

BINDING AUTHORITY

Insurance Coverage Decisions: Issued Today - Impact Tomorrow



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Coverage College Update – Registrations were brisk for the first week and we are well on our way to filling all of the slots. Thanks for the great support.

Binding Authority Contest Update: Results soon re: insurance coverage Olympic sports. [I know, the Olympics are over. It's on my list of things to do.]

Chrissie Hynde's Favorite Coverage Issue: Pretenders Defense Costs

Back On The Claim Gang

California Federal Court's Decision Is Not In The Middle Of The Road

The National Scorecard On Pre-Tender Defense Costs

Late notice is a difficult issue for insurers. Yet, its close cousin (sibling, even), pre-tender defense costs, is not.

As a starting point, even when a claim is reported months after it should have been, that is oftentimes *not late enough* to serve as a breach of the policy's notice requirement. What's more, even when a claim *is* sufficiently tardy, to qualify as having formally breached the policy's notice requirement, the insurer must usually prove that it was prejudiced by the insured's delayed notification in order for such breach to serve as a basis to exclude coverage. And prejudice is frequently difficult for insurers to establish. For these reasons, insurers have had a difficult go at it when attempting to disclaim coverage for defense and indemnity on the basis that their insured did not provide notice of a claim in a timely manner.

But insurers' fortunes have been significantly different when they are not seeking to completely disclaim coverage for defense and indemnity on account of late notice. Rather, the insurer is only asserting that it has no obligation to reimburse its insured for defense costs incurred by the insured *prior to* the time that the insured placed the insurer on notice of the claim. And unlike their unimpressive results in disclaiming all coverage for defense and indemnity on the basis of late notice, insurers have done remarkably well in avoiding any obligation to pay for pre-tender defense costs.

The difference between late notice and pre-tender defense costs, even within the same state, can be dramatic. For example, New Jersey sets a very high burden on insurers seeking to disclaim coverage for defense and indemnity on the basis of late notice—requiring a likelihood of appreciable prejudice. But when the issue is pre-tender defense costs, New Jersey law takes a one-hundred-and-eighty-degree turn, holding that an insurer is only obligated to pay for that portion of the defense costs arising after it was informed of the facts triggering the duty to defend—and no showing of prejudice is required.

Late notice and pre-tender defense costs seem remarkably similar. So why have insurers been so much more successful when it comes to pre-tender defense costs? In general, some courts are unwilling to saddle an insurer with an obligation to pay for defense costs that it had no ability to control. Other courts conclude that the duty to defend does not arise until the insurer receives notice. And some courts talk about the policy's prohibition against the insured making voluntary payments.

Pre-tender defense costs can be no small issue. While a claim that is reported late by three or four months may offer no basis to an insurer for a late notice disclaimer, a significant amount of defense costs may have been incurred during this pre-notice period—especially since litigation can be very active in the initial stages. Even a claim that is only a few weeks late in being reported could have rung up some meaningful defense costs during the pre-notice period. For this reason, the question whether coverage is available for pre-tender defense costs arises in numerous claim contexts—many more than whether late notice serves as a basis for disclaiming all coverage for defense and indemnity.

The National Scorecard On Pre-Tender Defense Costs

While it is certainly the majority rule that an insurer can disclaim coverage for pre-tender defense costs, without a showing of prejudice, a few states still have a prejudice requirement. For example, the last two **Pennsylvania** decisions (unreported federal) held that the insurer was required to prove prejudice to disclaim coverage for pre-tender defense costs.

So what's the national scorecard? Pre-tender defense costs was added as a new chapter in the 2nd Edition of *Insurance "Key Issues."* Based on that, which, at this point, excludes decisions from the past year (give or take), and putting aside lots of nuances, here is the picture of the national landscape (including D.C. as a state):

Insurer can disclaim: 16 states
Prejudice required: 4 states
Mixed: 7 states
No instructive authority: 24 states

Burgett, Inc. v. American Zurich Ins. Co., Eastern District of California, August 6, 2012

There is certainly case law in California addressing coverage for pre-tender defense costs. In *Burgett, Inc. v. American Zurich Ins. Co.*, the Eastern District of California recently addressed the following seemingly unresolved pre-tender defense costs issue:

An insured gave notice of a claim late. The court ultimately concluded that the insurer breached its duty to defend the underlying action and held that the insured should be awarded its reasonable defense costs. The insurer paid the insured its expenses, fees and prejudgment interest that it incurred in defending the underlying action. However, the insurer refused to pay the insured any fees that the insured incurred prior to tendering the defense to the insurer. *Burgett* at 1-2.

At issue was whether the normal rule, that the insurer was not obligated to pay the insured's pre-tender defense costs, was altered by the fact that, after it received notice of the claim, the insurer breached the duty to defend. As the *Burgett* opinion is brief, and the arguments and decision concise, I simply set them out below verbatim.

Here were the competing arguments:

The insured's argument:

[B]ecause Defendant originally declined to defend the *Persis* action, and Plaintiff had to seek a court order to invoke Defendant's duty to defend, the date Plaintiff tendered defense of the *Persis* action is irrelevant. More specifically, while Plaintiff concedes that the duty to defend does not arise until tender, Plaintiff asserts that the duty to reimburse is broader and requires a Defendant who has breached its duty to defend to pay all fees incurred by the insured, both pre-and post-tender. According to Plaintiff, "[i]n addition to Zurich's undisputed duty to defend post-tender, there is an additional implied-in-law duty which requires Zurich to reimburse Burgett for its expenses incurred in defending the *Persis* ... action[] which predated the date of tender in" the *Persis* action. Plaintiff maintains that "[s]uch rules of law, even when not squarely articulated, are properly deduced from the courts' decisional logic."

Id. at 3.

The insurer's argument:

California case law has long held that "no duty to defend can arise before the insured tenders the defense of the third party lawsuit to the insurer." Defendant asserts that "[t]ender of defense is a *condition precedent* to the insured's right to be indemnified.

Thus, whatever a carrier might do *after* tender cannot create a duty to reimburse fees incurred *prior* to tender, since no duty exists until tender.” (Emphasis in original.) Therefore, Defendant maintains, it has no duty to reimburse Plaintiff for fees and costs it incurred prior to tendering defense of the action.

Id. at 3-4.

The court’s decision:

Plaintiff’s inability to cite to any California law directly on point underscores the tenuous nature of its argument. Plaintiff cannot now, post hoc, argue that there is some unstated, yet implied, duty upon insurers to pay fees that it would not have had to pay had it originally accepted tender. Defendant, conversely, has cited to numerous cases supporting its contention that it is not obligated to reimburse Plaintiff for expenses incurred prior to tendering defense of the *Persis* action. While an insurer is undoubtedly liable for the consequences flowing directly from its breach, it is not liable for costs incurred before it did anything wrong, and was unaware that there was even a claim to defend.

Id. at 6.

A copy of the Eastern District of California’s August 6, 2012 decision in *Burgett, Inc. v. American Zurich Ins. Co.* is attached.

If you have an questions, please let me know.

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