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# Insurance Litigation Under Reservation of Rights: Reimbursement of Defense Costs and Control of Defense

Navigating Scope of Insurer and Insured Duties, Protecting Rights of Both Parties When an Insurer Reserves

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Today's faculty features:

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# Insurance Litigation Under Reservation of Rights: Reimbursement of Defense Costs and Control of Defense

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# **PRESERVING RIGHTS IN A RESERVATION OF RIGHTS LETTER**

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David Borovsky

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# Reservation of Rights Letter

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- If no potentially covered claims, carrier will issue a denial
- If all claims are covered, carrier will unequivocally agreed to defend and indemnify
- ROR only issued in specific circumstances
  - Claim has been asserted against insured
  - Insured seeks defense and indemnity
  - Coverage for potential future judgment is uncertain

# Definition

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- A reservation of rights letter is a written communication to the policyholder advising that the insurer's assumption of the defense is not unconditional.
- Distinguish: Non-waiver agreement is a bilateral agreement between the insured and policyholder that by defending the action, the insurer does not waive its rights to later assert some defense to coverage.



# Scope of Reservation of Rights

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- Coverage defenses – Some claims asserted are not covered under policy
- Policy defenses – Policy not enforceable for some reason, such as policyholder's breach of policy condition
- Reimbursement of defense fees or settlement payments
- Right to file lawsuit for declaratory relief

# Purpose

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- ROR notifies insured that the carrier has agreed to defend against the underlying claim, but the carrier is not yet agreeing to indemnify against a future judgment
- Serves to prevent waiver of carrier's coverage defenses
- Enables insured to make informed decisions
- Allows defense counsel to strategize in manner most beneficial to his or her client

# Reasons for Reserving Rights

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- Avoid indemnifying insured for non-covered claims
- Withdraw from defense at later date
- Seek reimbursement of defense and/or settlement payments

# Drafting the ROR Letter

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- Some jurisdictions contain specific statutory requirements:
  - Some jurisdictions require that letter be sent directly to the insured (including additional insureds) - *See e.g., Florida Statutes § 627.426; Colo. Rev. Stat. §10-1-131 (2013); 3 Colo. Code Regs. 702-5 (2013).*
  - Some jurisdictions impose specific requirements concerning the contents of an ROR - *E.g. Florida Statute § 627.426(2)*

# Drafting the ROR Letter

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- **Introduction:** Summarize the purpose of the letter, key rights being reserved
- **Fact Section:**
- Provide factual background and procedural history, including:
  - Key documents reviewed
  - Specific claims and allegations in the complaint
- Invite the insured to correct any misstatements of facts or facts that were omitted
- Acknowledge that allegations may lack merit, but that they do raise coverage issues

# Drafting the ROR Letter

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- **Policy Language section:**
- Cite all pertinent policy provisions
- Identify the policy number, the effective dates, the applicable limits, and any deductible
- Identify whether it is a “burning limits” policy and let the insured know whether defense costs reduce the available limits
  - “These payments will reduce the Limits of Insurance.”

# Drafting the ROR Letter

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- **Analysis section:**
- Provide explanation of claims that are potentially not covered
- Determine how much legal analysis to include
  - Has the insured retained coverage counsel?
  - Keep in mind that it will be addressed to a lay person (including potential future jurors)

# Drafting the ROR Letter

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- **Conclusion section:** Reiterate key points of ROR
- Be clear that carrier is providing a defense but that defense is subject to a complete reservation of all rights under the policy the applicable law
- Reserve the right to:
  - Continue to investigate the facts
  - Re-evaluate coverage upon the discovery of new facts or amendment to the pleadings
  - Participate in the defense
  - Deny coverage for all or part of any judgment or settlement



# Drafting the ROR Letter

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- Reserve the right to:
  - Withdraw from the defense
  - Seek reimbursement of defense fees and settlement costs
    - California's *Buss v. Superior Court* decision (16 Cal. 4th 35, 61 (Cal. 1997)) allows reimbursement where the insurer properly and timely reserved its rights
    - Other courts do not allow insurers to unilaterally reserve the right to seek reimbursement, absent a specific provision in the policy allowing the same. *General Agents Insurance Company of America, Inc. v. Midwest Sporting Goods Company*, 828 N.E.2d 1092 (Ill. 2005)

# Drafting the ROR Letter

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➤ Reserve the right to:

■ File a declaratory relief action

- Some states require a carrier to seek declaratory relief after a claim is submitted for coverage but before a formal declination of coverage is issued. *See, e.g. Atlanta Casualty Co. v. Fountain*, 262 Ga. 16, 17 (1992)
- Other states require the carrier to defend the action and later seek declaratory relief after its conclusion. *Hecla Mining Co. v. New Hampshire Ins. Co.*, 811 P.2d 1083, 1089 (Colo. 1991)
- Other states permit the filing of a declaratory relief action while the carrier is defending, although such an action may be stayed pending resolution of the underlying litigation. *E.g., Great American Ins. Co. v. Superior Court*, 178 Cal. App. 4th 221, 225 (Cal. Ct. App. 2009)

# Drafting the ROR Letter

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- Include a “catch all”
  - Please understand that this letter is intended to provide a detailed explanation of the basis for INSURER’S coverage determination, however there may be other policy terms and provisions or arguments that apply which are not specifically mentioned in this letter. INSURER’S failure to mention such matters does not mean that it is waiving the right to later assert them. INSURER expressly reserves the right to raise any other coverage defense not expressed in this letter.

# Considerations

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- You want to maintain an appropriate balance between adequately preserving coverage defenses, and not overwhelming the insured
- Touch upon everything that is reasonably triggered by the facts at hand
- Letter should be based on defenses presently known and can always be supplemented

# Considerations

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- ROR must be sent within a reasonable time. *See Penn-America Ins. Co. v. Sanchez*, 202 P.3d 472, 476-477 (Ariz. Ct. App. 2009)
  - Not timely where over 22 months elapsed between the filing of the underlying complaint and the purported reservation of rights. *Cozzens v. Bazzani Building Company*, 456 F.Supp. 192, 201 (E.D. Mich. 1978)
  - ROR letter sent three months into the underlying litigation and just over a month after service was effected was timely. *Amerisure Mutual Insurance Company v. Carey Transportation, Inc.*, 578 F.Supp.2d 888, 903-904 (W.D. Mich. 2008)
- Objective is to not prejudice the rights of the insured
  - *See Jones v. Continental Cas. Co.*, 123 N.J. Super. 353, 303 A.2d 91, 93 (Ch. Div. 1973) (when requested to defend, insurer "is entitled to a reasonable time period within which to investigate and determine whether there is coverage under the terms of the policy, so long as its actions do not in any way prejudice the insured")

# Deficient or Untimely Reservation

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- General rule: There is no specific time by which an insurer must provide a reservation of rights letter.
- General rule: Doctrines of waiver and estoppel cannot be used to create insurance coverage where none exists under the terms of the policy.
- Exception to general rule: Insurer assumes defense without timely reserving its right to deny coverage. *See, e.g., Farmers Texas County Mut. Ins. Co. v. Wilkinson*, 601 S.W.2d 520, 521-522 (Tex. Civ. App. – Austin 1980).

# Requirement of Prejudice

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- Majority rule: Policyholder must show prejudice by deficient or untimely reservation of rights in order to defeat reservations. *See, e.g., Doe for Doe v. Allstate Ins. Co.*, 653 So.2d 371, 374 (Fla. 1995).
- Presumption of prejudice: In some jurisdictions, an insurer's delay in or failure to promptly reserve its rights gives rise to a presumption of prejudice. *See, e.g., Knox-Tenn Rental Co. v. Home Ins. Co.*, 2 F.3d 678, 684 (6<sup>th</sup> Cir. 1993) (applying Tennessee law). In other jurisdictions, there is no presumption of prejudice. *See, e.g., Federal Ins. Co. v. Susquehanna Broadcasting Co.*, 727 F. Supp. 169, 171 (M.D. Pa. 1989).

# Factors for determining Waiver/Estoppel

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- Length of time between tender and reservation
- Length of time before tender
- Length of time insurer defends without reservation compared to length of time insurer defends with reservation
- Stage of litigation at time of reservation
- Insurer's diligence in investigating defenses
- Whether insured is represented by counsel (or discharged same)
- Whether insured exercised control over defense



# **POLICYHOLDER RIGHTS WHEN FACED WITH A DEFENSE UNDER ROR**

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Mark Garbowski  
Anderson Kill

# Policyholder Perspective

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- **The purpose of a reservation of rights letter is to give fair notice to the policyholder that the insurance company intends to assert defenses to coverage, and to identify those defenses.**
- **Based Upon What is Known at That Time**

# Waiver and Estoppel

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- **Waiver is the Voluntary and Intentional Relinquishment of a Known Right.**
  - failure to assert a known policy defense
  - Different treatment of coverage grant, exclusions, and conditions
  - Late notice, cooperation
- **Does the Letter Address What the Insurance Company Knows?**
  - Meaningful Description of Issues and Facts
  - Quote *Relevant* Policy Language

# Waiver and Estoppel

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- **Carrier Barred from Taking a Position Because of:**
  - prior action
  - upon which the policyholder relied
  - reliance was justifiable
  - reliance was detrimental (prejudice)
  - timeliness of letter or updates
- **Equitable Remedy**

# Non-Waiver Agreements

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- **Rarely Benefit Policyholder**
- **Possibly Supersedes Policy Terms**
- **Might Allow Insurance Company to Avoid Waiving Defenses it Fails to Assert in Letter**
- **Can Facilitate Insurance Company Recovery of Defense Costs**

# Policyholder Response

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- **Avoid signing non-waiver agreement**
- **Indicate disagreement with reservation of rights letters**
- **Ask for legal and policy-language support for insurance company position, if not provided**

# Cooperation Issues

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- **Policies Generally Contain, as a Condition of Coverage, a Duty to Cooperate in:**
  - investigation
  - defense
  - settlement
- **authorizes carriers to obtain records**

# Information Requests

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- **Public Information**
- **Litigation Matters**
- **Non-Litigation Matters**
- **Privileged Matters**



# Privileged Information

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- **Duty to Cooperate Does Not Imply a Duty to Disclose Privileged Communications in Coverage Dispute**
- **Most Courts Support Policyholders**
- **Attorney / Client Relationship**
  - underlying litigation
  - coverage issues

# Privileged Information

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- **Possible Waiver of Privilege As To Insurance Company -- “At Issue” Doctrine**
  - filing claim
  - demand defense cost
  - file suit against carrier
- **Possible Waiver of Privilege As To Third Parties**
  - Possible if no “common interest” with insurance company

# Voluminous Request

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- **Respond with All Non-Privileged Material**
- **Be Creative with Compliance**
- **Emphasize the Appearance of Cooperation**
- **Avoid Saying No**
- **Invite Insurance Company to View Documents On Site**
- **“Material” Matters**

# Independent Counsel

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- **Duty to Defend + Coverage Defense**
- **Conflict of Interest**
- **Majority Rule in One Form or Another**
  - entitled to own counsel at insurance company's expense
- **McGee v. Superior Court**
  - “Cumis counsel” when carrier issues reservation of rights letter

# California Civil Code § 2860

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- (a) If a policy of insurance impose[s] a duty to defend upon an insurer and a conflict of interest arises which creates a duty on the part of the insurer to provide independent counsel to the insured, the insurer shall provide independent counsel to represent the insured unless, at the time the insured is informed that a possible conflict may arise or does exist, the insured expressly waives, in writing, the right to independent counsel. An insurance contract may contain a provision which sets forth the method of selecting that counsel consistent with this section.
- (b) [A] conflict of interest does not exist as to allegations or facts in the litigation for which the insurer denies coverage; however, when an insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by counsel first retained by the insurer for the defense of the claim, a conflict of interest may exist. ...

# Independent Counsel

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- Fees
  - Reasonableness based on nature of the case and local rates
  - Arbitration of disputes
- Selection of Counsel
- Compliance with Litigation Guidelines
- Communication With Insurance Company

# Control: Strategy and Settlement

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- Policy language
- Is There Independent Counsel?
- Compartmentalization
- Settlement
  - Permission Before Forgiveness
  - Effect On Exclusions And Coverage Determination

# **INSURER DUTIES WHEN DEFENDING UNDER RESERVATION OF RIGHTS**

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David Borovsky

Becherer Kannett & Schweitzer



# If Defense Is Accepted With Reservation

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- Same basic defense obligation as if no ROR in place
- Must defend all claims, both covered and uncovered
- Insurer controls the defense and may appoint counsel of its choice
- Impact of coverage issues on the defense provided

# If Coverage Is Accepted With Reservation

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- If the insurer agrees to defend subject to a reservation of rights, the reservation may trigger right to independent counsel
  - In some states, a reservation of rights automatically triggers the policyholder's right to independent counsel – *e.g., Moeller v. American Guaranty & Liability Ins. Co.* 707 So.2d 1062, 1068-70 (Miss. 1998)
  - In some states, a reservation of rights triggers the insured's right to independent counsel if the insurers' reservation of rights creates a conflict that prevents defense counsel from jointly representing the policyholder and its carrier – *e.g., San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc.*, 162 Cal. App.3d 358, 364-75 (Cal.Ct.App. 1984) (*superseded by statute*, Cal. Civil Code § 2860)

# If Independent Counsel Is Required

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- In some states, the insured selects independent counsel
  - There may be statutory or other limitations on rates – *e.g.*, Cal. Civ. Code § 2860(d)
- In some states, the insurer has the right to select independent counsel
  - *E.g.*, *Michigan Millers Mut. Ins. Co. v. Bronson Plating Co.*, 496 N.W.2d 373, 378 (Mich.Ct.App. 1992)
- In some states, independent counsel must be mutually agreed upon
  - *E.g.*, Fla. Stat. Ann. § 627.426

# Insurer Duties re: Independent Counsel

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- Impact on Insurer's control of the defense and settlement
- Impact of coverage issues on the defense provided

# INSURER'S SUBSEQUENT WITHDRAWAL OF DEFENSE

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Anderson Kill

# Withdrawal Of Defense

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- Reason for Withdrawal
  - Court order finding no duty to defend
  - Unilateral Action
  - Developments In Underlying Case
  - Exhaustion of Limits
- Other Potential Carriers Responsible For Defense

# After Withdrawal Of Defense

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- Continue Keeping Insurance Company Informed of Case Progress
  - Settlement opportunities, talks, demands
  - Non-privileged information
- Seek Agreement That Policyholder Did Not Settle or Take Action Without Approval
- Reasonableness

# REIMBURSEMENT OF DEFENSE COSTS FOR UNCOVERED CLAIMS

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# Right to Reimbursement

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- Not all jurisdictions allow insurers to seek reimbursement of defense costs – *e.g.*, *General Agents Ins. Co. v. Midwest Sporting Goods Co.*, 828 N.E.2d 1092, 1104 (Ill. 2005)
- Other jurisdictions have established case law on the scope of the reimbursement – *e.g.*, *Buss v. Superior Court*, 939 P.2d 766, 779-84 (Cal. 1997)

# Right to Reimbursement

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## ➤ Practical Issues:

- Allocating between covered and non-covered claims
- Allocating a settlement payment or judgment against the insured

# Recovery of Defense Costs

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- Basis In Policy?
- Policyholder Assent
- Costs Incurred Before Assertion of Right
- Allocation of Costs
  - Treatment of costs relevant to covered and uncovered claims
  - Burden of Proof