Effective Reservations of Rights Why, What, When, and How

PRIMERUS ICBF SEMINAR
CHICAGO 2014
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Why Do Courts Require RoR's?

- Estoppel
- "The insurer can avoid estoppel by giving timely notice of its reservation of rights which fairly informs the insured of the insurer's position."
  - *World Harvest Church, Inc. v. GuideOne Mut. Ins. Co.*, 695 S.E.2d 6, 9 (Ga. 2010).

Generally, Jurisdictions Fall In To Two Basic Camps.

- States which recognize coverage by estoppel, and those that do not
- Coverage by estoppel typically means an insurer which provides a defense without reservation is estopped from denying coverage, even if a loss falls outside the policy's insuring agreement.
  - e.g. New Jersey- "[o]nce a carrier undertakes to defend, it is estopped to deny coverage." *Sussex Mut. Ins. Co. v. Hala Cleaners, Inc.*, 380 A.2d 693 (1977); "[W]here an insurer does not unambiguously reserve its rights, uncovered claims may be subject to the doctrine of waiver or estoppel..." *LP v. Homeland Ins. Co. of New York*, 741 S.E.2d 228, 233 (Ga.App. 2013).
  - No coverage by estoppel, e.g. Texas, New York, Connecticut, Missouri (maybe).

But

- Even in states that do not adhere to the principle of coverage by estoppel, a carrier may be estopped from disclaiming coverage based in exclusions or conditions absent a "timely and effective" reservation.
  - "There is a widely recognized exception to the general rule that estoppel cannot be used to expand the scope of insurance coverage…when an insurance company assumes the defense…without reservation of rights, and with knowledge, actual or presumed, of facts which would have permitted it to deny coverage, it may be estopped from subsequently raising the defense of noncoverage. The exception..applies when…(1)… the insurer had sufficient knowledge of facts or circumstances indicating noncoverage, (2) … the insurer assumed or continued defense of the insured without obtaining an effective reservation of rights … and (3) that the insured suffered some type of harm or prejudice."
    - *Breci v. St. Paul Mercury Ins. Co.*, 288 Neb. 626, 642, 849 N.W.2d 523, 535 (2014).

In Many States, Estoppel Is Tough To Prove

- For example, when an insurer defends its insured without reserving its rights for a period sufficient to prejudice the insured's ability to conduct his own defense, i.e., shortly before trial, a court may find that the insurer has waived the reservation of rights and should be estopped from denying coverage.
  - *Med. Protective Co. v. Fragatos*, 940 N.E.2d 1011, 1015 (Ohio App. 2010).

Notion of Prejudice

- Even in the absence of an effective RoR (or any RoR) some states require the insured to demonstrate prejudice from receiving an unqualified defense.
  - e.g. *Pekin Ins. Co. v. Skender Const.*, 2013 IL App (1st) 123532-U appeal denied, 117266, 2014 WL 1386462 (Ill. Mar. 26, 2014).
- "[P]rejudice will be found if the insurer's assumption of the defense induces the insured to surrender her right to control her own defense."
  - *Standard Mut. Ins. Co. v. Lay*, 989 N.E.2d 591, 596 (Ill. 2013).

RoR's Must Be Timely (whatever that means)

- "If an insurer provides a defense to its insured under a reservation of rights, it must "'communicate its reservation of rights to the insured to inform the insured of its position as to coverage...Its failure to do so "'promptly may result in a waiver of the right to deny coverage or an estoppel to assert an exclusion.'"
  - *Penn-Am. Ins. Co. v. Sanchez*, 202 P.3d 472, 476-77 (Ariz.App. 2008)(internal citations omitted).
    - Arizona courts employ notions of negligence and prejudice to determine if an RoR has been timely issued, which, ultimately, is an issue of fact. *Id.*

Promptness Is Typically A Fact-Based Inquiry

- "[A]n insurance company is required to issue a reservation of rights letter when the insured has 'knowledge of facts making the accident, injury, etc., outside the coverage of the policy.'"
  - *Ohio Cas. Ins. Co. v. Wellington Place Council of Co-Owners Homeowners Ass'n, Inc.*, 2014 WL 97395 (Ky. Ct. App. Jan. 10, 2014).
    - Insurer did not reserve rights because the law did not favor declination at the time the claim was tendered. Seventeen months later the law changed and an RoR was issued, but the court held it was "untimely" because the carrier was held to a duty to anticipate all contingencies, including a substantive change in the law.

Can I Get My Money Back?

- It depends on the jurisdiction and circumstances of the defense, including perhaps the terms of the RoR under which the defense costs are paid.
- A very thorough analysis of the issue and broad assessment of authority from multiple jurisdictions may be found in *Am. & Foreign Ins. Co. v. Jerry's Sport Ctr., Inc.*, 2 A.3d 526 (Pa. 2010).
  - The court ultimately concluded, "[A]n insurer may not obtain reimbursement of defense costs for a claim for which a court later determines there was no duty to defend, even where the insurer attempted to claim a right to reimbursement in a series of reservation of rights letters." *Id.* at 546.

But See

- *Travelers Cas. & Sur. Co. v. Ribi Immunochem Research, Inc.*, 108 P.3d 469, 480. (Mont. 2005)("[a] party cannot accept tendered performance while unilaterally altering the material terms on which it is offered")
  - (citing *United Nat. Ins. Co. v. SST Fitness Corp.*, 309 F.3d at 921. (6th Cir. 2002); see also *Colony Insurance Co. v. G & E Tires & Service, Inc.*, 777 So.2d 1034, 1039 (Fla.Cir.2000) (citing Restatement (Second) Of Contracts § 69 (1981)).

The Extreme

- Is the most recent and egregious pro-insured RoR case from the Western District of Missouri? Yes.
  - *Advantage Bldgs. & Exteriors, Inc. v. Mid-Continent Cas. Co.*, WD76880, 2014 WL 4290814 (Mo.App. Sept. 2, 2014).
    - Suit filed against insured in July 2008.
    - Insurer issued letter August 12, 2008 advising it would investigate.
    - On September 2, 2008 insurer issued RoR advising "if other facts come to our attention we will advise you."
    - Insurer determined by October 2009 its potential coverage limited to $53k of multimillion dollar exposure.
    - Insured first hammered insurer for settlement June 2, 2010.
    - Insurer attended mediation on July 10, 2010, but would not offer more than $50k, so was asked to leave.

Advantage (cont.)

- Insurer then issued a letter further explaining its coverage position (allegedly determined months prior) and filed a DJ.
- The insured paid $500 for a covenant not to execute, submitted to an uncontested bench trial resulting in a $4.6 million judgment against insured and assigned its rights to plaintiff.
- In January 2012, insurer won its DJ., BUT
- The bad faith failure to settle claim proceeded to trial in June 2012.
  - The court refused to allow the insurer to admit evidence that it actually won the DJ proving it owed no coverage.
  - Jury award for $5mm ($3mm compensatory, $2mm punitive)
  - Court of appels affirmed in part because based on ineffective RoR.

Rationale for *Advantage* Opinion

- Insurer's RoR was ineffective.
  - It did not, "fully and unambiguously inform the insured of the insurance company's position as to coverage."
  - An RoR "should be 'specific and unambiguous,' should 'fully explain the insurer's position ... with respect to the coverage issue,' and 'must avoid any confusion.'"
  - "The [RoR] letters generally discussed the nature of the underlying lawsuit and set forth various provisions of Advantage's general liability policy. Neither letter clearly and unambiguously explained how those provisions were relevant to Advantage's position or how they potentially created coverage issues."
    - What?

Excerpts From RoR Rejected in *Advantage*

- "Even if a claim is made against an insured for 'property damage' caused by an 'occurrence', there must be no applicable policy condition, term, exclusion, definition or endorsement that precludes coverage. Coverage A has the following exclusions that would further eliminate the potential application of Coverage A to this litigation. Your policies provide that the insurance otherwise available under Coverage A does not apply to:" (followed by applicable policy provisions)

- "A review of the documents provided to Mid–Continent Casualty indicates that Advantage was aware of this claim in late 2004 or early 2005. Additionally, Advantage incurred the expense of painting the building involved in this matter including labor and material and attempted to make repairs to the panels themselves by attaching fasteners to the panels using Advantage employees and fastening materials. Please note the following paragraphs found under the form…" (followed by applicable policy provisions)

Potential Effects of *Advantage*

- The opinion appears to require not only notice of applicable coverage defenses, but a full and complete explanation of the application of the policy to the allegations for which coverage rights reserved.
- The opinion also suggests a subjective standard will be applied to determine if the RoR is effective. ("[T]he insured must fully understand the insurer's position.")
- Even successful prosecution of a declaratory action may not bar a coverage-based "bad faith" claim.
  - (The efficacy of the operative RoR should be affirmatively asserted in the DJ to obtain collateral estoppel on the issue. That effort, if undertaken by the insurer, does not appear in the record, where the DJ was said to be limited to the policy terms.)

So, What Are We To Do?

- Disclaimer
- When- Early and Often (like voting her in Chicago).
- What- Identification of claims by quoting allegations or by neutral description and corresponding identification of applicable policy provisions (with short explanation in some states (MO)).
  - With disclaimer that insurer is not suggesting allegations have merit
- How- always registered mail and probably via email if available
  - Email is immediate and includes some evidence of receipt, but should never be sole means of transition
- By Whom?
  - Prefer direct from carrier, but may be issued by counsel
    - pros and cons of issuance from counsel for carrier, practical and ethical considerations

Do's

- These are general suggestions or considerations and must be tailored to the specific requirements of the subject jurisdiction.
  - Do state whether the RoR pertains to a pre-suit notice and investigation and, if so include a summary of available information and its sources.
  - Do demand that putative insured notify insurer immediately or any further claims or any legal action.
  - If issued after suit is filed, Do demand that insured continue to notify insurer of any amended or additional pleadings.
    - Be broad, e.g. cross claims may include claims or allegations not found in original pleading.

Additional Do's

- Do issue "general" placeholder RoR if potential coverage defense appears, but further investigation or legal analysis is necessary to confirm.
  - However, you should follow with specific RoR as soon as practicable.
  - Recognize some jurisdictions allow or at least consider general RoR's, others do not.
  - You must consider if issuance will impair your ability to work with the insured on a defensible claim, or open the door to sanctioned collusion.
- Do consider need for supplemental or updated RoR's throughout the underlying litigation.
- Do consider if a DJ will further protect your interest or if it may be required to perfect a coverage defense in your jurisdiction.
- Do demand or at least invite the insured to provide and additional or alternate facts or law that support coverage.

More Do's

- Do advise the putative insured of their right to counsel and encourage them to seek advise on the nature and effect of the RoR.
  - Some states may require the retention "independent" counsel for the insured.
- Do identify any failure to cooperate by the insured, particularly if it has affected your ability to assess potentially applicable coverage defenses.
- Do notify putative insured of continuing duty to cooperate and consent to settle provision if applicable.
  - Particularly in states that allow the insured to reject an RoR and enter into covenant not to execute
  - Wisdom example
- Do split the file, even if not required
  - Avoids situation where person who identifies coverage defenses is also overseeing defense, which could result in a judgment on an uncovered theory.
  - May afford some further protection of privileged material

Do Not's (or Maybe Do Nots)

- Do Not promise additional investigation or communication, unless you plan and can execute appropriate follow-up.
- Do Not issue RoR's as a matter of course in all claims, unless fully supported by the jurisdiction, i.e. there's no "downside".
- Do Not rely on a general RoR unless expressly permitted by all potentially applicable state law.
- Do Not consider coverage to the exclusion of all other issues, i.e. the amount in controversy, the insured's willingness to participate in the defense or settlement, the opportunity to settle or the strength of the defense.

Cont. – Maybe Do/Do Not

- Do Nots used to include characterizing the claims or allegations, beyond reciting counts or quoting allegations.
  - New Missouri case and authority cited suggests potential duty to "explain" coverage position which necessarily requires some characterization of the subject claims in relation to the applicable policy provisions
- "Reserve" the right to disclaim coverage for claims or damages that clearly are not covered. Consider definitive coverage position on all clearly covered or uncovered claims, i.e. the non-reservation reservation.
  - Highly dependent on jurisdiction.

Remember

- “Just how dumb you are depends a lot on which part of the United States you're standing in.” (or something like that)– The Bandit