Articles + Publications | March 12, 2015

Under California Law, Absent Extraordinary Circumstances, Insurers Have No Obligation to Pay for Pre-Tender Fees and Costs under Duty to Defend or Reimbursement Policies

Originally published in California Insurance Law Quarterly - Winter 2014-15 Newsletter

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Disputes between policyholders and insurance carriers often arise in the context of an insured's payments made before providing notice of a claim to its carrier. However, California courts routinely hold that, absent special circumstances discussed in more detail below, when the policy at issue includes a standard "no-voluntary-payment" clause, such "pre-tender fees and costs" are not covered by the policy.

California courts have long held that no-voluntary-payment provisions are enforceable and preclude coverage in the context of pre-tender defense fees and costs incurred in connection with a duty to defend policy. *See, e.g. Insua v. Scottsdale Ins. Co.*, 104 Cal. App. 4th 737, 745 (2002) (holding that no-voluntary-payment provision precluded recovery of pre-tender defense costs); *Jamestown Builders, Inc. v. General Star Indemnity Co.*, 77 Cal. App. 4th 341, 345-50 (1999) (holding that no-voluntary-payment provision precluded recovery of pre-tender expenses). Moreover, no-voluntary-payment provisions are enforced without regard to whether or not the insurer is prejudiced by the insured's delayed notice of the underlying matter. *See, e.g. Jamestown Builders, Inc.*, 77 Cal. App. 4th at 349-50; *Low v. Golden Eagle Ins. Co.*, 110 Cal. App. 4th 1532, 1544 (2003) (explaining that, unlike a notice provision or cooperation clause, no-voluntary-payment provisions are enforceable without a showing of prejudice).

The application of no-voluntary-payment provisions in reimbursement policies without a duty to defend was somewhat of an open issue under California law before 2013, and insureds would often argue that the existing precedent only applied to situations where the carrier had a duty to defend. This issue, however, was addressed by the Central District of California in *National Bank of California v. Progressive Casualty Insurance Company*, where the court explicitly rejected the insured's argument that "[t]he logic underlying the exclusion of pre-tender fees is inapplicable where . . . [the insurer] owes no duty to defend and . . . never undertakes [the insured's] defense." 938 F. Supp. 2d 919, 939 (C.D. Cal. 2013). According to the *National Bank of California* court, the proper inquiry was not whether the policy at issue created a duty to defend on the part of the insurer, but rather whether the insured agreed through the acceptance of the policy not to voluntarily make payments in connection

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with a claim without the insurer's consent. *Id.* Accordingly, the *National Bank of California* court held that the rule regarding pre-tender defense fees and costs should be the same in the context of reimbursement policies without a duty to defend as it is in the context of duty to defend policies.

Although no-voluntary-payment provisions are enforceable and routinely enforced under California law, there are limited circumstances in which California courts will refuse to enforce those provisions. The *Jamestown Builders* court summarized these situations when it explained that no-voluntary-payments provisions will be enforced "in the absence of economic necessity, insurer breach, or other extraordinary circumstances." 77 Cal. App. 4th at 346 (citing *Gribaldo, Jacobs, Jones & Assocs. v. Agrippina Versicherunges A. G.*, 3 Cal. 3d 434, 449 (1970)). California courts have interpreted these exceptions very narrowly and generally disallowed insureds' attempts to undermine the effect of no-voluntary-payment provisions.

With regard to the "economic necessity" and "extraordinary circumstances" exceptions, the *Jamestown Builders* court itself interpreted them to mean that "an insured may be able to avoid the application of a no-voluntary-payments provision where the previous payments were made involuntarily because of circumstances beyond its control." 77 Cal. App. 4th at 348. This may occur where "the insured is unaware of the identity of the insurer or the contents of the policy" or where "the insured may be faced with a situation requiring immediate response to protect its legal interests." *Id.* However, insureds' attempts to avail themselves of this exception are met with criticism by California courts and are often rejected. *See Dietz Int'l Pub. Adjusters of Cal., Inc. v. Evanston Ins. Co.*, 796 F. Supp. 2d 1197, 1216-1271 (C.D. Cal. 2011) (rejecting insured's argument that payments were made involuntarily because he was busy paying off claims in order to preserve his business, which was "a complete mess" after an embezzlement; the court explained that the "[f]ailure to investigate and assess potential coverage does not support a finding that payments made prior to tender [are] involuntary"); *see also Jamestown Builders, Inc.*, 77 Cal. App. 4th at 349 (rejecting insured's arguments that payments were involuntary because it was "inordinately preoccupied with the magnitude of remedial work" and its erroneous belief that the policy would not provide coverage; the court explained that the insured had ample opportunity to review the policy, investigate the claims and tender its defense and noted that the insured's "ignorance of its policy rights does not extend the time in which it was required to take action").

With regard to an "insurer breach," the *Jamestown Builders* court noted that application of the no-voluntary-payment provision in a policy is "superseded by an insurer's antecedent breach of its coverage obligation." *Jamestown Builders*, 77 Cal. App. 4th at 348. "[I]nsurers that decline a tendered defense are out of luck." *Id.* at 347. However, while the *Jamestown Builders* court appears to have recognized an exception to the applicability of a no-voluntary-payment provision in the context of insurer breach, it appears that the court was doing nothing more than stating the general rule of law in California that an insurer which denies coverage to its insured is not permitted to rely on an insured's breach of policy conditions in a subsequent coverage dispute. The Eastern District of California, in *Burgett, Inc. v. American Zurich Insurance Co.*, specifically addressed whether pre-tender fees and costs were recoverable by an insured in the event of an insurer's breach

of the duty to defend and held that such payments were not recoverable because an insurer's duty to defend arises upon tender. 875 F. Supp. 2d 1125, 1126-1128 (E.D. Cal. 2012). The court rejected the insured's reliance on *Jamestown Builders* and explained that, "[w]hile an insurer is undoubtedly liable for the consequences flowing directly from its breach, it is not liable for costs incurred before it did anything wrong, and was unaware that there was even a claim to defend." *Id.* at 1128. The *Burgett* court found that it did not have to reach the "pre-tender payments" issue because, "under California law, the duty to [defend] does not arise until tender, and thus, [the insurer] [was] not required to pay pre-tender expenses." *Id.* at 1128 n.4. In other words, under *Burgett*, even in the event of a breach, an insurer has no obligation t o pay "pre-tender fees and costs."

In summary, as the enforceability of no-voluntary-payment provisions is established under California law in the context of duty to defend policies, and has been held to apply with equal force in the context of reimbursement policies, the question of whether defense fees and costs incurred prior to tender are recoverable by an insured will often turn on whether there is "economic necessity, insurer breach, or other extraordinary circumstances." Although a plain reading of these exceptions may suggest broad application, as explained above, California courts have narrowly construed these exceptions and have generally rejected arguments to circumvent no-voluntary-payments provisions in favor of enforcement.

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