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Client Alert

The Dreaded Pre-Tender Issue: Indiana Courts Should Reconsider Whether Pre-Tender Costs Are Recoverable

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The Dreaded Pre-Tender Issue: Indiana Courts Should Reconsider Whether Pre-Tender Costs Are Recoverable

The ability of a policyholder to recover pre-tender costs is an evolving area of insurance coverage law. In *Dreaded, Inc. v. St. Paul Guardian Insurance Company*, the Indiana Supreme Court held that, under the facts of that case, a policyholder could not recover the legal expenses it incurred defending itself from a claim asserted by the Indiana Department of Environmental Management ("IDEM") prior to giving notice of or tendering the claim to its insurer. [1]. And while *Dreaded* was limited to the facts of that case, the Indiana Court of Appeals in *Travelers Insurance Company v. Maplehurst Farms, Inc.* interpreted *Dreaded* to mean that pre-tender costs are simply not recoverable. [2]. The courts' decisions in *Dreaded* and *Maplehurst* rested, in part, on two grounds: (1) an insurer's duty to defend its policyholder does not arise until the policyholder provides notice of the claim; [3] and (2) the insurance policy provision requiring a policyholder to give notice of a claim to the insurer is a condition precedent to coverage. [4].

Indiana courts should reconsider the holdings in *Dreaded* and *Maplehurst*. [5]. These holdings result in the forfeiture of coverage, which is unfair and disfavored under Indiana law, [6] and ignore the realities of long-tail environmental claims. [7]. To begin, *Dreaded*'s explanation of the duty to defend is incomplete.

An insurer's duty to defend its policyholder is not triggered by notice of the claim, but rather by the existence of a potentially covered claim. [8].

In *Dreaded*, IDEM sent the policyholder a letter in 2000 demanding that it investigate possible soil contamination at a former business site. [9]. The policyholder hired a law firm and environmental consultant to defend and investigate the claim. [10]. In 2004, the policyholder notified its insurer of the IDEM claim and requested that the insurer take up defense of the claim and reimburse it for past defense costs. [11]. The insurer agreed to defend going forward, but refused to reimburse the policyholder for past costs. [12]. The policyholder sued to recover these costs.[13].

The trial court granted summary judgment in favor of the insurer, concluding in part that "[a] policyholder has a duty to tender claims in order to trigger an insurer's duty to defend under a general liability policy." [14]. On appeal, the policyholder urged the courts to employ a prejudice analysis, i.e., the policyholder should be "entitled to recover its pre-notice defense costs unless [the insurer] can prove that it was prejudiced by [the policyholder's] late notice." [15].

Despite precedent to support using a prejudice analysis in delayed notice cases, [16] the Court refused to adopt this approach. The Court held that "as to claims seeking recoupment of an insured's pre-notice defense costs predicated on an alleged breach of an insurer's duty to defend, the insurer's duty to defend did not arise and prejudice is an irrelevant consideration."[17]. The Court's finding was based on its belief that an "insurer's duty to defend simply does not arise until it receives [notice]." [18].

Dreaded is wrong on this point. The duty to defend arises according to the coverage grant within the policy. It is certainly true that an insurer cannot *breach* its duty to defend until it has been given notice of the underlying claim. But that does not end the inquiry. There is an important distinction between when the duty to defend is triggered and when the insurer's legal obligation to pay can be breached. The Washington Supreme Court explained the distinction in *National Surety Corp. v. Immunex Corp.* [19]. Prior to

the *Immunex* decision, that court held that "an insurer's duty to defend does not arise unless the insured specifically asks the insurer to undertake the defense" and that "[t]he duties to defend and indemnify do not become *legal obligations* until a claim for defense or indemnity is tendered." [20]. But nothing in these prior holdings, the court noted, was meant to suggest that pre-tender costs are not recoverable. [21]. The court concluded:

> In fact, the duty to defend arises not at the moment of tender, but upon the filing of a complaint alleging facts that could potentially require coverage. . . . Certainly breach of the duty to defend cannot occur before tender. The scope of the duty, however, is defined not by its breach, but by the contract. Accordingly, an insured can recover pre-tender fees and costs except where a later tender prejudiced the insurer. [22].

Washington is not alone. Several jurisdictions apply similar reasoning in allowing the recovery of pre-tender costs. [23].

Dreaded is not the only case where courts have concluded that the duty to defend does not arise until the claim is tendered to the insurer. [24]. However, as the Maryland Supreme Court noted in*Sherwood Brands v. Hartford Accident & Indemnity Company*, "[i]n none of those cases . . . does the court give any reasoned basis for such an approach." [25]. *Dreaded*, like many of the cases before it, provides no analysis on this issue.

There are several reasons why the duty to defend arises upon the existence of a potentially covered claim and not upon notice of the claim. First, as *Immunex* correctly noted: "The scope of the duty . . . is defined . . . by the contract." [26]. Commercial general liability policies state that the insurers have the duty to defend where there is a suit that seeks damages from property damage or bodily injury arising from an occurrence. [27]. When such a suit arises, an insurer becomes legally obligated to defend its policyholder. [28]. Notice or tender to the insurer have nothing to do with defining and/or triggering the insurer's duty. Those words ("notice" or "tender") are non-existent in the

coverage grant. [29]. The essential triggering event in a duty to defend analysis is the existence of a potentially covered claim—not notice to the insurer.

Second, almost all liability policies give the insurer both the *right* to control the defense of a potentially covered claim and the *duty* to provide that defense. [30]. An insurer's *right* to control the defense arises as soon as a potentially covered claim arises—which is why insurers may (and often do) raise a late notice defense if the policyholder does not immediately give notice to the insurer. Therefore, the insurer's *duty* to defend must similarly attach at that moment. The right to control the defense, and the corresponding duty to defend, attach as soon as there is something to defend. [31]. As the Maryland Supreme Court noted in *Sherwood Brand*:

> [I]t would hardly be sound to conclude that the right does not exist or does not arise until the notice is given, for if that were the case, the right of control vested in the insurer would effectively be within the control of the insured. . . . The duty to defend, rationally, should attach at the same moment the correlative right to control attaches . . . . If that is when the insurer has a right to exercise control, that is also when its duty to do so should arise. [32].

Third, the idea that notice is a condition precedent to an insurer's duty to defend does not derive from the terms of the policy. If one of the policyholder's obligations under an insurance policy is a condition precedent (and thus capable of forfeiting coverage) the language should clearly illustrate this. [33]. The policy in *Dreaded* provides no such indication. In fact, the policy only states that "[f]ailure to comply *could* affect coverage." [34]. The policy never states that late tender delays the triggering of the duty to defend. [35]. A policy's insuring agreement, which provides the insurer's right and duty to defend, determines what is covered and when that coverage is triggered, not the policy's condition provisions.

An insurer has a duty to defend its policyholder from the onset of the potentially covered claim. Of course, it cannot breach this duty until it has been notified. But delayed notice does not simply erase the insurer's duty to defend between the

onset of the claim and notice of the claim so long as the insurer has not been prejudiced by delayed notice of the claim. Therefore, the insurer should be required to reimburse the policyholder for reasonable defense costs—the same costs it would have been required to pay had the policyholder provided immediate notice of the claim.

With delayed notice, the insurer may lose some control of the claim prior to receiving notice, but that does not necessarily mean the insurer has been harmed. The policyholder's defense counsel may have conducted the defense in the same manner if it was under the control of the insurer. Unless the insurer can show that the policyholder's defense counsel performed inadequately or prejudiced the insurer in some substantial way, the insurer should be required to fulfill its duty to defend by reimbursing the policyholder for its reasonable defense costs.

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[1]. Dreaded, Inc. v. St. Paul Guardian Ins. Co., 904 N.E.2d 1267, 1273 (Ind. 2009).

[2]. Travelers Ins. Co. v. Maplehurst Farms, Inc., 953 N.E.2d 1153, 1160 (Ind. Ct. App. 2011).

[3]. *Dreaded, Inc.*, 904 N.E.2d at 1273; *Maplehurst Farms, Inc.*, 953 N.E.2d at 1160.

[4]. *Dreaded, Inc.*, 904 N.E.2d at 1271.

[5]. There are other reasons, besides those addressed in this article, why these holdings should be reconsidered. *See* George M. Plews and Ryan T. Leagre, *Pre-Tender Costs Should Be Recoverable Absent Prejudice*, ABA ENVTL. LITIG. NEWSL. (Winter 2013) (explaining how historic contract principles disfavor treating the non-occurrence of a policy condition as a bar to coverage because of the resulting disproportionate forfeiture).

[6]. Skendzel v. Marshall, 301 N.E.2d 641, 644, 650 (Ind. 1973) ("Forfeitures are generally disfavored by the law. . . . [A] court of equity must always approach forfeitures with great caution, being forever aware of the possibility of . . . exorbitant monetary loss.").

[7]. In many cases, actions are initiated against landowners or prior landowners for decades-old contamination. Oftentimes, the policyholder corporation has dissolved, its officers have dispersed, or its insurance agent and risk managers have passed away. Therefore, policyholders may not discover that they have applicable insurance coverage until years after the claim or action is initiated.

[8]. *See, e.g.,* Sherwood Brands v. Hartford Accident & Indem. Co., 698 A.2d 1078 (Md. 1997)

[9]. Dreaded, Inc. v. St. Paul Guardian Ins. Co., 904 N.E.2d 1267, 1268–69 (Ind. 2009).

[10]. *Id*. at 1269.

[11]. *Id.*

[12]. *Id.*

[13]. *Id.*

[14]. *Id*.

[15]. *Id.* at 1270.

[16]. Miller v. Dilts, 463 N.E.2d 257 (Ind. 1984); Morris v. Econ. Fire and Cas. Co., 848 N.E.2d 663, 666 (Ind. 2006).

[17]. *Dreaded, Inc.*, 904 N.E.2d at 1268.

[18]. *Id.* at 1273.

[19]. Nat'l Sur. Corp. v. Immunex Corp., 297 P.3d 688 (Wash. 2013).

[20]. *Id*. at 688–89.

[21]. *Id.* at 689.

[22]. *Id*. (internal quotation and citations omitted).

[23]. *See* Sherwood Brands v. Hartford Accident & Indem. Co., 698 A.2d 1078 (Md. 1997); Aetna Cas. & Sur. Co. v. Dow Chem. Co., 44 F. Supp. 2d 847, 857 (E.D. Mich. 1997) (distinguishing between "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). . . . The duty to defend 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, 207 (D. Mass. 2004) (concluding that the "question of when the duty*arises* is distinct from when the duty is *breached*[.]"); Rite Aid Corp. v. Liberty Mut. Fire Ins. Co., No. 1:CV-03-1801, 2006 U.S. Dist. LEXIS 57094, *18 (M.D. Pa. Aug. 14, 2006) (rejecting the notion that the duty to defend only arises after notice).

[24]. *See Sherwood Brands*, 698 A.2d at 1084 (citing Washington v. Federal Kemper Ins., 482 A.2d 503, 507 (Md. Ct. Spec. App. 1984); Oweiss v. Erie Ins. Exchange, 509 A.2d 711, 714–15 (Md. Ct. Spec. App. 1986); Mount Vernon Ins. v. Scottsdale Ins., 638 A.2d 1196, 1205 (Md. Ct. Spec. App. 1994); Scottsdale Ins. v. American Empire Surplus Lines, 791 F.Supp. 1079, 1084–85 (D.Md.1992); Hartford Acc. & Indem. Co. v. Gulf Ins. Co., 776 F.2d 1380, 1383 (7th Cir. 1985); Rovira v. LaGoDa, Inc., 551 So.2d 790, 794 (La. Ct. App. 1989); Am. Mut. Liability Ins. v. Mich. Mut. Liability, 235 N.W.2d 769, 774–75 (Mich. Ct. App. 1976)).

[25]. *Sherwood Brands*, 698 A.2d at 1085.

[26]. *Immunex*, 297 P.3d at 688–89.

[27]. *See generally* 9a COUCH ON INSURANCE 3D § 129:3 (Nov. 2014).

[28]. *See, e.g., Sherwood Brands*, 698 A.2d at 1085.

[29]. By contrast, in a claims-made policy, notice, or tender, or both are key terms triggering an insurer's duty to defend.

[30]. *See* 14 COUCH ON INSURANCE 2D § 51.35 at 438 (1996). For example, the general liability policy in *Dreaded* provided St. Paul Guardian Insurance Company with "the *right* and *duty* to defend . . . against a claim or suit . . . covered by this agreement." Dreaded, Inc. v. St. Paul Guardian Ins. Co., 904 N.E.2d 1267, 1270 (Ind. 2009).

[31]. *Sherwood Brands*, 698 A.2d at 1083.

[32]. *Id*. The court in *Sherwood* predicated it's holding on the basis that a policyholder's obligation to provide notice to the insurer is merely a promise rather than a condition precedent. While *Dreaded* described the notice provision as a condition precedent, this finding also needs reevaluation. This, however, will be the subject of a future article.

[33]. Mrozik Constr., Inc. v. Lovering Assoc., 461 N.W.2d 49, 52 (Minn. Ct. App. 1990) (citing Restatement (Second) of Contracts § 227 comment b (1981) ("When, however, it is doubtful whether or not the agreement makes an event a condition of an obligor's duty, an interpretation is preferred that will reduce the risk of forfeiture.")).

[34]. *Dreaded, Inc.*, 904 N.E.2d at 1270.

[35]. *Id.*