

Insurance Recovery

January 28, 2020

Policyholders May Recover Pre-Tender Defense Costs if Insurers Cannot Show Appreciable Prejudice

By **Lynda A. Bennett** and **Jason D. Meyers**

What You Need To Know:

- Pre-tender defense costs are recoverable in certain circumstances.
- Insurers have the burden of persuasion to demonstrate appreciable prejudice to avoid payment of pre-tender defense costs.
- Carefully consider applicable state law before engaging with an insurer on coverage disputes.

Introduction

Recently, a trial court granted a policyholder's summary judgment motion for the payment of pre-tender defense costs because the insurer failed to demonstrate that the policyholder's delayed notice caused the insurer to suffer appreciable prejudice. *The Lewis Clinic for Educ. Therapy v. McCarter & English, LLP et al.*, Docket No. MER-L-747-19, Superior Court of New Jersey, Civil Division, Mercer County. This decision is significant because insurers routinely deny coverage for pre-tender defense costs, citing the voluntary payment clause and a right to control the defense. Here, the court rejected the insurer's arguments because the insurer did not—and could not—show that it would have taken a different course to defend the claim or that it was prejudiced in any way by the defense strategy employed by the policyholder to resolve the claim.

Background

In 2018, a college preparatory school (the "Policyholder") hired a law firm to represent it in a trademark dispute that settled approximately four months later. The Policyholder noticed

its commercial general liability (CGL) insurer, Philadelphia Indemnity Insurance Company (PIIC), approximately three months into the dispute. The CGL policy provided coverage for the Policyholder's defense costs, including attorneys' fees, but it also contained two other important provisions. The notice of claim provision required the Policyholder to notice PIIC of a claim "as soon as practicable," and the voluntary payment provision required that the Policyholder not, "except at [its] own cost, voluntarily make a payment, assume any obligation, or incur any expense ... without [PIIC's] consent."

Though the defense costs totaled close to \$147,000, PIIC covered only the approximately \$13,000 incurred after the notice date. As a result, the Policyholder sued PIIC to recover the remaining defense costs.

Appreciable Prejudice Standard Applies to Notice and Voluntary Payments Provisions

The court stated that coverage exclusions in insurance policies apply if the policyholder's actions caused the insurer appreciable prejudice, which "requires findings of whether substantial

rights have been irretrievably lost by virtue of the failure of the insured” (internal quotation marks and citation omitted).

The court also stated that, with regard to notice provisions in occurrence-based policies, the insurer bears the burden of persuading the court that (i) the notice provision was material; (ii) the policyholder breached the notice provision; and (iii) the breach resulted in appreciable prejudice to the insurer. Additionally, with regard to a policyholder’s good faith failure to comply with a voluntary payments provision, the insurer bears the burden of persuading the court “of a likelihood of appreciable prejudice in order to deny coverage” (internal quotation marks and citation omitted).

Recovery of Pre-Tender Defense Costs

The court held that PIIC failed to demonstrate the materiality of the two provisions at issue and to persuade the court that PIIC suffered appreciable prejudice. The court stated that “lack of control of the litigation is not, by itself, enough to meet the [appreciable prejudice] standard” and that “[e]ven if PIIC had put forth the argument that it might have negotiated a more favorable settlement, it would have been pure speculation.”

As a result, the court granted the Policyholder’s motion for summary judgment on the issue of liability. This case will remain an important one to watch because the court did not resolve the issue of damages, and specifically whether the insurer must pay the full hourly rates charged by the law firm chosen by the Policyholder without the insurer’s prior consent.

Key Takeaways

State laws vary with respect to the recovery of pre-tender defense costs. Certainly, the easiest way to avoid this coverage dispute is for policyholders to remain vigilant in complying with policy obligations by providing timely notice and securing the insurer’s consent before costs are incurred. However, when that does not happen in a particular circumstance, policyholders should not accept an insurer’s knee-jerk denial of pre-tender costs. This decision demonstrates that some courts will carefully analyze whether an insurer will unfairly benefit from a bright-line rule that excludes all pre-tender defense costs. Where, as here, the insurer has suffered no prejudice by the delayed notice provided, courts should, and sometimes will, find that the breach is not material and the insurer’s coverage obligation remains.

Contacts

Please contact the listed attorneys for further information on the matters discussed herein.

LYNDA A. BENNETT

Partner

T: 973.597.6338

lbennett@lowenstein.com

JASON D. MEYERS

Associate

T: 973.597.2310

jmeyers@lowenstein.com

NEW YORK

PALO ALTO

NEW JERSEY

UTAH

WASHINGTON, D.C.

This Alert has been prepared by Lowenstein Sandler LLP to provide information on recent legal developments of interest to our readers. It is not intended to provide legal advice for a specific situation or to create an attorney-client relationship. Lowenstein Sandler assumes no responsibility to update the Alert based upon events subsequent to the date of its publication, such as new legislation, regulations and judicial decisions. You should consult with counsel to determine applicable legal requirements in a specific fact situation. Attorney Advertising.