

Commentary

The 'Pre-Tender' Defense Costs Coverage Defense: A 'Real' Defense To Claims For Defense Costs Incurred By Additional Insureds Prior To Tender

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I. Introduction

Commercial general liability ("CGL") primary policies generally provide two types of benefits to insureds; a defense for potentially covered lawsuits and indemnification for judgments and settlements covered by the policy. An insurer's agreement to provide a defense to its insured has become, in many instances, more valuable than the insurer's promise to pay judgments. The insurer's promise to provide a defense, however, is not without preconditions. Commercial general liability policies require that insureds provide notice of claims or lawsuits "as soon as practicable" or, in more recent policies, "as soon as possible." Frequently, however, insureds fail to provide their insurers with timely notice and/or fail to timely tender their defense to their general liability carriers. There are a number of reasons for this circumstance. For example, insureds may fail to provide notice or tender a claim or lawsuit because they do not know or do not believe that a policy may provide coverage for the claim or lawsuit filed against them. Insureds may fail to provide notice and/or tender claims or lawsuits to their insurers

because they simply forget that policies even exist. This situation frequently arises in situations involving long-tail exposure claims or claims for coverage for long-term environmental contamination. In addition, insureds may consciously forego providing notice and/or tendering claims or lawsuits to their insurers on the belief that the claims or lawsuits lack merit or can be resolved quickly and inexpensively, thus avoiding the loss history.

While the aforementioned examples in no way exhaust the universe of reasons for an insured's failure to provide timely notice and/or tender of a lawsuit, one thing is fairly certain. Upon later discovery of the existence of the policy or realization that the claim or lawsuit cannot be easily resolved, an insured will inevitably look to its insurers to assume the defense and reimburse it for the pre-tender defense costs.¹ The issues surrounding notice and tender of claims become even more complicated when the party seeking a defense and coverage under the policy seeks coverage based upon its status as an "additional insured."² In many of these situations, the putative additional insured not only lacks a relationship with the insurer from which it is seeking a defense but the insurer's first notice of the existence of the specific entity seeking coverage often takes place upon receipt of the tender letter from that entity. In addition, the putative additional insured's notice to the carrier may take place months or perhaps years after the litigation has commenced, during which time the entity (or its own insurer) has incurred substantial defense costs.

This commentary begins by discussing the distinctions between the defenses of late-notice and pre-tender defense costs. Thereafter, it examines cases where courts have denied recovery of pre-tender defense costs and the primary bases upon which courts have relied in precluding the recovery of such costs. The commentary concludes by discussing the legal and practical bases for denying additional insureds' requests for reimbursement of pre-tender defense costs.

II. Differentiating Between The Late-Notice Defense And The Pre-Tender Defense Costs Defense

Although the coverage defense of late notice and the preclusion of recovery for pre-tender defense costs appear to be conceptually similar, they are actually separate and distinct coverage defenses and are treated as such by many courts. There are two critical distinctions between these related coverage concepts. The first is in the application of the two defenses. Although courts in a number of jurisdictions impose a prejudice requirement in order to avoid the consequences of an insured's breach of the notice provisions in a policy, the majority of courts that have recognized and applied the pre-tender defense cost defense do not impose such a prejudice requirement. See e.g. Faust v. Travelers, 55 F. 3d 471, 472 (9th Cir. 1995) (refusing to impose a prejudice requirement in denying an insured's request for reimbursement of defense costs incurred prior to tender of the lawsuit); Scottsdale Ins. Co. v. American Empire Surplus Lines Ins. Co., 791 F. Supp. 1079, 1084-85 (D. Md. 1992) (noting that although insurer could not deny coverage by virtue of the insured's late notice because the insurer was not prejudiced thereby, the insurer was not obligated to pay the defense costs incurred prior to tender); Xebec Development Partners, Ltd. v. National Union Fire Ins. Co., 12 Cal. App. 4th 501, 15 Cal. Rptr. 2d 726 (1993) (holding that the existence or absence of prejudice is irrelevant with respect to payment of defense costs incurred prior to tender as notice is a condition precedent to the insured's right to coverage).³ This important distinction was recognized in American Mut. Liab. Ins. Co. v. Beatrice Cos., 924 F. Supp. 861 (N.D. Ill. 1996) (applying Massachusetts law). The Court in American Mutual, in pointing out the distinction between late notice and the "no pre-notice defense costs rule" stated as follows:

The "no pre-notice defense costs" rule does not conflict with the "notice-prejudice" rule. For one thing, the two are contingent on separate acts. In deciding whether there is a duty to defend, the court must inquire into whether the insured tendered the defense to the insurer. It often happens that the insured tenders the defense when it provides notice of the claim. However, courts recognize that the two are not identical. On the other hand, in deciding whether late notice has absolved an insurer of its duty to reimburse for defense costs, the court must evaluate if — considering when the insured gave notice of the occurrence or claim — the insurer was prejudiced. The lines of inquiry are separate.

Id. at 873 (citations omitted).

The second critical distinction between the two defenses is in their effect. Whereas the insured's failure to provide timely notice results in a complete forfeiture of coverage under the policy, incurring defense costs prior to the insured's tender of its defense to an insurer normally only results in the insured's inability to recover such defense costs. In Thus, the inability to recover defense costs incurred prior to tender is essentially a partial coverage defense that does not involve the forfeiture of coverage.⁴ The United States District Court for the Northern District of Illinois in American Mutual described this important distinction in the following manner:

[T]he policies that prompted courts to graft the prejudice requirement onto the notice requirement have little bearing on the question of pre-tender defense costs. The prejudice requirement was adopted to prevent complete forfeiture based upon technical failure of the insured to provide timely notice. In contrast, enforcement of the rule that pre-tender defense costs are not recoverable does not result in complete forfeiture of an insured's right to recover fees. Rather, the rule gives the insured the choice of defending some or all of a claim on its own. There are tactical reasons why an insured may want to withhold the defense from an insurer that clearly covers a risk. For example, especially in a high-profile case, an insured may not want to lose control of

events to the insurer Because the policies justifying the prejudice requirement do not apply to the tender requirement, courts have concluded that (at least between sophisticated parties) the “no pre-tender defense costs” rule remains viable even in jurisdictions that have adopted the “notice-prejudice” rule.

Id. (citations omitted). Accordingly, it is not uncommon for an insurer to agree to defend an insured while at the same time refusing to reimburse the insured for the defense costs incurred prior to tender. In addition, it is not uncommon for courts to conclude that an insured has waived its right to recover pre-tender defense costs for failure to provide timely notice of a lawsuit but not its right to recover costs incurred after tender. *See Fireman's Fund Ins. Co. v. Ex-Cell-O Corp.*, 790 F. Supp. 1318 (E.D. Mich. 1992) (recognizing that an insured can waive some past defense cost coverage without waiving future coverage and that the moment of tendering the defense is the critical point in such a calculation).

With these two important distinctions in mind, we turn to the bases relied upon by courts in denying reimbursement of defense costs incurred by insureds prior to tendering the lawsuits to their respective insurers.

III. Jurisdictions Concluding No Coverage For Pre-Tender Defense Costs

Courts generally rely on two specific bases for concluding that insurers are not obligated to reimburse insureds for defense costs incurred by insureds prior to tender of their lawsuits. The first is based upon the act that gives rise to an insurer's duty to defend. More specifically, courts in a number of jurisdictions conclude that insurers are not liable for costs incurred by insureds prior to tender because an insurer's duty to defend does not arise until the insured provides notice and requests a defense. The second is based upon the voluntary payments provision contained in most CGL policies. Each of these bases will be examined in more detail below.

A. No Coverage For Pre-Tender Defense Costs Because Duty To Defend Is Not Triggered Until Tender of the Lawsuit

The first of the two primary grounds relied upon by courts to deny insureds' requests for reimbursement of defense costs incurred prior to tender focuses upon

the act that gives rise to the insurer's duty to defend. Courts in a number of jurisdictions have held that an insurer's obligation to defend its insured does not arise until the insurer is notified of the lawsuit. *See e.g. Rodriguez v. Texas Farmers Ins. Co.*, 903 S.W.2d 499, 507 (Tex. App. Amarillo 1995) (recognizing that the duty to defend arises upon proper notice, that is, the insured was served and the insured forwarded the citation to the insurer); *Oregon Ins. Guaranty Assoc. v. Thompson*, 760 P. 2d 890, 893 (Ore. App. 1988) (recognizing that notice of the claim is a condition precedent to the duty to defend). In reaching such a conclusion, courts often cite to the notice conditions contained in the policy. For example, most CGL policies contain a separate condition section captioned “Duties In the Event of Occurrence, Offense, Claim or Suit.” The requirements set forth in this section, to send suit papers immediately, to cooperate, to assist the insurer, etc., are placed upon the named insured and any other insured involved in the claim or suit. Accordingly, in jurisdictions where an insurer's duty to defend is not triggered until notice is provided by the insured, courts have generally held that defense costs incurred prior to tender are not covered, as coverage under the policy had not been triggered at the time the costs were incurred. *See Allan D. Windt, Insurance Claims and Disputes*, § 4.44 (4th Ed. 2001) (“[M]ost of the courts that have addressed the issue [of pre-tender defense costs] have held that an insurer is not liable for pre-tender defense costs because (1) the policy coverage is not triggered until such notice is given, and (2) until the policy coverage is triggered, defense costs are not covered.”). *See also Gully & Associates, Inc. v. Wausau Ins. Co.*, 536 So. 2d 816 (La. App. 1 Cir. 1988) (holding that an insurer's duty to provide a defense does not arise until the insurer receives notice of the litigation and that the insurer is not responsible for legal fees and costs incurred prior to the notification).

For example, in *Cellex Biosciences v. St. Paul Fire & Marine Ins. Co.*, 537 N.W.2d 621 (Minn. Ct. App. 1995), an insurer refused to reimburse an insured for the attorney's fees the insured incurred during the two months between the filing of the lawsuit and the insured's tendering of the lawsuit to its insurer. In upholding the trial court's grant of summary judgment in favor of the insurer, the Court of Appeals of Minnesota noted that tender of defense is a condition precedent to the duty to defend. *Id.* at 623. The Court, in relying on the principle that an insurer's

duty to defend does not arise until it receives tender of the lawsuit, concluded that the trial court did not err in ruling that the insured's expenses did not fall within the coverage provided by the policy. *Id.* As noted by the Court, "[the insurer] had not been notified of the claim; therefore, its duty to defend had not yet been invoked. *Id.* See also *Scottsdale Ins. Co. v. American Empire Surplus Lines Ins. Co.*, 791 F. Supp. 1079, 1084 (D. Md 1992) (concluding that the insurer was not obligated to pay the pre-tender defense costs as "it is well settled that an insurer's obligation to defend is triggered only when the insured tenders to the insurer the defense of an action.").

In a case decided several years later, the United States Court of Appeals for the Eleventh Circuit, applying Georgia law, focused exclusively on the notice provisions contained in a policy and concluded that an insurer, as a matter of law, was not responsible for pre-tender defense costs incurred by the insured. *Elan Pharm. Research Corp. v. Employers Ins. of Wausau*, 144 F.3d 1372 (11th Cir. 1998). In *Elan*, the insured sought reimbursement for two months of defense costs that it incurred in defense of a patent infringement case before it requested a defense from its insurer. *Id.* at 1374. During the two month period, the insured retained counsel and incurred over \$500,000 in defense costs. *Id.* at 1381. The trial court granted summary judgment in favor of the insurer on the issue and the insured appealed. *Id.* The Court of Appeals relied upon the language of the conditions provisions of the CGL policy that required notice "as soon as practicable" and that suit papers be forwarded "immediately" and concluded that the insurer was not obligated to pay the pre-tender defense costs. *Id.* The court explained that requiring the insurer to pay costs incurred before tender would render the "contractual terms necessary to trigger . . . [the insurer's] performance under the policy meaningless." *Id.* The Court further explained that the insurer's duty to defend was not triggered until the insured notified the insurer and "as a result, [the insurer] is not liable for the litigation expenses . . . incurred before that date." *Id.*

B. No Coverage For Pre-Tender Defense Costs Because Voluntary Payments Provision Provides That Such Costs Are Incurred At The Insured's Sole Expense

The second of the two primary grounds relied upon by courts to deny insureds' request for reimbursement

of defense costs incurred prior to tender is the voluntary payments provision contained in most standard general liability policies. Most CGL policies contain a separate condition section captioned "Duties In the Event of Occurrence, Offense, Claim or Suit." In the 2001 ISO CGL policy form, for example, the voluntary payments provision is set forth in subparagraph d. of the aforementioned section. The provision states:

- d. No insured will, except at that insured's own cost, voluntarily make a payment, assume any obligation, or incur any expense, other than for first aid, without our consent.

Insurance companies have successfully argued that pre-tender defense costs constitute voluntary payments and have relied upon the above-cited voluntary payments provision to defeat insureds' requests for reimbursement of defense costs incurred unilaterally by insureds prior to tendering the lawsuit to their insurers. See *Chesapeake & Ohio Ry v. Certain Underwriters at Lloyd's*, 834 F. Supp. 456, 461 (D.D.C. 1993) (concluding that an insurer's duty to defend is conditioned on the insurer giving consent to incur defense costs); *Crown Center Redevelopment Corp. v. Occidental Fire & Cas. Co.*, 716 S.W.2d 348, 357 (Mo. Ct. App. 1986) (acknowledging that the duty to defend is contractual and when the contract provides that the insurer will only pay those defense costs to which it consented, the insurer is not liable for any defense costs except for those it has expressly consented to pay).

For example, in *L'Atrium on the Creek I, L.P. v. National Union Fire Ins. Co.*, 326 F. Supp. 2d 787 (N.D. Tex. 2004), the insured retained its own counsel and began defending a case involving allegations that one of its employees had sexually assaulted a woman at an apartment complex. *Id.* at 790. Approximately two years after the lawsuit was filed, the insured for the first time requested that its insurer provide it with a defense. *Id.* at 791. The insured's counsel explained during a telephone call that he did not request a defense earlier in the litigation because the pending case law in the state suggested that the insurer would not have been obligated to provide a defense or indemnification. *Id.* The insurer ultimately agreed to provide a defense but refused to

reimburse the insured for defense costs incurred prior to the date the insured requested a defense. *Id.* at 792. In support of its position, the insurer cited to the voluntary payments provision in the policy. The insured filed suit seeking recovery of these costs and the insurer moved for summary judgment based, in part, on the voluntary payments provision. *Id.* The Court concluded that, as a matter of law, the insurer did not owe the insured a duty to reimburse it for expenses incurred in violation of the voluntary payments clause. *Id.* at 793.

In *Smart Style Indus. v. Pennsylvania Gen. Ins. Co.*, 930 F. Supp. 159 (S.D.N.Y. 1996), insureds sought reimbursement of legal fees they incurred in defense of an underlying trademark action. Although the insurer agreed to provide a defense to the insureds, it contested its obligation to pay for defense costs before the insureds requested a defense of the lawsuit. *Id.* at 162. In asserting this position, the insurer relied upon a voluntary payments provision which stated that “no insureds will, except at their own cost, voluntarily make payment, assume any obligation, or incur any expense, other than for first aid, without our consent.” *Id.* at 161. Although the court rejected the insurer’s argument that coverage was not triggered, pursuant to the voluntary payments clause, until an insurer actually gives its consent, the court did conclude that the insurer was only liable for the defense costs incurred after the date the insureds notified it of the action. *Id.* at 164. The court, in ruling in favor of the insurer and applying the voluntary payments provision to the pre-tender costs, recognized that one of the major principles underlying the need for the inclusion of such a provision in an insurance policy is to ensure that the insurer is in a position to control and influence the litigation strategy. In the *Smart Style* case, “the [insurer] had no opportunity to control the litigation or to influence the litigation strategy, as it had not been placed on notice of the lawsuit.” *Id.*⁵ See also *Wm. C. Vick Construction Co. v. Pennsylvania National Mut. Cas. Ins. Co.*, 52 F. Supp. 2d 569, 596 (E.D.N.C. 1999) (concluding that the insurer, pursuant to the voluntary payments provision, was not obligated to pay for pre-notification legal expenses and recognizing that “a contrary result would require the insurer to pay for those defense costs for which it had no opportunity to control.”).

In a more recent case, an insured filed suit against its general liability carriers seeking defense and settlement costs stemming from the failed sale of a home. *Tradewinds Escrow, Inc. v. Truck Ins. Exchange*, 97 Cal. App. 4th 704, 118 Cal. Rptr.2d 561 (Cal. App. 4th Dist. 2002). The insurer denied coverage based upon a provision that specifically excluded indemnity for actions based upon the furnishing of escrow services. *Id.* at 707. The insurer also refused to pay pre-tender defense costs in connection with the defense of the underlying action. *Id.* The insured delayed tendering the lawsuit to its general liability carrier as it believed that the lawsuit would be covered under its errors and omissions policy. *Id.* at 708. The policy at issue contained the standard voluntary payments provision that stated that “[n]o insureds will, except at their own cost, voluntarily make a payment, assume any obligation, or incur any expense, except for first aid, without our consent.” *Id.* at 710. In addressing the provision, the court noted that:

Such clauses bar reimbursement for pre-tender expenses based on the reasoning that until the defense is tendered to the insured, there is no duty to defend. They are also based on the equitable rule that “the insurer [is invested] with the complete control and direction of the defense” and cannot be expected to pay for that which it does not control. Only when the insured has requested and been denied a defense may it ignore the “no voluntary payment” provision of the policy. Thus, where the insured has failed to demand a defense and relinquish control over the case, it cannot expect the quid pro quo of pre-tender voluntary payments, expenses, or other obligations incurred by the insured pre-tender without the insurer’s consent.

Id. (citations omitted). The court ultimately concluded that the insurer was not obligated for the pre-tender defense costs incurred by the insured and that “a showing of prejudice is not part of the equation in evaluating the denial of pre-tender defense costs.” *Id.* at 711. In so holding, the court further noted that the seventeen-month delay in tendering the lawsuit to the insurer was the result of the insured’s mistaken belief that the insurance policy issued by its errors and omissions’ carrier would provide coverage for the lawsuit. *Id.* at 712.

IV. Reasons For Denying Additional Insureds' Attempts To Recover Pre-Tender Defense Costs

A. The Two Primary Principles For Denying Insureds' Requests For Reimbursement Of Pre-Tender Defense Costs Should Apply Equally To Additional Insureds

As set forth in the cases cited above, courts generally rely on two principles for denying insureds' requests for the reimbursement of pre-tender defense costs from their insurers. Both of these principles should apply, without exception, to entities seeking coverage under a CGL policy regardless of whether the entity is a named insured or an additional insured.

The plain language of standard CGL policies dictates that these two principles apply equally to any entity qualifying as an insured under the policy. In this regard, the notice requirements contained in section 2.c of standard CGL policies (captioned "Duties In the Event of Occurrence, Offense, Claim or Suit") require *insureds* to send suit papers immediately, to cooperate, and to assist the insurer. In addition, the voluntary payments provision broadly applies to all insureds as the provision states that "[n]o *insured* will, except at that *insured's* own cost, voluntarily make a payment, assume any obligation, or incur any expense . . ." (emphasis added). The inclusion of the word "insured" rather than "named insured" in each of these provisions clearly demonstrates the intent to have both the notice provisions and the voluntary payments provision apply equally to all insureds seeking a defense under the policy. Although some courts have refused to strictly apply one or both of these provisions in cases involving additional insureds, such refusals clearly contradict the plain and unambiguous policy language.⁶ See e.g. *The Kirby Co. v. Hartford Cas. Ins. Co.*, 2004 U.S. Dist. LEXIS 11736 (N.D. Tex. 2004) (denying an additional insured's request for pre-tender defense costs under a business insurance policy pursuant to the voluntary payments provision and rejecting the additional insured's claim that its lack of knowledge about the policy should excuse it for failing to give notice earlier).

Further, in seeking a defense as an additional insured under CGL policies, the additional insured almost always argues that it is entitled to all of the same rights and benefits under the policies as any other insured under the policy. Entities seeking coverage as additional insureds generally contend that, as an

insured, they are entitled to a full and complete defense and equal access to policy limits, among other benefits. Additional insureds should not be permitted to argue that they are entitled to all of the same rights as insureds under the policy but then argue that the corresponding duties and obligations applicable to insureds should not apply. Accordingly, the notice and voluntary payment provisions must be applied equally to all insureds seeking a defense under the policy. A contrary conclusion would effectively result in a more lenient grant of coverage to additional insureds than that granted to the named insured, the entity that actually paid the premium for the policy.

In addition, many CGL policies, including standard ISO CGL policy forms, memorialize the aforementioned equal application of policy duties and obligations to additional insureds through the inclusion of severability provisions. For example, the 1993 CGL ISO form contains the following "Separation of Insureds" policy condition:

7. Separation of Insureds

Except with respect to the Limits of Insurance, and any rights or duties specifically assigned in this Coverage Part to the first Named Insured, this insurance applies:

- a. As if each Named Insured were the only Named Insured; and
- b. Separately to each insured against whom claim is made or "suit" is brought.

Based upon the plain language set forth above, the duties and obligations under standard CGL policies apply separately, and equally, to all insureds. The plain language of the policy, therefore, dictates that the notice and voluntary payment provisions, which form the primary bases for denying requests for pre-tender defense costs, should and must apply to entities seeking a defense and/or coverage as additional insureds.

B. Courts Should Deny Additional Insureds' Requests For Pre-Tender Defense Costs Regardless Of Whether The Insurer Has Been Prejudiced

Additional insureds seeking recovery of pre-tender defense costs generally contend that they are entitled

to such costs because the insurer has failed to demonstrate that it has been prejudiced by the defense costs incurred by the additional insured. Although the reasons for the failure of the additional insured to tender the claim and/or request a defense vary, additional insureds almost always argue that the insurer was not prejudiced because the defense of the putative insured, and by extension the costs incurred in the defense, inure to the benefit of the insurer. In other words, additional insureds contend that the insurer benefits from the defense because an aggressive and timely defense will result in lower overall exposure to the insurer (as the party who may be held liable for any settlements or judgments). The attempt to impose a prejudice requirement to the pre-tender defense cost defense is a carry-over from the prejudice requirement imposed by many jurisdictions in applying the late notice defense. Although courts in many jurisdictions now require a showing of prejudice in order to prevail on a late notice defense, a showing of prejudice has no place in the application of the pre-tender defense cost defense. See *Ingalls Shipbuilding v. Federal Ins. Co.*, 410 F.3d 214, 227 (5th Cir. 2005) (Mississippi law) (refusing to permit an additional insured from recovering defense costs incurred during the four and one-half months between its being added as a party and its tender to the insurer even absent a showing of prejudice and commenting that the additional insured, as a sophisticated party “could have been expected to request a defense under the policy if it had desired one” as “it would be absurd to require an insurance company to force itself on such a sophisticated party if its services have not been requested.”).

As explained in detail above, the pre-tender and late notice defenses are separate coverage defenses that differ both in their application and in their effect. In addition, as noted by the United States District Court for the Northern District of Illinois in *American Mutual*, “the policies that prompted courts to graft the prejudice requirement onto the notice requirement have little bearing on the question of pre-tender defense costs.” *American Mutual*, 924 F. Supp. at 873 (noting that the prejudice requirement was adopted to prevent complete forfeiture based upon technical failure of the insured to provide timely notice). Courts should therefore deny additional insureds’ requests for reimbursement of pre-tender defense costs regardless of whether the insurer has been prejudiced.

C. Refusing Additional Insureds’ Requests For Payment Of Pre-Tender Defense Costs Creates An Incentive For Prompt And Timely Notice

The situation giving rise to an entity’s request for a defense as an additional insured often stems from some type of contractual relationship between the additional insured and the named insured. The insurer, in most instances, is unaware that the named insured has entered into a specific contract whereby the named insured agreed to provide coverage to a potential additional insured. Although the insurer may be aware that the policy at issue contains provisions and/or an endorsement that permits the inclusion of additional insureds, the insurer will most likely be unaware of the actual entity to which coverage has been extended through the contractual relationship between the named insured and the additional insured. When claims are later made or suits are brought against both the named insured and the additional insured, the insurer will likely be unaware that it has additional exposure as a result of the coverage extended to the additional insured.

The additional insured, however, is often aware or should be aware of the coverage provided by the insurer. The additional insured’s contract, lease or other contractual linkage to the named insured’s policy typically requires disclosure of the name of the insurer and a Certificate of Insurance, which provides the details of the company’s insurance program. The named insured is usually obligated, if not willing, to provide the information. Further, the additional insured can immediately send its tender even to an unknown insurer by sending such tender or demand in writing to the named insured who will, in turn, forward the tender on to its insurer.

As set forth above, courts in many jurisdictions have required a showing of prejudice in order for an insurer to prevail on a late notice defense. In light of the prejudice requirement, the insurer may have a difficult time prevailing on such a defense. Sophisticated insureds are likely aware of this fact and will therefore choose to select their own counsel and control the defense and then later seek reimbursement from the insurer. Consequently, insurers are very often faced with situations in which an additional insured has retained its own counsel and incurred defense costs prior to requesting a defense and/or

without the insurer's consent. Absent a relationship between the insurer and the additional insured, there is very little incentive for the additional insured to tender the lawsuit at the outset of litigation. However, if courts deny additional insureds' requests for reimbursement of pre-tender defense costs, those same sophisticated insureds may think twice before incurring defense costs without notifying the insurer of their claims for coverage as additional insureds. Denying recovery for pre-tender defense costs, therefore, provides additional insureds with an incentive to involve the insurance carrier in the earliest stages of litigation. The insurer can then, in turn, set appropriate reserves, determine its potential exposure, and control and formulate a strategy for defending the case. Also, it is important for the insurer to be aware of an additional insured's claim for coverage at the early stages of litigation as the extension of a defense and coverage to the additional insured will likely impair the policy limits of the named insured's policy or, at the very least, change the manner in which the insurer handles settlement since both the named and additional insured will ostensibly be making claims for the same policy limits.

**D. Denying Reimbursement Of
Pre-Tender Defense Costs Recognizes
The Insurers' Contractual Obligations
Under Liability Policies**

Insurers generally have two contractual obligations under CGL policies: (1) a duty to pay damages to which the policy applies; and (2) a duty to defend any suit seeking those damages. In complying with defense obligations, insurers, in turn, are afforded the opportunity to select counsel and control the defense and settlement of claims or suits. By permitting recovery of pre-tender defense costs to additional insureds courts are, in essence, sanctioning a procedure by which defense costs are incurred at the insured's sole discretion and then simply reimbursed by insurers without any insurer input into the nature or cost of the expense incurred. As one recent federal court has noted, such a procedure "would essentially turn an insurer's defense obligation into a duty to reimburse, without affording the insurer the opportunity to control the defense and settlement of the underlying obligation." *Century Indem. Co. v. Aero-Motive Co.*, 318 F. Supp.2d 530, 544 (W.D. Mich. 2003). A duty to reimburse, however, is not a duty or obligation assumed by insurers under standard CGL policies. In

fact, the voluntary payments provision aims to ensure that an insurer's duty to defend is not transformed into a duty to reimburse. Accordingly, courts should deny additional insureds' requests for reimbursement of pre-tender defense costs, regardless of the cause of the delay in tendering the lawsuit, because to hold otherwise would impose a duty on insurers that they did not assume when issuing the policy.

V. Conclusion

Courts should apply the same rationale to additional insureds as to named insureds in precluding additional insureds' requests for reimbursement of defense costs incurred prior to tender. Precluding recovery of pre-tender defense costs not only results in the enforcement of the duties assumed by insurers under the plain language of CGL policies, but it encourages entities seeking coverage as additional insureds to tender claims and lawsuits in the earliest stages of litigation. The insurer is then, in turn, in a better position to formulate a defense strategy and manage the risk on behalf of both the additional insured and the named insured (the party that actually paid the policy premium). The pre-tender defense costs coverage defense, therefore, constitutes an equal coverage defense to claims for pre-tender defense costs incurred by named insureds as well as additional insureds.

Endnotes

1. In many cases, notice and tender take place simultaneously. As such, the term "pre-tender defense costs" for purposes of this commentary includes both defense costs incurred by an insured prior to notice and defense costs incurred by an insured prior to tender.
2. The term "additional insured" for purposes of this commentary is used broadly to include an entity that is not the Named Insured.
3. But see *Nationwide Mut. Fire Ins. Co. v. Beville*, 825 So. 2d 999, 1004 (Fla. Dist. App. 4th Dist. 2002) (applying the standard notice-prejudice rule to an insurer's refusal to pay pre-tender defense costs and holding that the insurer is liable for such costs absent a suggestion that the insured's expenses were unreasonable or in some way prejudicial to

the insurer); Westchester Fire Ins. Co. v. G. Heileman Brewing Co., Inc., 321 Ill. App. 3d 622, 747 N.E.2d 484 (2001) (concluding that insurers must show prejudice in order to deny coverage for pre-tender defense costs).

4. The conduct of the pre-tender defense, however, may implicate coverage defenses associated with the duty to cooperate or to avoid voluntary payments.
5. This rationale makes sense in light of the fact that the insurer is the entity that is being asked to pay the defense costs and the entity which, in most instances, faces actual exposure for any settlements or judgments resulting from the case. The insurer has both the right and the duty to defend. The insurer, then, must be in a position to control and influence

the litigation. The voluntary payments provision is one mechanism for ensuring insurer control.

6. The most common example is when courts simply ignore the notice provisions of the policy and permit additional insureds to recover pre-tender defense costs (or pre- and post-tender defense costs) despite untimely notice/tender on the grounds that the untimely notice/tender was due to "excusable neglect." See e.g. Collins v. Grange Mutual Cas. Co., 2004 Ohio 5434 (Ohio Ct. App. 2004) (recognizing that where the additional insured's ignorance of coverage is understandable, failure to give timely notice is excusable). Courts should reject such excuses as the putative insureds are often large, sophisticated companies with risk managers who are well aware of the coverage available to the company. ■