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Insurance Law: Strategies For Seeking Pre-Litigation Coverage

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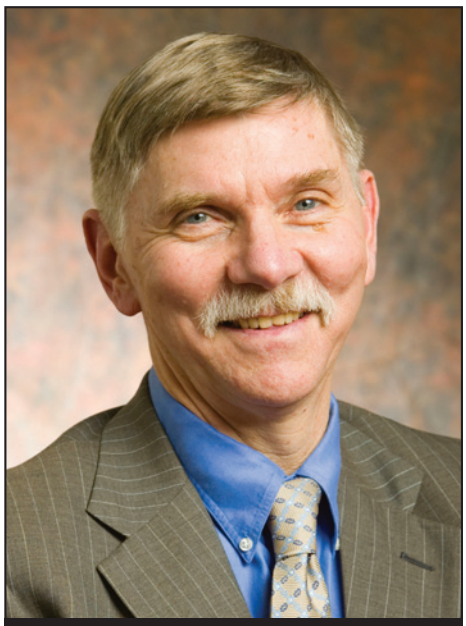

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Most liability insurance policies contain two promises to the policyholder. The first is the insurer's promise to pay for the policyholder's legal liability — the duty to indemnify. The second is the insurer's promise to defend the policyholder against a covered suit — the duty to defend. When a policyholder is faced with a claim by a third party, the insurer must pay the costs of defending the lawsuit as well as any resulting judgment against the policyholder.

The duty to defend is broader than the duty to indemnify — an insurer must defend against any claim that is even possibly covered by the policy, whereas the insurer need only indemnify against claims that are actually covered by the policy. However, narrow interpretations of undefined policy terms can allow an insurer to escape its duty to defend.

This issue arises in the interpretation of the term "suit." Typical commercial general liability policy language states that the insurer will pay anything that the policyholder becomes legally obligated to pay as damages (the indemnity promise), and "will have the right and duty to defend the insured against any 'suit' seeking those damages" (the defense promise). The term "suit" is generally defined as a "civil proceeding," which is an undefined term, and as such, is open to interpretation. With few exceptions, a majority of courts have held that a "suit" means a complaint or legal action filed in a court of law. *See, e.g., Linemaster Switch Corp. v. Aetna Life & Cas. Corp.*, 1995 WL 462270 (Conn. Super. Ct. July 25, 1995).

This narrow interpretation of the duty to defend any "suit" can be problematic in situations where a policyholder is facing claims from a third party that has not yet filed a complaint. For example, consider a scenario where the owner of a property hires a contractor to construct a building on that property, and the contractor's work turns out to be defective. Rather than immediately filing suit against the contractor, the property owner simply asks the contractor to fix the problem. The contractor agrees to do so, perhaps in an effort to comply with a contract or maintain positive business relations with the owner, and incurs substantial costs investigating and remediating the defective work. Fortunately, for the contractor, it has general liability insurance to cover costs such as these — or so it thinks, until it receives a denial of coverage from its insurer on the basis that there is no "suit."

Despite the narrow interpretation of a "suit" as a legal action, policyholders may be able to get their insurers involved pre-litigation. The policyholder may be able to apply an exception to the "suit" rule to obtain a defense, policy language may entitle the policyholder to indemnity in absence of a suit, or the policyholder may be able to convince the insurer to get involved before litigation is

initiated if it is clear that they will eventually have to provide coverage anyway.

In the above scenario, because the owner never filed suit against the contractor, the insurer has no duty to defend the contractor, because there is no "suit" seeking damages. Although the insurer may not be obligated to provide a defense, it may nonetheless be in its best interest to do so. By proactively trying to rectify the situation, the contractor is avoiding litigation, which would probably result in even greater damages for the owner as well as additional defense fees, all of which would be covered by the insurer. By working together, the contractor and the insurer can mitigate the damages and prevent the property owner from making a larger future claim against the contractor, saving time, money and conflict for all parties involved.

Furthermore, the insurer may be willing to pay justifiable defense costs even before suit is filed if it knows that it will ultimately assume defense of the action. Accordingly, policyholders should always put their insurers on notice when pre-suit defense costs are incurred in hopes that the insurer will consider the practicality of providing a pre-suit defense.

There are limited exceptions to the general interpretation that the duty to defend any suit is triggered by the filing of a complaint. Notably, a policyholder may be entitled to expenses incurred in defending itself in administrative proceedings. For example, in the environmental context, some courts have held that an environmental liability claim by a government entity is the functional equivalent of suit, because it can result in the imposition of damages or fines. However, there must be something more than a mere request for information or a non-adversarial communication in order to constitute a "suit." *See, e.g., R.T. Vanderbilt Co., Inc. v. Continental Casualty Co.*, 273 Conn. 448 (2005); *EDO Corp. v. Newark Ins. Co.*, 898 F. Supp. 952 (D. Conn. 1995).

The duty to defend is broader than the duty to indemnify — an insurer must defend against any claim that is even possibly covered by the policy, whereas the insurer need only indemnify against claims that are actually covered by the policy.

Even when an insurer denies coverage, the policyholder may be able to recover pre-litigation defense costs if suit is eventually filed despite the fact that the insurer initially refused to pay for these expenses. For example, in some instances, investigation or other defensive measures cannot be delayed until after suit is filed. If such costs are necessary to the policyholder's defense, and litigation is inevitable, a court may allow recovery of pre-suit defense costs. *See Liberty Mutual Insurance Co. v. Continental Casualty Co.*, 771 F.2d 579 (1st Cir. 1985).

Furthermore, if the insurer wrongfully denies coverage and the policyholder settles the claims against it pre-suit, the policyholder may be entitled to reimbursement of the amount reasonably spent on defense fees and settlement. *See Alderman v. Hanover Insurance Group*, 169 Conn. 603 (1975). Therefore, it is important to put the insurer on notice and request coverage pre-suit.

Unlike the duty to defend, the duty to indemnify is not necessarily triggered by a "suit." An insurer is generally obligated to pay "those sums that the insured becomes legally obligated to pay" because of bodily injury or property damage. The phrase "legally obligated to pay" does not necessarily require an entry of a final judgment establishing the insured's liability following the filing of a "suit." A suit merely enforces a legal obligation that already exists; it does not create the obligation. *See Megonnell v. United Services Auto. Association*, 796 A.2d 758 (Md. 2002); and *Desert Mountain Properties Limited Partnership v. Liberty Mutual Fire Insurance Co.*, 236 P.3d 421 (Ariz. Ct. App. 2010).

In the above scenario, it is likely that the contract between the property owner and the contractor stated that the contractor agreed to be responsible for any damage it caused to the project. The contractor became "legally obligated to pay" by virtue of its contract with the property owner, triggering the insurer's duty to indemnify the contractor. Therefore, the insurer may be obligated to indemnify the policyholder even where no suit has been filed and there is no duty to defend.

However, where the policy insures against "those sums that the insured becomes legally obligated to pay as damages," some courts have held that the legal liability must be established by a judicial or administrative proceeding. *See Permasteelisa CS Corp. v. Columbia Casualty Co.*, 2009 WL 1874087 (D. N.J. June 29, 2009).

Insurers should always be put on notice of potential claims, even before suit is filed against the policyholder. This eliminates the possible defense of late notice by the insurer and may lead to an early resolution of the claim. ■