party shall bear its own costs.

Mitchell H. Kaplan
Justice of the Superior Court

Dated: March 20, 2017