Insurer Not Liable for Pre-Tender Defense Costs

Partners

Allen N. David

Related Practices

Insurance Coverage and Bad Faith Litigation

By Allen N. David on March 16, 2017

Under Massachusetts law, when an insured fails to comply with its contractual obligation to give notice of a claim, an insurer still has a duty to defend unless it can show that it has been prejudiced by the late notice. See Boyle v. Zurich American Ins. Co., 472 Mass. 649, 655-58 (2015). Left unanswered by Massachusetts appellate courts was the related question of whether an insurer is liable for defense costs incurred before the insured notifies the insurer of the claim and tenders the defense to the insurer. In Rass Corp. v. The Travelers Companies, Inc., 90 Mass. App. Ct. 643 (2016), the Massachusetts Appeals Court resolved the issue by holding that an insurer has no liability for defense costs incurred by its insured before the insured gives it notice of the claim.

The rule in the majority of states is that there is no liability for pre-tender defense costs. See Windt, Insurance Claims and Disputes §4:44 at 327-34 (6th ed. 2013). A minority of jurisdictions hold that an insurer is liable for pre-tender defense costs unless it can prove prejudice. The issue has been considered by several judges of the Federal District Court for Massachusetts with split results. Compare Hoppy's Oil Serv. Inc. v. Insurance Co. of N. America, 783 F. Supp. 1505, 1509 (D. Mass. 1992) (insurer not liable for pre-tender costs) and Managed Health Care Sys., Inc. v. Paul Fire & Marine Ins. Co., 2001 WL 341114949 at *2 (D. Mass. Sept. 28, 2001) (same) with Liberty Mut. Ins. Co. v. Black & Decker Corp., 383 F. Supp. 2d 200, 2007 (D. Mass. 2004) (insurer liable for pre-tender costs in absence of prejudice). Courts outside of Massachusetts applying Massachusetts law have likewise been split on the issue. Compare American Mut. Liab. Ins. Co. v. Beatrice Co., 924 F. Supp. 861, 872 (N.D. Ill. 1996) (no liability) with Dominion Energy, Inc. v. Zurich American Ins. Co., 2016 WL 1032771 at *7 (D. Conn. March 15, 2016).

In Rass Corp. v. The Travelers Companies, Inc., 90 Mass. App. Ct. 643 (2016), the Massachusetts Appeals Court resolved the issue by holding that an insurer has no liability for defense costs incurred by its insured before the insured gives it notice of the claim.

The Court's holding is based on three reasons. First, "an insurer cannot be aware of a duty to defend an insured until notice is given." The contrary view "would be irrational." Second, when an insurer receives late notice, it is unable to control the costs that have already been incurred. Third, the contrary rule could an insured the incentive "to delay providing notice for as long as possible, knowing that, absent prejudice, the insurer would have to cover the bill for reasonable defense costs." Id. at 649-50. The insured sought, but was denied, further appellate review by the Massachusetts Supreme Judicial Court. 2017 WL 749506 (Mass. Jan. 26, 2017).

Three observations on this decision are in order. First, one can safely say that under Massachusetts law an insurer is not liable for defense costs the insured incurs before giving the insurer notice of a claim regardless of whether the insurer has been prejudiced by the late notice. In this respect, the rule governing liability for pre-tender defense costs differs significantly from the rule governing the duty to defend. Second, the Appeals Court is an intermediate appellate court. Although the Supreme Judicial Court denied further review, it is still possible that in the future it could rule differently in an appropriate case. There is no need, however, for insurers to base their decisions on this issue on the possibility that

 |

the Supreme Judicial Court could change the law at some time in the future. Third, the case strongly suggests that the notice must come from the insured rather than from some other source. It may still be open, however, for an insured to argue that an insurer who has actual notice of a claim from some other source but chooses not to act on this notice could be liable for reasonable pre-tender costs running from the time the insurer had actual notice.

