Daily Journal
CORPORATION

TOP STORIES

AUGUST 18, 2008

No Notice, No Coverage?

FOCUS COLUMN

By Kirk A. Pasich

This article appears on Page 7

Many, if not most, liability insurance policies contain a provision that states an insured is to notify its insurance carrier of claims or suits against it. These provisions often state that the insured should forward certain information to the carrier. However, many courts long have recognized that an insured's failure to comply with such a provision is not an absolute bar to coverage. See, e.g., Shell Oil Co. v. Winterthur Swiss Ins. Co., 12 Cal. App. 4th 715 (1993), which found that "California law is settled that a defense based on an insured's failure to give timely notice requires the insurer to prove that it suffered substantial prejudice ... Prejudice is not presumed from delayed notice alone. The insurer must show actual prejudice, not the mere possibility of prejudice."

In spite of this law, many insurance carriers have argued that if there was a delay in notice, they are excused from paying pre-notice defense costs incurred by the insured. Rather than characterize their argument as "late notice" defense, many carriers claim that they are relieved from their duty to pay such defense costs because they were incurred before the insured "tendered" the claim or suit to the carrier for a defense. They argue that until the claim is "tendered," they have not had the opportunity to assume their duty to defend and that they cannot, as a matter of law, have a duty to defend before they are given the opportunity to defend. They often define "tender" as notice of the suit against the insured, plus being asked by the insured to defend it, plus being given the chance to take control of the insured's defense. Their argument is flawed for several reasons.

First, most insurance policies contain no requirement that a claim be "tendered" to a carrier. Indeed, as one court has recognized, the adoption of a "tender" requirement would do nothing other than provide "a loophole through which the insurer may escape a lawful contractual obligation." Federated Mut. Ins. Co. v. State Farm Mut. Auto. Ins. Co., 282 Ill. App. 3d 716, 668 N.E.2d 627 (1996). Had insurance carriers wanted to condition performance of their duties on a "tender," they could have included appropriate language in their policies. Having failed to do so, they should not be able to create such a loophole.

Second, while insurance carriers argue otherwise, many courts have not held that reimbursement of pre-tender expenses automatically is barred. In fact, in Shell Oil Co. v. National Union Fire Ins. Co., 44 Cal. App. 4th 1633 (1996), the court specifically rejected the carrier's argument that it only had to pay defense fees after "tender." Furthermore, many courts held that "a defense based on an insured's failure to give timely notice requires the insurer to prove that it suffered substantial prejudice." See Clemmer v. Hartford Ins. Co., 22 Cal. 3d 865 (1978).

Third, insurance carriers attempt to escape these basic and controlling principles by arguing that "voluntary payments" provisions in their policies excuse them from paying pre-tender fees and expenses. These provisions typically state that "[n]o insured will, except at that insured's own cost, voluntarily make a payment, assume any obligation, or incur any expense ... without [the insurance carrier's] consent." Commercial General Liability Coverage Form, Section IV.2.d. Courts have reached differing conclusions as to whether pre-tender fees and costs constitute such "voluntary payments" that a carrier need not pay. Some courts have held that insureds cannot recover pre-tender fees and expenses. See, e.g., Xebec Dev. Partners, Ltd. v. Nat'l Union Fire Ins. Co., 12 Cal. App. 4th 501 (1993), which found that "[T]he existence or absence of prejudice to [the carrier] is simply irrelevant to [the carrier's] duty to indemnify costs incurred before notice. ... The prejudice requirement ... applies only to the insurer's attempt to assert lack of notice as a policy defense against payment even of losses and costs incurred after belated notice." However, other courts have held that pre-tender fees are recoverable at least in some circumstances. The court in Fiorito v. Superior Court, 226 Cal. App. 3d 433, 440 (1990), found that fees were not "voluntary" when the insured could not locate a policy and was "forced" to retain counsel to defend a lawsuit to protect his legal interests. Jamestown Builders, Inc. v. General Star Indem. Co., 77 Cal. App. 4th 341 (1999) determined that "There are numerous circumstances in which a no-voluntary-payments provision may be deemed inapplicable or where disputed issues of material fact prevent resolution short of trial. First, insurers that decline a tendered defense are out of luck. ... The no-voluntary-payments provision is superseded by an insurer's antecedent breach of its coverage obligation. ... Second, an insured may be able to avoid application of a no-voluntary-payments provision where the previous payments where made involuntarily because of circumstances beyond its control."

Fourth, carriers - and many insureds - ignore the fact that a California statute obligates carriers to pay defense costs even in the absence of advance notice. Section 2778 governs indemnity contracts, including insurance policies. It addresses an indemnitee's right to have the indemnitor either pay its defense costs or defend it costs: "In the interpretation of a contract of indemnity, the following rules are to be applied, unless a contrary intention appears: An indemnity against claims, or demands, or liability, expressly, or in other equivalent terms, embraces the costs of defense against such claims, demands, or liability incurred in good faith, and in the exercise of a reasonable discretion" and "The person indemnifying is bound, on request of the person indemnified, to defend actions or proceedings brought against the latter in respect to the matters embraced by the indemnity."

The wording of the two subsections itself shows that there is a difference in an indemnitee's notice obligation - an indemnity for the "costs of defense" requires only that the costs be "incurred in good faith, and in the exercise of a reasonable discretion." By comparison, the duty to defend is triggered only "on request of the person indemnified." Indeed, the legislative history behind Section 2778 demonstrates that an insured is entitled to recover the reasonable costs of defense incurred, even if incurred before notice or tender. The legislative history cites to four cases, each of which is more than 100 years old. See Westervelt v. Smith, 2 Duer. 49 (1853); Mott v. Hicks, 1 Cowan 513 (1823); Smith v. Compton, 3 Barnewell & Adolphus 407 (1832); Warwick v. Richardson, 10 Messon & Welsby 284 (1842). In each of these cases, the court recognized that an indemnitor was obligated to pay the indemnitee's pre-notice costs. For example, in Mott, Mott co-signed a note to enable Hicks to make a purchase. The buyer brought suit against Mott on the note. Mott did not inform Hicks of this suit.

Ultimately, judgment was entered against Mott for the full amount of the note. Mott sought to recover the amount of judgment, as well as the costs of suit, from Hicks. In considering the amount of damages available to Mott, the court concluded that Mott was "entitled to recover, not only the amount of the note, but also the damages and costs sustained in consequence of the

suit against him." Thus, the court awarded Mott the defense costs he incurred, even though he did not notify Hicks of the suit in which he incurred those costs.

The California Supreme Court recently has addressed Section 2778. In Crawford v. Weather Shield Mfg. Inc., 44 Cal. 4th 541 (2008), drew a clear distinction between the duty to defend, which requires a tender, and the duty to pay defense costs, which does not require an advance tender. It explained: "A duty to defend another ... is thus different from a duty expressed simply as an obligation to pay another, after the fact, for defense costs the other has incurred in defending itself. Section 2778, the statute governing the construction of all indemnity agreements, makes the distinction clear" (emphasis added).

The court pointed to its earlier decision in Gribaldo, Jacobs & Associates v, Agrippina Versicherunges A. G., 3 Cal. 3d 434 (1970), noting that there the insurance policy expressed the intent that the insurers had no duty to defend and that the insureds did not ask them to defend in advance, so there was no breach of section 2778. Therefore, the court pointed out that in Gribaldo, insureds could not proceed under subdivision 4, but did recover under subdivision 3 defense costs that they had incurred.

The Crawford court also pointed to City of Watsonville v. Corrigan, 149 Cal. App. 4th 1542 (2007), endorsing the court of appeal's holding that "by failing to request a defense, or to notify the indemnitor of the third party action, and by unilaterally deciding to conduct its own defense, the indemnitee does not necessarily forfeit its contractual right to reimbursement of its defense costs under the indemnity provisions of subdivision 3 of the statute."

Therefore, the Crawford court concluded that the duty to defend "is nonetheless distinct and separate from the contractual obligation to pay an indemnitee's defense costs, after the fact, as part of any indemnity owed under the agreement."

Given the above, insureds should not readily acquiesce in a carrier's argument that there is no coverage for "pre-tender" fees. There may, indeed, be coverage for such fees in many circumstances.

Kirk Pasich is a partner at Dickstein Shapiro in Los Angeles and the chair of its insurance coverage practice. He represents insureds in complex coverage matters.