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Pre-Suit Duties of Insurers and Policyholders: Differing Judicial Constructions

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Commercial general liability (CGL) policies are sometimes referred to as "litigation insurance." These policies typically obligate the insurer to defend any "suit" seeking potentially covered "damages" that the insured may be "legally obligated to pay." Since 1986, standard CGL policy forms have defined "suit" to include a "civil proceeding" and an "arbitration proceeding," and in 1988, "[a]ny other alternative dispute resolution proceeding" was added to the definition.

In the context of a CGL insurer's duty to defend, the definition of "suit" seems straightforward enough. However, the issue of whether an insurer has any obligations before a "suit" is filed can engender disputes between insurers and insureds, particularly because not all jurisdictions are in agreement regarding the scope of an insurer's pre-suit obligations.

Consider, for example, the lurid facts of *Sanders v. Phoenix Insurance Co.*, 843 F.3d 37 (1st Cir. 2017). A divorce attorney (Doe) had an intimate relationship with a client (Sanders), who later committed suicide. Sanders's estate (Estate) blamed Doe for the death. It served Doe and his law firm with a pre-suit demand letter, as required by M.G.L. ch. 93A. Under Massachusetts law, plaintiffs are required to send such a letter at least thirty days before bringing suit for "unfair or deceptive acts or practices in the conduct of any trade or commerce." The purpose of the demand letter requirement is to avoid litigation by giving the recipient the opportunity to respond with a reasonable settlement offer; if the recipient does not make a "reasonable offer of settlement," it becomes liable for treble damages and attorneys' fees.

Doe received the letter. He forwarded it to his professional liability carrier. The carrier denied coverage on various grounds, including the absence of an actual, filed "suit" for "damages." Fearing reputational damage if his name was "exposed in public court documents," Doe then entered into pre-suit settlement discussions with the Estate. After mediation, the case settled, and Doe resolved the case without suit being filed. As part of the resolution, Doe agreed with the Estate to a negotiated sum – $500,000 – and assigned the Estate his rights against the insurer with respect to its failure to defend or indemnify him.

The insurer argued successfully – in the district court and the First Circuit – that Doe had no such rights under Massachusetts law. "The Policy … provides that it must only furnish counsel to defend

the insured in the face of a suit …. [The insurer] has no obligation to provide a defense in the absence of a suit." *Sanders*, 843 F.3d at 37. Because Sanders's claim was resolved prior to litigation, the courts found, Doe's policy was not triggered, and no coverage obligations arose.

Interestingly, in reaching this conclusion, both courts rejected a prior district court decision, *Cytosol Labs., Inc. v. Federal Insurance Co.*, 536 F. Supp. 2d 80 (D. Mass. 2008), which found a pre-suit MGL ch. 93A demand letter *did* trigger a duty to defend:

> Although not a formal lawsuit, …. Cytosol's failure to respond adequately to the letter would significantly affect its ability to defend itself in a subsequent action involving these same issues. In addition, [the claimant] stands ready to file suit, and the only reason [it] has not sued Cytosol is because of a tolling agreement …. Accordingly, a duty to defend is triggered, and this court has jurisdiction to consider this dispute.

Id. at 90. How could two courts – applying the same policy language to the same type of pre-suit demand letter – get to such seemingly divergent results?

DISCUSSION

I. The CGL Policy Language

A. The Requirement of A "Suit"

The standard CGL policy insuring agreement, Form CG 00 01 12 07, begins as follows:

> We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. We will 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 "bodily injury" or "property damage" to which this insurance does not apply. We may, at our discretion, investigate any "occurrence" and settle any claim or "suit" that may result …

The policy defines "suit" as follows:

> "Suit" means a civil proceeding in which damages because of "bodily injury," "property damage," or "personal and advertising injury" to which this insurance applies are alleged. "Suit" includes:
>
> a. An arbitration proceeding in which such damages are claimed and to which the insured must submit or does submit with our consent;

> b. Any other alternative dispute resolution proceeding in which such damages are claimed and to which the insured must submit or does submit with our consent.

As with all policy provisions, this language defines and limits the parties' obligations. So, for the most part – with limited exceptions – an insurer has no duty to defend its insured unless there is some adversary legal proceeding, falling within the policy definition of "suit." (Of course, there are occasions when an insurer may choose to become involved, prior to the filing of a "suit," even though it has no clear legal duty to do so. For example, a carrier may conclude that both the carrier and the policyholder would benefit from pre-suit settlement. By getting involved early, the carrier may be able to prevent the claim from escalating. It may be able to avoid unnecessary and potentially large attorney fee expenditures to litigate a covered claim with a high likelihood of liability. In general, however, the decision as to whether to become involved in this way is left to the discretion of the carrier and its claims personnel. Tying an insurer's obligation to the existence of a "suit" in this way makes sense in that it provides insurers with a definable event that triggers their policy obligations.

Tying an insurer's obligation to the existence of a "suit" may also make sense from the perspective of defining and underwriting risk. Underwriters, who are charged with evaluating and pricing risks, can readily access information as to the number and extent of suits, or damage awards against a company, or within a relevant industry group or segment. By manipulating and analyzing this data, they can reach a pricing formula that accurately and fairly reflects the exposure of a particular insured to future "suits" of similar kinds. Using these numbers, they can fairly agree to transfer and assume some of that risk.

By contrast, when demands are resolved informally (prior to suit being filed) it is much harder for underwriters to identify, valuate and price the exposures presented. These claims are not tested through litigation. They are not usually reduced to a judgment or settlement through an adversary process. They may be negotiated and resolved based on abstract concepts of "fairness," with an eye toward the preservation of ongoing business relationships, or the avoidance of negative publicity, or other matters that difficult to estimate monetarily, and are not properly the concern of insurers.

Finally, pre-suit settlements tend to be private. They may or may not be reported, and – particularly in cases where the carrier has not been properly notified – they may be infected by collusion between the insured and the injured party. *Gribabldo, Jacobs, Jones & Assoc. v. Agrippina Versicherungers A.G.*, 3 Cal.3d 434, 449 (1970) (noting concern "to prevent collusion as well as to invest the insurer with the complete control and direction of the defense or compromise of suits or claims.")

B. The Requirement of "Damages"

In addition to the requirement of a "suit," there is also a second requirement that must be met to trigger an insurer's obligations under the policy insuring agreement: the suit must be one for "damages" to which the policy applies. In most policies, the term "damages" is not defined. Although the term is generally understood to include compensatory monetary relief, other types of relief may also constitute "damages." For example:

- *Injunctive Relief*

  Some jurisdictions, such as California, have found that "damages" requires a payment of money, and does not include injunctive relief. *See Columbia Cas. y Co. v. Gordon Trucking, Inc*., 758 F. Supp. 2d 909 (N.D. Cal. 2010). In other jurisdictions, the term "damages" may include injunctive relief. *See, e.g., School Union No. 37 v. United Nat'l Ins. Co.*, 617 F.3d 554, 563 (1st Cir. 2010); *Omega Flex, Inc. v. Pac. Emplrs. Ins. Co.*, 78 Mass. App. Ct. 262, 267 (2010). Moreover, a legal proceeding that seeks injunctive relief and "other relief" has been found to trigger an insurer's duty to defend. *See Country Mut. Ins. Co. v. Bible Pork, Inc.*, 2015 IL App (5th) 140211.

- *Statutory Damages, Fines or Penalties*

  When fines or penalties are involved, some courts deem it to be against public policy to shift such costs to insurers. *See, e.g., Carney v. Coull Bldg. Inspections, Inc.*, 847 N.Y.S.2d 895 (2007); *State Farm Fire & Cas. Co. v. Martinez,* 26 Kan. App. 2d 869, 875 (2000). In other cases, the question of whether statutory damages or penalties constitute covered "damages" may depend on whether the specific damages, fines or penalties at issue are compensatory or punitive in nature and, if the latter, whether applicable public policy precludes coverage for punitive relief. *See Standard Mut. Ins. Co. v. Lay*, 2013 IL 114617 (statutory damages available under the federal Telephone Consumer Protection Act of 1991 are covered because they are remedial in nature and not punitive); *Ulta Salon v. Travelers Property Cas. Co. of Am.*, 2011 WL 2279527 (Cal. App. 2011) (civil penalties sought pursuant to the California Safe Drinking Water and Toxic Enforcement Act of 1986 for failure to warn of a harmful toxin not covered because not damages because of bodily injury).

- *Plaintiff's Attorney Fee Awards*

  Many, but not all, courts have found that a plaintiff's attorney fee award constitutes damages. *See Mid-Continent Cas. Co. v. Petroleum Solutions, Inc.*, No. 4:09-0422, 2016 WL 5539895 (S.D. Tex. Sept. 29. 2016) (attorneys'

fee award under the Texas Product Liability Act against an innocent seller qualified as "damages … because of property damage" but seller's attorneys' fees incurred in successfully prosecuting its claim against the manufacturer did not constitute "damages"); *Church Mut. Ins. Co. v. Exec. Bd. of the Mo. Baptist Convention*, No. 03-4224-CV-W-SOW, 2005 WL 1532948, at *10 (W.D. Mo. June 24, 2005) (award of attorneys' fees and costs "is indistinguishable from a damages award for [insurance] coverage purposes."). Some courts find that plaintiff's attorney fee awards are court costs, which are covered as part of the insurer's duty to defend, rather than damages. *See Prichard v. Liberty Mut. Ins. Co*., 84 Cal. App. 4th 890 (2000).

II. The Insured's Pre-Suit Duties

For obvious reasons, CGL policies require insureds to notify their insurers promptly of any "suit," seeking "damages," that may be covered under a policy. The purpose of these provisions is to allow insurers to involve themselves in the resolution of such "suits," and to efficiently manage their own and their insured's financial exposures.

Toward this end, most policies contain language like the following, captioned "Duties In The Event Of Occurrence, Offense, Claim Or Suit":

> b. If a claim is made or "suit" is brought against any insured, you must:
>
> > (1) Immediately record the specifics of the claim or "suit" and the date received; and
> >
> > (2) Notify us as soon as practicable.
> >
> > You must see to it that we receive written notice of the claim or "suit" as soon as practicable.
>
> c. You and any other involved must:
>
> > (1) Immediately send us copies of any demands, notices, summonses, or legal papers received in connection with the claim or "suit,"
> >
> > (2) Authorize us to obtain records and other information,
> >
> > (3) Cooperate with us in the investigation or settlement of the claim or defense against the "suit," and

(4) Assist us, upon our request, in the enforcement of any right against any person or organization which may be liable to the insured because of injury or damage to which this insurance may also apply.

In addition to notice of suits and claims, CGL policies require insureds to notify their insurers "as soon as practicable of an 'occurrence' or an offense which may result in a claim." ISO CGL form CG 00 01 04 13, for example, states as follows:

a. You must see to it that we are notified as soon as practicable of an "occurrence" or an offense which may result in a claim. To the extent possible, notice should include:

(1) How, when and where the "occurrence" or offense took place;

(2) The names and addresses of any injured persons and witnesses; and

(3) The nature and location of any injury or damage arising out of the "occurrence" or offense.

Finally, most CGL policies make clear that there is no coverage for "voluntary payments," i.e.., payments incurred by an insured without the assent of an insurer: "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."

III. Risks of Ignoring Pre-Suit Policy Language

A. Risks To Insureds – Untimely Notice

In some cases, insureds fail to provide timely notice to an insurer of an occurrence, claim or suit. Many such delays are innocent: the insured was simply unaware of its coverage, or did not anticipate that the suit would proceed, or simply forgot to provide notice.

In some cases, however, insureds may intentionally delay in notifying their insurers of a claim, particularly a claim that has not yet ripened into a formal lawsuit. For example, an insured might not want to immediately cede the handling of a civil claim to its insurer, because of concerns for potential collateral consequences – negative publicity, impact to reputation, unwanted regulatory attention, even criminal liability. Recognizing that insurance is, fundamentally, a financial relationship – an insurer's principal goal is to address and resolve the monetary impacts of a claim – an insured might not trust the insurer to manage these other aspects with proper sensitivity. By intentionally delaying in notifying its insurer of a claim, the insured may hope to keep the insurer at arm's length until the risk of regulatory or reputational harm have died down, or other collateral aspects of the matter have been addressed.

Courts treat the consequences of late pre-suit notice in a variety of ways. In most jurisdictions, an insurer cannot deny coverage based on the timing of the insured's notice unless the insurer can demonstrate that it was prejudiced by the late notice. *See, e.g., Sherwood Brands, Inc. v. Great Am. Ins. Co.*, 13 A.3d 1268, 1270 (Md. 2011); *Stresscon Corp. v. Travelers Prop. Cas. Co. of Am.*, 2013 COA 131, ¶ 26 (Colo. Ct. App. 2013); *Ansul, Inc. v. Emp'rs Ins. Co.*, 2012 WI App 135, ¶ 24 (Wis. Ct. App. 2012). In some instances, the prejudice requirement is statutory. See, e.g., Mass. Gen. Laws ch. 175, § 112; Md. Code Ann., Ins. § 19-110; Wis. Stat. § 631.81. But in a few jurisdictions, lack of timely notice is a valid coverage defense, regardless of prejudice. See, e.g., *Travelers Indem. Co. of Ill. v. United Food & Comm'l Workers Int'l Union*, 770 A.2d 978, 991 (D.C. 2001); *Fireman's Fund Ins. Co. v. Care Mgmt.*, 361 Ark. 800 (Ark. 2010). And in other jurisdictions, prejudice may be considered only if the insured has a reasonable justification for the delay. *See County Mut. Ins. Co. v. Livorsi Marine, Inc.*, 856 N.E.2d 338 (Ill. 2006). Even in jurisdictions that require prejudice as a basis for denial of coverage, prejudice will often be found if the insurer is deprived of the opportunity to investigate or defend.

A delay in notice may also leave the insured liable for the costs incurred in defending a matter prior to the date notice was given. While courts are split regarding whether an insurer is liable for pre-tender defense expenses, a majority of courts find that pre-tender defense expenses are not covered. These courts reason that "a tender of defense is a condition precedent to the creation of a duty to defend," *Towne Realty, Inc. v. Zurich Ins. Co.*, 548 N.W.2d 64, 68 (Wis. 1996), and the insurer "can only be liable for damages which 'naturally flow' from its breach of a contractual duty," and no such duty exists until the insured puts the insurer on notice of a claim. Towne at 68 (citation omitted, emphasis in original). *See also Elan Pharm. Research Corp. v. Employers Ins. of Wausau,* 144 F.3d 1372 (11th Cir. 1998) (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.")

There is, however, a substantial minority view that insurers should be required to pay pretender defense expenses. These courts reason that there is nothing in the CGL policy that ties an insurer's duty to defend to notice. Instead "the duty to defend arises when an underlying suit is brought against the insured with allegations that are arguably within the scope of the insurance policy's coverage . . . an insurer's duty to defend is triggered when the underlying claim is brought and thus pre-exists any obligation on the part of the insured as to notice or compliance with the voluntary payment provision of an insurance contract." *Episcopal Church v. Church Ins. Co.*, 53 F. Supp. 3d 816, 828 (D.S.C. 2014).

As another court reasoned, to hold that "the duty to defend could not possibly arise before notice or tender" would:

> confuse events which give rise to the duty to defend (an underlying suit is brought against the insured with allegations that are arguably within the insurance policy's indemnification provisions) and events which give rise to an insurer's breach of that duty (awareness of the need for defense and an

> unjustified refusal to defend) . . . . [T]he duty to defend pre-exists any obligation on the part of the insured as to notice or compliance with the voluntary payment provision of an insurance contract . . . . The duty arises when the underlying claim is brought and thus pre-exists the insured's obligation to notify its insurer of that suit.

Liberty Mut. Ins. Co. v. Black & Decker Corp., 383 F. Supp. 2d 200, 205 (D. Mass. 2004) (quoting *Aetna Cas. & Surety Co. v. Dow Chem. Co*., 44 F. Supp. 2d 847, 857 (E.D. Mich. 1997)). Jurisdictions that require insurers to cover pre-tender defense expenses typically hold that the "insurer must establish prejudice to forfeit the coverage to which the insured would otherwise be entitled." *See Weaver v. State Farm Mut. Auto. Ins. Co.*, 936 S.W.2d 818, 821 (Mo. banc 1997). According to the Weaver court, a notice condition is not a "technical escape-hatch by which to deny coverage in the absence of prejudice nor to evade the fundamental protective purpose of the insurance contract to assure the insured and the general public that liability claims will be paid up to the policy limits for which premiums were collected." Weaver, 936 S.W.2d at 820. *See also Smith & Nephew, Inc. v. Federal Ins. Co.*, 2005 WL 3434819 (W.D. Tenn. 2005) ("a prejudice analysis should apply to both the existence of a duty to defend after late notice, as well as to whether that duty includes pre-tender costs"); *TPLC, Inc. v. United Nat'l. Ins. Co.,* 44 F.3d 1484 (10th Cir. 1995) (finding insurer cannot avoid paying pre-tender defense costs absent a showing of prejudice); *Griffin v. Allstate Ins. Co.*, 29 P.3d 777 (Wash. 2001).

The bottom line, in many jurisdictions, is that timely notice may be crucial – at a minimum, to avoid prejudice to an insurer – when a pre-suit dispute becomes a filed lawsuit. It is less common for insurers to be able to establish prejudice from late notice of an "occurrence," particularly because insurers often contend that their duty to defend does not arise until a suit is filed. But even before a lawsuit is filed, there may be compelling pragmatic reasons for an insured to give prompt notice of an occurrence or claim that could become a suit. First, as noted above, the insurer may agree to provide defense counsel to investigate and attempt to resolve the claim before litigation is filed. Second, as discussed below, there are instances in which pre-suit demands may trigger an insurer's duty to defend. Providing prompt notice maximizes the potential that if a pre-suit demand is deemed to be a "suit" for purposes of CGL coverage, the insurer will be required to pay for pre-suit defense expenses.

B. Risks To Insureds – Voluntary Pre-Suit Payments

Sometimes – as in the Sanders case, above – policyholders facing *potential* litigation want to minimize their risk and exposure by engaging in pre-suit settlement discussions, and even pre-suit settlement agreements. In such cases, the preferred practice is for the insured to notify the insurer. In some cases (as noted above) the insurer may agree to become involved – notwithstanding the lack of a clear legal duty to do so – if it believes its interests are aligned with the insured's, and early involvement could head off a larger future liability that is likely to be covered under the policy.

On the other side of the coin, most, if not all, CGL policies include a consent to settle provision that prohibits an insured from settling claims without the consent of the insurer. The standard form of these provisions is quoted above. It provides:

> 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.

A more elaborate clause was construed in *First Commonwealth Bank and First Commonwealth Financial Corporation v. St. Paul Mercury Insurance Company*, 2014 U.S. Dist. LEXIS 141538 (Oct. 6, 2014). It provides:

> [t]he Insureds agree not to settle or offer to settle any Claim, incur any Defense Costs or otherwise assume any contractual obligation, admit any liability, voluntarily make any payment or confess or otherwise agree to any Damages or judgments with respect to any Claim covered by this Policy without the Insurer's written consent, which shall not be unreasonably withheld. The Insurer shall not be liable for any settlement, Defense Costs, assumed obligation, admitted liability, voluntary payment, or confessed or agreed Damages or judgment to which it has not consented."

If a policyholder – in contravention of these clauses – enters into a pre-suit settlement agreement or voluntarily makes payments to a claimant, most jurisdictions hold that the carrier will not be liable for such settlement. Though there are some circumstances in which an insurer's conduct may result in waiver or estoppel of the insurer's ability to rely upon the consent to settlement provision—including notice, failure to notify insured of the consent to settle requirement, breach of the policy or duty of good faith and fair dealing, and failure to intervene—such circumstances are beyond the scope of this article.

It should also be noted that there are a few jurisdictions, Arizona included, that have broadly interpreted the term "legally obligated to pay" and have required carriers to indemnify policyholders for pre-suit payments and/or voluntary settlements. Thus, in *Desert Mountain Properties Ltd. P'ship v. Liberty Mut. Fire Ins. Co.*, 225 Ariz. 194, 197, ¶ 1, 236 P.3d 421, 424 (Ariz. Ct. App. 2010), *aff'd*, 226 Ariz. 419, ¶ 1, 250 P.3d 196 (2011), soil settlement caused cracks and other damage to 50 new homes. After multiple complaints from October 1999 throughout 2000 from customers, the developer, Desert Mountain Properties, incurred average costs of $200,000 per home to correct the soils issues and repair the damage. *Id.* On May 16, 2001, Desert Mountain sent notice of a claim to Liberty Mutual for coverage for already incurred repair costs of $640,000 and additional necessary repairs. Liberty Mutual requested additional information before making a coverage determination. Desert Mountain informed Liberty Mutual that it needed to proceed with repairs over the summer months when residents would be away so as to avoid relocation costs. Liberty Mutual again requested the additional information and informed Desert

Mountain that it was not authorizing the repair work. Desert Mountain provided some, but not all, of the requested documents by the end of June 2001. *Id.* at 198, 425.

Desert Mountain, believing it had an obligation to repair the damages, continued to make additional repairs. Eventually, in February 2003, Liberty Mutual denied Desert Mountain's claim for coverage citing, among other provisions, the policies' voluntary payments provision. Desert Mountain sued Liberty Mutual, and a jury found in favor of Desert Mountain on its contract claim. *Id.* at 199, 426.

On appeal, Liberty Mutual argued that "because none of the homeowners sued Desert Mountain over the soil settlement problems, Desert Mountain was not 'legally obligated' to make the repairs." *Id.* at 200, 427. Liberty Mutual also argued that it "agreed to pay monetary damages for [Desert Mountain's] legal obligations for causing property damage; it did not underwrite a warranty program for [Desert Mountain] to rectify its defective work." *Id.*

Liberty Mutual relied upon California cases holding that "an insurer's duty to indemnify an insured for sums the insured becomes 'legally obligated to pay as damages' only extends to amounts a court has ordered the insured to pay." *Id. citing County of San Diego v. Ace Prop. & Cas. Ins. Co.*, 37 Cal.4th 406, 33 Cal.Rptr.3d 583, 118 P.3d 607, 617 (2005) ("'damages' has legally and traditionally always been understood as limited to money ordered by a court"); Certain Underwriters at *Lloyd's of London v. Superior Court*, 24 Cal.4th 945, 103 Cal.Rptr.2d 672, 16 P.3d 94, 105 (2001) ("insurer's duty to indemnify the insured for 'all sums that the insured becomes legally obligated to pay as damages' is limited to money ordered by a court").

The Arizona Court of Appeals rejected the California courts' reasoning as the minority view, and reasoned that a legal obligation to pay "means any obligation enforceable by law, including, for example, an obligation created by statute, contract or common law." *Desert Mountain Properties*, 225 Ariz. at 201, 236 P.3d at 428 (Ariz. Ct. App. 2010). The Arizona Court of Appeals held that "coverage for sums an insured becomes 'legally obligated to pay as damages' may be triggered even in the absence of a civil lawsuit against the insured or a court order requiring the insured to make payment." *Id.*

The Arizona Court of Appeals also rejected the idea that interpreting the "legally obligated to pay" language as it did would result in carriers being obligated to pay meritless claims: "But the insuring clause imposes no indemnification obligation when an insured pays to settle a meritless claim; if a claim lacks merit, the insured by definition is under no "legal obligation to pay."

Liberty Mutual next argued that the policy's voluntary payments provision precluded coverage because the insured voluntarily incurred repair costs without Liberty Mutual's consent. *Id.* at 206, 433. The Arizona Supreme Court previously held that the purpose of voluntary payments provision is "to protect the insurer's right to a fair adjudication of the insured's liability and to prevent collusion between the insured and the injured person." The court held an insured's breach of the clause ordinarily would "relieve[ ] a prejudiced insurer of liability under the policy." *Id. citing*

Arizona Property & Casualty Insurance Guaranty Fund v. Helme, 153 Ariz. 129, 136, 735 P.2d 451, 458 (1987). In *Desert Mountain Properties*, The Arizona Court of Appeals found that Liberty Mutual did not establish prejudice because it did not contest that the repairs were reasonable and necessary, or that the insured's voluntary payment affected Liberty Mutual's ability to settle or defend the claims. *Desert Mountain Properties*, 225 Ariz. at 206, 236 P.3d at 428 (Ariz. Ct. App. 2010).

Consequently, and contrary to the majority of jurisdictions, the Arizona Court of Appeals held: (1) a carrier's duty to indemnify an insured for settlement payments prior to a "suit," and (2) a carrier can only rely upon the voluntary payments provision if its ability to defend or settle the claim was prejudiced by the voluntary payment.

C. Risks To Insurers – Assuming Pre-Suit Obligations

As stated previously, a carrier may sometime have incentive to step up to provide a defense to its insured – or even to resolve a potential claim, prior to suit being filed. However, a carrier that does this may also face risks of its own. Among other things:

- The carrier may have difficulty recovering from its reinsurers. *See, e.g., American Empl. Ins. Co. v. Swiss Reinsurance America Corp.*, 275 F.Supp.2d 29 (D. Mass. 2003) (denying reinsurance cover for carrier that entered global pre-suit settlement of environmental claims, including at twenty-seven sites where the carrier "had no information … and [was] thus unable to assess … alleged damages")

- The carrier may find the insured arguing later that its provision of presuit defense does not exhaust limits of a cost-erosive policy

- Or the carrier may find itself barred from seeking recovery of the presuit expenses from other, jointly liable carriers, on a theory of equitable contribution, because the pre-suit expenses constitute "voluntary payments," and "equity will not aid a volunteer." *See Hartford Ins. Co. v. Ohio Cas. Ins. Co.,* 145 Wn. App. 765 (2008) ("an insurer who acts as a volunteer in making payment on behalf of its insured will lose the right to recover contribution from other insurers on the loss").

EXCEPTIONS TO GENERAL "SUIT" RULE

I. Costs Incurred "In Anticipation of Litigation"

The foregoing cases demonstrate some risks – to both insurers and insureds – in undertaking defense or settling a case prior to suit. On the other hand, divergent authority exists. For example, one significant line of cases finds pre-suit costs may be recoverable if they were "reasonably incurred …. to legitimately protect [the insured] in anticipation of a suit being filed." *See, e.g., LM Ins. Co. v. Canal Ins. Co.*, 2012 U.S. Dist. LEXIS 89792 (E.D. Ky. Jun 28, 2012).

Thus, for example, in *Liberty Mutual Insurance Co. v. Continental Casualty Co.*, 771 F.2d 579 (1st Cir. 1985), an insured installed glass panels in the John Hancock Tower in Boston, Massachusetts. The panels failed. Numerous glass panels were blown from the building onto the streets below. The insured notified its carrier that the owner considered it to be in breach of contract, and the insured planned to present the carrier with any claims that might be filed for personal injury or property damage. Nonetheless, the insured continued to work with the owner to try to fix the problem. This caused a delay of several years in the filing of lawsuits.

Eventually, the owner filed suit. One carrier defended, but a second carrier did not, arguing – among other things – that there was no legal obligation to defend prior to filing of suit. The court found these costs recoverable "in the circumstances of this particular case":

> Under the circumstances of this particular case, we hold that the pre-suit services were correctly considered as part and parcel of the defense against the liability suits. John Hancock made its initial claim no later than June 1, 1973, and Continental was notified of it immediately thereafter. The extent of the window problem was so great that it was almost certain that a suit would be filed. Indeed, John Hancock and Robertson, as well as others involved in the construction of the Hancock Tower, entered into an agreement to delay the filing of any suits until after further efforts were made to solve the immediate problems posed by the defective curtain wall. Without this agreement, the suit would have been filed much sooner, in which case the technical issue now before us probably would not have arisen.
>
> Finally, both the exhibits and the testimony of witnesses strongly suggest that most, if not all, of the pre-suit services would have been performed after suit was filed had they not been performed before and that the insurance experts felt that Robertson had little choice but to retain counsel and prepare to defend itself when it did. Under these particular circumstances, we conclude that it was not error to allow the jury to evaluate the pre-suit services and charges for their reasonableness.

Ten years later, in *High Voltage Engineering Corp. v. American Employers Insurance Co.*, 1995 Mass. Super. LEXIS 501 (1995), the court concluded that "there is no per se rule limiting the defense costs … to those incurred after the actual filing of … suits." It found that:

> in some narrow circumstances, an insurer may be held liable for presuit costs …. [such as] where (1) the third party made its initial claim against the insured before the third party actually filed suit, (2) the insured immediately notified the insurer of the third party's claim, (3) the nature of the claim created a near certainty that a suit would be filed, (4) the presuit services would have been performed after the suit was filed had they not been performed before, and (5)

> after the insurer's refusal to defend, the insured had little choice to retain counsel and prepare to defend itself when it did …. Under these narrow circumstances, "the presuit services were correctly considered as part and parcel of the defense against the liability suits." *Id.*

1995 Mass. Super. LEXIS at 501 (*citing Liberty Mut.*, 771 F.2d at 579).

Likewise, in *Arch Insurance Co. v. Scottsdale Insurance. Co.*, 2010 U.S. Dist. LEXIS 115256 (W.D. Wash. 2010), a crane collapsed during construction of a tower in Bellevue, Washington. The general contractor (LCL) notified its carrier (Arch) of the accident, and the likelihood of litigation. Arch appointed counsel, and undertook various pre-suit expenses: "storing the remains of the crane, retaining experts to examine the crane in preparation for litigation, making efforts to settle, and advocating for LCL during investigations." *Id.* at * 12. It also tendered to the crane operator's insurer (Scottsdale) as an additional insured. Scottsdale declined to defend, on various grounds.

In the ensuring coverage litigation, the court determined that Scottsdale did, in fact, owe LCL a defense, and the duty extended to the pre-suit costs Arch had incurred:

> Having found that LCL is an additional insured with respect to the Scottsdale policy, the Court now turns to the scope of fees and costs that Arch may recover. Scottsdale argues that pre-suit costs are not recoverable because Scottsdale is not responsible for expenses that were incurred by LCL or Arch prior to the filing of the first suit. However, there is no authority to support this proposition. The duty to defend is broad and encompasses those expenses that are reasonably related to the defense of a covered claim …. In *Nordstrom v. Chubb*, [820 F. Supp. 530, 536 (W.D. Wash. 1992), aff'd on other grounds, 54 F.3d 1424 (9th Cir. 1995),] this court specifically held that "[n]o right of allocation exists for the defense of non-covered claims that are 'reasonably related' to the defense of covered claims." Therefore, where the duty to defend necessarily encompasses certain pre-suit expenses, those expenses will not be allocated as distinct.
>
> The issue of whether costs are reasonably related to the defense of covered claims is a factual inquiry …. In this case, Plaintiff Arch has explained that its pre-litigation costs were incurred in storing the remains of the crane, retaining experts to examine the crane in preparation for litigation, making efforts to settle, and advocating for LCL during investigations …. Scottsdale does not plead sufficient evidence to raise an issue of fact as to whether the pre-suit costs were reasonably related to the defense of covered claims.
>
> Scottsdale further asserts that Arch may not recover pre-suit expenses because Arch voluntarily paid these costs. An insurer who acts as a volunteer in

> making payments loses the right to recover contribution from other insurers …. An insurer is considered a volunteer if the insurer has no right or interest of its own to protect and is under no obligation to pay. However, payments made by an insurer under the threat of civil suit are not considered voluntary, nor is the existence of a possible defense to coverage sufficient to render an insurer's actions voluntary.
>
> In this case … [g]iven the situation of the crane collapse, Arch operated under the near certainty that claims and litigation would follow. As LCL was Arch's insured, it cannot be said that Arch had no obligation to make expenditures to facilitate the defense of its insured …..

2010 U.S. Dist. LEXIS 115256, at * 11 - * 12 (citations omitted).

II. Emergency Response By Insured

A second line of cases, embodied in *Leebov v. United States Fidelity and Guaranty Co.,* 401 Pa. 477 (1960), arises when insureds argue that the insured must take some emergency action to prevent a "suit" from arising.

In *Leebov*, a contractor purchased a liability policy from USF&G. That policy said the insurer agreed "to pay on behalf of the Insured all sums which the Insured shall become obligated to pay by reason of the liability imposed upon him by law for damages because of injury to of destruction of property, including the loss of use thereof, caused by accident and arising out of the hazards hereinafter defined." While Leebov was excavating along a hillside before construction of a warehouse, a landslide began, and a porch on a house atop the hill collapsed.

Leebov ceased operations, drove his trucks to the hillside, pounded stakes to hold his trucks in place. He summoned a shoring expert and notified USF&G what was happening. USF&G sent its safety engineer to the scene, who approved of what had been done. Leebov spent $13,000 to repair the damage and prevent further loses. The homeowner whose porch was destroyed filed suit, USF&G refused to defend, and Leebov defended and settled for $1,700.

The court noted that if Leebov "had not taken immediate and substantial measures to remedy the perilous situation, disastrous consequences might have befallen the adjoining and nearby properties." In that event USF&G would have been required to pay considerably more. The court observed that would be a "strange kind of argument and an equivocal type of justice" to say the USF&G must pay $100,000 if the damage had been allowed to happen, and a not much smaller sum that would have avoided that "foreseeable disaster".

Similarly, in *Broadwell Realty Services, Inc. v. Fidelity & Casualty Co.*, 218 N.J. Super. 516, 528 A.2d 76 (1987) the Department of Environmental Protection (DEP) sent a "directive letter" to the insured, Broadwell. Broadwell leased property to a lessee who operated a franchise service station

on the property The letter stated that hazardous substances had escaped from an underground storage tank on the insured's land and migrated to adjacent land. The letter stated that failure to take immediate "cleanup action" it would result in treble damages and placement of a claim and lien upon all of its real and personal property.

The court held that the costs of preventive measures taken by Broadwell on its own property in response to the DEP directive were designed to abate the continued flow of contaminants on to adjacent lands and were recoverable under the policy. The court found that the interceptor trenches dug on Broadwell's property and the observation / recovery pumping wells installed on its property would have been covered if installed on the third party's property. The court reasoned that "It would be folly to argue, under such circumstances, that the insured would be required to delay taking preventive measures, thereby permitting the accusation of mountainous claims at the expense of the insurance carrier." In other words, the insured need not "calmly await further catastrophe". "Abatement measures designed to prevent the continued destruction of adjacent property are plainly compensable under the policy." *Id.* at 526-27 [citation omitted]. The measures were taken to discharge a legal obligation to DEP or at the very least to prevent what would have been an avoidable legal obligation to pay damages to a third party.

Similarly, in *State of California v. Allstate Ins. Co.*, 45 Cal. 4th 1008, 1015, 90 Cal. Rptr. 3d 1, 8, 201 P.3d 1147, 1153 (2009) the State constructed and operated a hazardous waste disposal site known as the Stringfellow Acid Pits. The State directed construction of open, unlined evaporation ponds to contain the hazardous waste, channels to divert rainwater around the site, and a barrier dam at the bottom of the site. The facility was opened in 1956 and closed in 1972 after groundwater contamination was discovered. More than 30 million gallons of liquid industrial waste were deposited in the Stringfellow ponds during operation. The policies contained sudden and accidental pollution exclusions.

Severe rainstorms struck the area, a state of emergency was declared. Concerned about rising levels in the site's evaporation ponds, Anderson, the executive officer of the Regional Water Quality Control Board had additional storage ponds dug on the site and started pumping water to the new ponds. As heavy rain continued, the main pond was again full. The Board placed sandbags on top of the dam and pumping continued, though it was limited when one of the two pumps broke. When a crack was observed in the face of the dam, Anderson ordered wastes released through a spillway to prevent an uncontrolled release of up to 20 million gallons. The controlled release was stopped several days later, but restarted three days after that when the dam began to give way. It was stopped again four days later when the danger of collapse had passed.

The court agreed with the insurers that in one obvious sense the 1978 discharges were not accidental: the wastes were intentionally released at Anderson's direction. But this was done only to prevent a larger, uncontrolled discharge of wastes if, as threatened, the dam broke. That, the State argued, would have been an accidental discharge. The court held that to the extent the conditions threatened a "sudden and accidental" release of wastes from the Stringfellow site, the

qualified pollution exclusion does not bar coverage for liability arising from the State's intentional releases performed to prevent such a greater accidental release.

Similarly, in *Goodyear Rubber & Supply v. Great Am. Ins. Co.*, 545 F.2d 95, 96 (9th Cir. 1976) the court held (under Oregon law) that liability for salvage costs covered under property damage liability policy, where salvager had acted to prevent further damage from fire, a covered source of damage. “It would be a strange kind of justice, and a stranger kind of logic, that would hold the defendant to be liable for as much as $ 450,000 if the barge and its contents had been consumed by fire, but free of liability for a much lesser amount because of the fortuity of rescue.” *Id.*, 545 F.2d at p. 96.

But if the situation is not an emergency, failure to get consent will bar coverage. In *Jamestown Builders v. Gen. Star Indem. Co.*, 77 Cal. App. 4th 341, 344, 91 Cal. Rptr. 2d 514, 515 (1999) Jamestown developed 300-home housing tracts Many of the new homeowners were dissatisfied with the construction, complaining the houses were not watertight. These complaints began slowly but intensified as more homeowners demanded that Jamestown fix the problems and compensate them for damages. Jamestown was faced with a "deluge of problems." It paid approximately $ 1,240,000 for repairs and damages. It investigated and repaired all known water intrusion related problems. No lawsuits were filed against it. The developer never tendered any of these damage claims to General Star during this period. Jamestown argued it did not give notice to General Star because it was "inordinately preoccupied with the magnitude of the remedial work". The court did not accept this argument, and held that the voluntary payment provision precluded coverage for those payments.

III. Demands “Equivalent” To Suits

There are also certain types of demands that do not meet the classic definition of a “suit,” but courts have found to be the function equivalent of “suits” for purposes of triggering a CGL insurer’s duty to defend. Along these lines, for example, numerous courts have found that environmental PRP letters, administrative cleanup orders, and state administrative environmental proceedings are “suits.” In addition, some courts have found that pre-suit claims made pursuant to construction notice and opportunity to repair statutes constitute “suits” for purposes of the duty to defend.

A. Statutory Notice and Opportunity to Repair Notices.

Under Florida law, a claimant must follow certain procedural requirements before bringing a lawsuit for a construction defect. See Fla. Stat. § 558.004. Chapter 558 requires the claimant to “serve written notice of claim on the contractor, subcontractor, supplier, or design professional, as applicable” before filing suit. See *id.* The respondent, in turn, must serve a written response that offers to: (1) “remedy the alleged construction defect at no cost to the claimant”; (2) “compromise and settle the claim by monetary payment,”; (3) “compromise and settle the claim by a combination of repairs and monetary payment.” The respondent also may respond with a statement disputing

the claim or informing the claimant that any monetary payment will be determined by the recipient's insurer. *See id.*

The court in *Altman Contractors, Inc. v. Crum & Forster Specialty Insurance Co.*, 232 So. 3d 273, 277 (Fla. 2017), held that Florida's Chapter 558 process is a "suit" within the meaning of the commercial general liability policy. Although the chapter 558 notice and repair process if not a "civil proceeding under the policy terms because the recipient's participation in the chapter 558 settlement process is not mandatory or adjudicative," the court explained, it does fall within the CGL policy's definition of "suit" because the CGL definition of "suit" includes "[a]ny other alternative dispute resolution proceeding in which such damages are claimed and to which the insured submits with our consent." *See id.* at 278. Similarly, the court in *Melssen v. Auto-Owners Insurance Company*, 285 P.3d 328 (Colo. App. 2012), found that notice under Colorado's right to repair statute also constituted a "suit" because it was alternative dispute resolution, and the insurer waived its right to consent.

Applying Utah law, the court in *Cincinnati Insurance Co. v. AMSCO Windows*, 593 F. App'x 802 (10th Cir. 2014), found that a notice under Nevada's notice and opportunity to repair statute did not constitute a "suit" because "noncompliance [with the civil pre-litigation process] does not result in any adverse judgment or obligation but rather imposes limited consequences in subsequent litigation." *Id.* at 809. Moreover, the insurer did not consent to the insured participating in the process and the statute does not provide for compulsory arbitration. *See id.* at 809 (discussing Nev. Rev. Stat. § 40.649).

Had the policies been governed by Nevada law rather than Utah law, the result may have been different, as the Nevada notice and opportunity to repair statute provides that an insurer "[m]ust treat the claim as if a civil action has been brought against the contractor" and "[m]ust provide coverage to the extent available under the policy of insurance as if a civil action has been brought against the contractor." *See* Nev. Rev. Stat. § 40.649. Similarly, the California construction defect right to repair statute, California Civil Code § 910, states that such notice "shall have the same force and effect as a notice of commencement of a legal proceeding." Relying on that provision, the court in *D.R. Horton Los Angeles Holding Co., Inc. v. American Safety Indemnity Co.*, 2012 U.S. Dist. LEXIS 1881 (S.D. Cal. Jan. 5, 2012), found that a Section 910 notice triggered an insurer's duty to defend.

B. Environmental Remediation Demands and Proceedings.

Although jurisdictions are split on this issue, most courts have found that PRP letters, environmental cleanup letters, and administrative environmental proceedings trigger a CGL insurer's duty to defend, even in the absence of a lawsuit. Courts finding a duty to defend typically find that the term "suit" is ambiguous, and a "coercive" environmental demand from a regulator triggers the duty to defend. *See, e,g., Aetna Cas. & Sur. Co. v. Commonwealth of Ky.*, 179 S.W.3d 830 (Ky. 2005); *R.T. Vanderbilt Co. v. Cont'l Cas. Co.*, 870 A.2d 1048 (Conn. 2005); *Johnson Controls, Inc. v. Emp's Ins. of Wausau*, 665 N.W.2d 257 (Wis. 2003); *Compass Ins. Co. v. City of*

Littleton, 984 P.2d 606 (Colo. 1999). In contrast, courts finding no duty to defend typically interpret “suit” to require a lawsuit or ADR proceeding as required by the policy. *See, e.g., Foster-Gardner, Inc. v. Nat’l Union Fire Ins. Co. of Pittsburgh, Pa*., 959 P.2d 265 (Cal. 1998); *Lapham-Hickey Steel Corp. v. Prot. Mut. Ins. Co.*, 166 Ill. 2d 520, 532 (1995).

IV. Arbitration /ADR

Another proceeding that some parties view as “equivalent to” suits are arbitration and other forms of alternative dispute resolution proceedings. Since these are technically not a lawsuit, standard coverage forms have been changed to adapt to their increasing use. Since 1985, the Commercial General Liability coverage form, CG 00 01 04 13 has defined “suit” to include "an arbitration proceeding alleging such damages to which you must submit or submit with our consent." Since 1988, the definition has also included other alternative dispute resolution proceedings. The current language, in effect since 1996, reads:

> “Suit” means a civil proceeding in which damages because of “bodily injury,” “property damage” or “personal and advertising injury” to which this insurance applies are alleged. “Suit” includes:
>
> a. An arbitration proceeding in which such damages are claimed and to which the insured must submit or does submit with our consent; or
>
> b. Any other alternative dispute resolution proceeding in which such damages are claimed and to which the insured submits with our consent.

It should be noted, however, that liabilities arising out of arbitration and ADR proceedings will only give rise to coverage if the insured “submits with [the insurer’s] consent.” An insured that is considering the resolution of liabilities through arbitration or ADR should seek out the consent of its insurer, or risk a subsequent denial of coverage.

V. Crisis Management Coverage

Another exception to the general “suit” requirement is crisis management coverage. This coverage goes beyond the traditional provision of a litigation defense. It pays expenses which the insured incurs to address negative publicity caused by a crisis event, such as such as a serious accident, an explosion, an act of violence, a contamination or product recall incident or in connection with cyber policies, a breach of an insured’s network. Some endorsements also pay expenses required to provide immediate support to victims and their families, such as funeral expenses, psychological counseling, travel, and temporary living costs. Features that can vary by policy include whether the insured has a choice of the crisis communications firm or must choose from a pre-approved list of firms, the duration of coverage (until the crisis is over - which raises the question of who determines this and by what standard; or the limit exhausted), and whether the limit of coverage is a sublimit of other coverage or a separate limit.

Typically, these endorsements tie back to the scope of coverage in the policy. If it is a general liability or umbrella liability policy, the endorsement will require that the crisis arise from bodily injury, property damage and personal and advertising injury. It may add coverage for imminent threat of such injury or damage. It may add some defined type of incident such as sexual misconduct to this scope. Or it may limit the scope of the coverage to death or serious bodily injury to more than one or two or three or more persons. The endorsements cover fees and expenses charged by a crisis management firm in providing public relations and media management services. Some endorsements also include fees and expenses of the insured's employees, some do not. The endorsements may also provide coverage for emergency transportation and psychological services to provide relief or support to persons affected by the crisis.

The endorsements often have very precise timing requirements. The endorsement may require telephone notice within 24 hours. It may also require written notice as soon as practicable with a description of how, when and where the covered crisis took place, the names and addresses of any affected parties and witnesses, and the location and nature of the injury or damage. It may require a claim for reimbursement - if the insured's own expenses are covered and if the insured seeks to recover those - within a specific time frame, for example 90 days. And it may require backup documentation for expenses that exceed a certain threshold level, for example $50.

These endorsements often are found on umbrella policies, so remember to check the umbrella policy for such coverage if it is not found in the primary policy.

ALTERNATIVE POLICY LANGUAGE

The discussion above focuses on language used in the insuring agreement of ISO Form CGL policies. But in some contexts – for example, where insureds assume liability through captives or specialized risk retention groups – policies may be drafted more broadly, to avoid the "suit" requirement and "legally obligated to pay" language. The following manuscript language represents one risk retention group's approach to this issue:

> [Risk Retention Group] hereby agrees, subject to the limit of liability and all other limitations, terms, exclusions and conditions hereinafter mentioned, to indemnify the Insured for all sums which the Insured shall be obligated to pay by reason of liability imposed upon the insured by law or assumed under contract or agreement by the Insured for damages on account of
>
> > [1] personal injury [defined to mean "bodily injury (including death at any time resulting therefrom), mental injury, mental anguish, shock, sickness, disease, disability, false arrest, false imprisonment, wrongful eviction, detention, malicious prosecution, discrimination, humiliation, and all libel, slander, or defamation of character or invasion of rights of property],

[2] property damage or

[3] advertising liability

anywhere in the universe, resulting from an occurrence; provided, however, that the aggregate limit, the per occurrence limit.

Note the absence here of a "suit" requirement, and the broad language providing indemnity for all sums the insured is "obligated to pay … by reason of liability imposed … by law" – not just sums the insurer is "legally obligated to pay as damages." The unique structure of captive and risk retention arrangements make such broader language possible.

POST-SUIT DUTIES

One final note. The discussion above centers on carriers' obligation (or lack of obligation) before "suit" is filed. But an analogous issue arises after suit is over, and a judgment or settlement has been secured. Can the carrier in those circumstances simply pay its limits and walk away? Or does the carrier have to continue defending through "final judgment," i.e., resolution of JNOV and post-trial motions? What if the carrier is only liable for part of the verdict — say, in a pro rata long-tail context? Can it pay that part and leave the insured to continue defending post-trial motions, etc., as to the un-covered part?

What about after final judgment? Does the carrier have to fund an appeal, if the insured wants one? Authority is mixed. Many states require the carrier to fund an appeal only if there a "reasonable chance" it will prevail. *Davis*, 434 Mass. at 146; *Sullivan*, 33 Mass. App at 157 n.4; *Med. Prof'l Mut. Ins. Co. v. Newton-Wellesley Hosp.*, 1999 Mass. Super. LEXIS 529; see *P. Gioioso & Sons. Inc. v. Liberty Mut. Ins. Co.*, 2018 Mass. App. Unpub. LEXIS 79 (Mass. App. 2018). Buy what if the carrier and the insured disagree about whether the appeal is "reasonable" — does the carrier have to seek a declaratory judgment and argue publicly that its insured's appellate argument is frivolous? While the appeal is still pending and the insured's dispute with a plaintiff is still going on?

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