"Oh You're So Reserved:" Trends and Topics in Reservation of Rights Letters

I. Overview of Reservation of Rights Letters

A. What they are

When an insurer first receives notice of a claim against its insured which is arguably covered but still questionable, insurers typically advise the insured that the insurer will defend the insured under a reservation of rights. Barry R. Ostrager and Thomas R. Newman, *Handbook on Insurance Coverage Disputes* § 2.02 (17th ed. 2015) ("*Ostrager & Newman*"). As the duty to defend is generally broader than the duty to indemnify, a reservation of rights where coverage is arguable "allow[s] the insurer to challenge its liability on the underlying claim while still fulfilling its obligations under the policy." 14A Steven Plitt, Daniel Maldonado, Joshua D. Rogers, and Jordan R. Plitt, *Couch on Insurance* § 202.39 (3d ed. 1995); *see also Liberty Mutual Ins. Co. v. Metropolitan Life Ins. Co.*, 260 F.3d 54 (1st Cir. 2001); *Home Federal Sav. Bank v. Ticor Title Ins. Co.*, 695 F.3d 725 (7th Cir. 2012). A reservation of rights letter is a written response to a claim that an insurer may issue to its insured which specifically reserves the insurer's right to deny indemnity or withdraw from the proffered defense should the claim fall outside the insurer's coverage obligations. *Couch on Insurance* at § 202.39.

B. Purpose

The purpose of a reservation of rights letter is to timely and fairly inform an insured of the insurer's coverage position and preserve the insurer's right to assert any defenses to coverage, while still fulfilling the insurer's duty to defend the insured in the interim. *Ostrager & Newman* at § 2.02[a]. Otherwise, by assuming and controlling the insured's defense without a sufficient reservation of rights, an insurer runs the risk of being estopped from subsequently denying coverage. *See Minn. Commercial Ry. Co. v. General Star Indem. Co.*, 408 F.3d 1061, 1063 (8th

Cir. 2005); *see Steadfast Ins. Co. v. Stroock & Stroock & Lavan LLP*, 277 F. Supp. 2d 245, 254 (S.D.N.Y. 2014); *see also Ostrager & Newman* at § 2.02[a]. This fulfills in the immediate near-term the insurer's duty to respond to the insured's claim. *Couch on Insurance* at § 202.2. After reserving its rights, an insurer may seek to have any identified coverage issues resolved by way of a separate declaratory judgment action or by submitting the question to the factfinder in the case itself. *See RSUI Indem. Co. v. New Horizon Kids Quest, Inc.*, 933 F.3d 960, 963 (8th Cir. 2019); *see also Couch on Insurance* at § 202.3. Furthermore, an insurer may also have secondary goals in submitting a reservation of rights letter, including maintaining a productive relationship with its insured and demonstrating to a reviewing court that the insurer acted reasonably and clearly to clarify its position. *See generally Couch on Insurance* § 202.18.

C. What reservation of rights letters should generally include

A successful reservation of rights letter effectively informs the insured of all potential defenses to coverage which the insurer has identified in its initial analysis of the claim. The letter should be clearly labelled as a reservation of rights, identify the policy or policies and any specific policy language at issue, specifically note the right to deny indemnity coverage and withdraw from the defense, and contain a discussion of the relevant factual background and claims made by the insured. *See e.g.*, *Western Heritage Ins. Co. v. Love,* 24 F. Supp. 3d (W.D. Mo. 2014), *aff'd*, *Western Heritage Ins. Co. v. Asphalt Wizards*, 795 F.3d 832 (8th Cir. 2015). As a general rule a reservation of rights letter should include the specific factual and legal bases upon which the insurer may subsequently wish to contest coverage, as well as which specific claims those factors pertain to. *See id.*, *see also Ostrager and Newman* at § 2.02[b]. For example, this includes factual developments which may alter the insurer's initial coverage analysis, specific terms of the insurance policy which may preclude coverage, and any related statutory or precedential factors.

See Ostrager & Newman at § 2.02[b]; *see Western Heritage*, 24 F. Supp. 3d at 877-78. In addition, the letter should lay out the proposed defense arrangement and advise "the insured of any actual or potential conflicts of interest between the insurer and the insured," including the insured's right to independent defense counsel to address said conflict if so entitled. *Western Heritage*, 24 F. Supp. 3d 877-78.

D. What recipient of ROR letters reads, sees, and takes away from these letters

An effective reservation of rights letter will have notified the policyholder of the insurer's position and essential reasoning regarding coverage of the claim or claims at issue. Where a reservation of rights letter contains some reservations and some denials, the recipient may be inclined to interpret any vaguely-worded reservations as admissions of coverage. Alternatively, the insured may read a poorly-identified reservation of rights letter as a denial letter, frustrating the insurer's purpose in providing their coverage position. *See e.g.*, *Cay Divers v. Raven,* 812 F.2d 866, 871 (3d Cir. 1987). This highlights the importance, pursuant to the goal of the reservation, that the letter be clear regarding the insurer's position on each claim. Where the reservation of rights letter highlights an actual conflict of interest between the insurer and insured, based on the particular governing authority, the insured may require independent counsel to safeguard their interest not shared with the insurer. *See Couch on Insurance* at § 202.48.

II. Key Language to Include in Reservation of Rights Letters

In order to most effectively accomplish an insurer's goals and adequately protect its interests, a reservation of rights letter should follow best practices calibrated to achieving that result. The reservation of rights letter should specifically raise each possible defense to coverage and note the right to raise additional defenses which may become relevant in light of further investigation. *See Ostrager & Newman* at § 2.02[b]. When the coverage issues on which the

reservation of rights letter is based are fact dependent, the insurer should stay apprised of developments in the underlying litigation and their impact on the reservation of rights. *See id*. Issuing a supplemental reservation of rights letter is often advisable where testimony or documents in the underlying action impact the coverage issues. *See e.g., Wellons, Inc. v. Lexington Ins. Co.*, 931 F. Supp. 2d 1228 (N.D. Ga. 2013), *aff'd*, 566 Fed. Appx. 813 (11th Cir. 2014).

In the event that only some claims are arguably covered, depending on governing law, the insurer should inform the insured that they have the right to or may wish to retain independent counsel to address claims that have been denied in the letter. *See, e.g., Sempra Energy v. Associated Elec. and Gas Ins. Servs. Ltd.*, 473 F. Supp. 3d 1052, 1065 (C.D. Cal. 2020); *see J.E.M. v. Fidelity Cas. Co. of N.Y.*, 928 S.W.2d 668, 674 (Tex. App. 1996); *see also Couch on Insurance* at § 202.48.

If an insurer intends to institute a declaratory judgment action, that is often conveyed in the reservation of rights letter. *See Couch on Insurance* at § 202.42. The insurer may wish to assert this right immediately upon the conclusion of the initial investigation of a claim and notify the insured of its intention to do so, in order to resolve coverage disputes before committing to a potentially lengthy and costly defense. *See Scherschlight v. Empire Fire & Marine Ins. Co.*, 494 F. Supp. 936, 938-39 (D.S.D. 1980), *aff'd,* 662 F.2d 470 (8th Cir. 1981).

Some jurisdictions that permit reimbursement of defense costs require an insurer to notify the insured of the insurer's intent to seek reimbursement in the event the coverage issue is resolved in the insurer's favor. *Couch on Insurance* § 202.41. The best practice is for an insurer to include a provision stating that it retains the right to later seek reimbursement of defense costs if it is ultimately determined that there is no duty to defend. *See Ostrager & Newman* at § 2.03[c]; *see e.g., Walbrook Insurance Co. Ltd. v. Goshgarian & Goshgarian,* 726 F. Supp. 777 (C.D. Cal. 1989); *First Federal Savings and Loan v. Transamerica Title*, 793 F. Supp. 265 (D. Colo.

1992), *aff'd,* 19 F.3d 528 (10th Cir. 1994). In jurisdictions where reimbursement is not permitted, courts have rejected the insurer's claim for reimbursement of defense costs based purely on a purported reservation of the right to seek reimbursement. *See e.g., Westchester Fire Ins. Co. v. Wallerich*, 563 F.3d 707 (8th Cir. 2009); *see also Employers Mut. Cas. Co. v. Bartile Roofs, Inc.,* 618 F.3d 1153, 1175-76 (10th Cir. 2010).

III. Deadlines for Insurers to Issue ROR letters in Various Key Jurisdictions

As discussed in more detail below, most states require that insurers acknowledge a tender of a claim and make a coverage determination within a specified time period. Insurers can comply with these deadlines and preserve their right to subsequently deny or disclaim coverage through the issuance of a reservation of rights letter. The effectiveness of the ROR letter depends on each jurisdiction's requirements with respect to the timeliness component. Some states specify that a ROR letter must be issued within a certain number of days after receipt of a notice of the claim. Other states, however, do not provide a set time deadline and require only that the ROR letter be issued within a "reasonable" time. As you can imagine, what is "reasonable" varies based on the jurisdiction and the particular facts of each case. At the end of the day, whether a ROR is timely depends on the jurisdiction, policy language, and specific factual circumstances underlying the claim at issue. The highlights below are to be considered general guidelines, but not black letter law, for several key jurisdictions.

California - Anything Goes

Where an insurer unconditionally defends an action brought against its insured with knowledge of potential grounds for forfeiture or non-coverage under the policy, however, it may be subject to a waiver of the terms of the policy and an estoppel to the insurer to assert grounds for coverage. *Miller v. Elite Ins. Co.*, 100 Cal. App. 3d 739, 754, 161 Cal. Rptr. 322 (Ct. App. 1980). That said, there is no discrete timeframe under which insurers must provide an insured a reservation of rights letter. *Garamendi v. Golden Eagle Ins. Co.*, 116 Cal.App.4th 694 (2004) ("In virtually every case discussing the waiver issue … the courts have found that there was no waiver if the insurer made a reservation of rights at any time, even if years after the defense was undertaken."); *Ringler*

Assocs. Inc. v. Maryland Cas. Co., 80 Cal. App. 4th 1165, 1189, 96 Cal. Rptr. 2d 136 (2000) ("[T]he courts have repeatedly held that an insurer does not waive or relinquish any coverage defenses it fails to assert at the time of its acceptance of a tender of defense, even when it does not make any express and full reservation of rights for a substantial period of time after the defense has been accepted.");

While insurers may not have to rush to issue an ROR letter (assuming they do not have knowledge of potential grounds for denial), they still must provide a response to communications from a claimant "that reasonably suggest a response is expected" within 15 days. Cal. Code Regs. tit. 10, § 2695.5. Likewise, written notices of claims must be acknowledged within 15 days. Cal. Code Regs. tit. 10, § 2695.5

Florida - Strict 30 Day Compliance

Florida adheres to one of the more strict requirements that insurers must issue written notice of reservation of rights to the named insured within 30 days after the insurer knew or should have known of the coverage defense. Fla. Stat. Ann. § 627.426(c)(2)(a); *Fla. Physicians Ins. Co. v. Stern*, 563 So. 2d 156, 159 (Fla. Dist. Ct. App. 1990). If this deadline is not met an insurer cannot deny coverage for the particular coverage defense for which no reservation of rights letter is issued. Note that Fla. Stat § 627.426 applies only to coverage defenses; it does not preclude insurers from asserting no coverage or application of a policy exclusion. *Harris Specialty Chemicals, Inc. v. U.S. Fire Ins. Co.*, No. 3:98-CV-351-J-20B, 2000 WL 34533982, at *11 (M.D. Fla. July 7, 2000).

After this 30 day deadline, the insurer has 60 days to either notify the claimant of its refusal to defend, defend and obtain a non-waiver agreement disclosing the facts and provisions on which the reservation is issued, or retain independent mutually agreeable counsel to defend the insured. Fla. Stat. Ann. § 627.426(c)(2)(b).

Similarly, insurers must affirm or deny coverage, or provide a written statement that the claim is being investigated, within 30 days after poof of loss statements have been completed. Fla. Stat. Ann. § 626.9541.

Illinois - Reasonable Promptness

Under Illinois law, an insurer wishing to preserve its rights under a policy must notify the insured "without delay" or "with reasonable promptness". Ill. Admin. Code tit. 50, § 919.50; *Am. States Ins. Co. v. Nat'l Cycle, Inc.*, 260 Ill. App. 3d 299, 306, 631 N.E.2d 1292, 1297 (1994) (finding no waiver where three and a half months passed between insurer providing counsel and issuance of reservation of rights letter). If no ROR letter is issued an insurer waives all questions of policy coverage by assuming an insured's defense. *Id.* at 306. This said, Illinois courts have provided the guidance that the sooner the insurer sends the ROR letter to the insured, the better. *Am. Fam. Mut. Ins. Co. v. Westfield Ins. Co.*, 2011 IL App (4th) 110088, ¶ 20, 962 N.E.2d 993, 998 ("the better rule is that the reservation-of-rights letter be sent earlier, rather than later, if that is possible."). As with most reasonableness standards, a delay in providing the insured notice of policy defenses is not dispositive of estoppel or waiver, but can be a factor in determining whether prejudice to the insured exists—the longer the delay, the less reasonable the insurer's conduct. *Twin City Fire Ins. Co. v. Old World Trading Co.*, 266 Ill. App. 3d 1, 11, 639 N.E.2d 584, 590 (1993).

Insurer must exercise reasonable promptness (15 working days) when responding to communications with respect to claims. 215 Ill. Comp. Stat. Ann. 5/154.6(b); Ill. Admin. Code tit. 50, § 919.40. Upon receipt of a claim, an insurer must "adopt and implement reasonable standards for the prompt investigations and settlement of claims," which means that the insurer must communicate with all insureds and claimants when liability is reasonably clear within 21 working days after notification of a loss. 215 Ill. Comp. Stat. Ann. 5/154.6(c); Ill. Admin. Code tit. 50, § 919.40. The insurer has 30 days after completing its investigation to provide the insured with its affirmation or denial of liability, and must provide a reasonable written explanation of the basis of the denial. Ill. Admin. Code tit. 50, § 919.50.

New Jersey – No Unreasonable Delay

New Jersey follows a reasonableness standard with respect to the timing of the issuance of a disclaimer of coverage or ROR letter under which the insurer must not "unreasonably delay" disclaiming coverage. *Griggs v. Bertram*, 88 N.J. 347, 357 (1982) ("Unreasonable delay in disclaiming coverage, or in giving notice of the possibility of such a disclaimer, even before assuming actual control of a case or a defense of an action, can estop an insurer from later repudiating responsibility under the insurance policy."). This said, a delay in timely notifying an insured as to the insurer's decision regarding the applicability of policy exclusions will only act as an estoppel if the insured can show "actual prejudice". *Reliance Ins. Co. v. Armstrong World Indus., Inc.*, 292 N.J. Super. 365, 376 (App. Div. 1996). In the event an insurer undertakes defense of a claim "with knowledge of facts that are relevant to a policy defense or to a basis for noncoverage of the claim, without a valid reservation of rights to deny coverage at a later time, it is estopped from later denying coverage." *Griggs v. Bertram*, 88 N.J. 347, 356 (1982).

N.J.A.C. § 11:2-17.6(b) provides that insurer must acknowledge receipt of claim within 10 working days after receipt. Insurers are then required to commence an investigation on all claims (except auto physical damage claims) within 10 days of receipt of notification of claim. N.J.A.C. § 11:2-17.7(a). N.J.A.C. § 11:2-17.7(c) requires insurers complete investigation of first party claims within 30 calendar days of receipt of proof of loss, and 45 days from receipt of notice for third-party claims. Insurers have 90 calendars days from receipt of notice to complete investigation of third-party bodily injury claims. If an insurer cannot complete the investigation within these timeframes the insurer must send the claimant written notice within these periods stating the reasons for needing additional time and must include the contact information for the insurer's handling office. N.J.A.C. § 11:2-17.7(e) The insurer must then provide a written update every 45 days thereafter until the claim is either honored or rejected. N.J.A.C. § 11:2-17.7(e).

New York - As Soon as is Reasonably Possible

N.Y. Ins. Law § 3420(d)(2) requires an insurer disclaim or deny coverage through written notice "as soon as is reasonably possible." Generally, 30 days is considered reasonable under the statute. However, where grounds for denial are obvious from the face of the complaint, notice of claim, or the policy, a 30 day delay in disclaiming coverage may be unreasonable. *W. 16th St. Tenants Corp. v. Pub. Serv. Mut. Ins. Co.*, 290 A.D.2d 278, 279, 736 N.Y.S.2d 34, 35 (2002); *First Fin. Ins. Co. v. Jetco Contracting Corp.*, 1 N.Y.3d 64, 70, 801 N.E.2d 835, 839 (2003) (48 day delay unreasonable).

At least one New York case voided a coverage disclaimer issued just 8 days after written notice of the claim where the insurer had prior knowledge of the underlying facts (notice of the subject accident) prior to receipt of formal written notice of the claim. *Plumbing v. Burlington Ins. Co.*, 2021 NY Slip Op 01498 (1st Dep't March 16, 2021). Thus, it is notice of the underlying facts, and not the date of receipt of formal notice of the claim, that triggers the temporal window for a response from the insurer under Insurance Law § 3420(d)(2). *Id.*

Pennsylvania - Close in Time

ROR letters must be sent "close-in-time" to the institution of a potentially covered legal action to be considered "timely" in Pennsylvania. *Selective Way Ins. Co. v. MAK Servs., Inc.*, 232 A.3d 762, 768 (Pa. Super. 2020). For some perspective, ROR letters sent within a week of receipt of the complaint have been found timely, but ROR letters issued seven months after receipt of the complaint have been considered untimely. *Brugnoli v. United Nat. Ins. Co.*, 284 Pa. Super. 511, 519, 426 A.2d 164, 168, *order clarified sub nom. Brugnoli v. United Nat'l. Ins. Co.*, 434 A.2d 105 (Pa. Super. 1981); *Erie Ins. Exch. v. Lobenthal*, 114 A.3d 832, 840 (Pa. Super. 2015). An insured may only claim estoppel on the basis of a late ROR letter if a showing of actual prejudice is made. *Merchants Mut. Ins. Co. v. Artis*, 907 F. Supp. 886, 891 (E.D. Pa. 1995). "Actual prejudice occurs when an insurer assumes the insured's defense without timely issuing a reservation of rights letter asserting all possible bases for a potential denial of coverage." *Westport Ins. Corp. v. McClellan*, 493 F. Supp. 3d 315, 324 (E.D. Pa. 2020).

Texas - a Reasonableness Standard

Providing an insured a reservation of rights letter "within a reasonable time" is sufficient for an insurer to comply with Texas' Unfair Claim Settlement Practices statute. 28 Tex. Admin. Code § 21.203 (10) (noting an insurer commits an unfair settlement claims practice by "failing to affirm or deny coverage of a claim to a policyholder within a reasonable time. The reasonable submission of a reservation of rights letter by an insurer to a policyholder within a reasonable time is deemed compliance with the provisions of this paragraph."); *Comsys Info. Tech. Servs., Inc. v. Twin City Fire Ins. Co.*, 130 S.W.3d 181, 190 (Tex. App. 2003) (finding a month and a half delay in providing reservations of rights letter was arguably unreasonable).

Generally under Texas law what is a reasonable time depends on the facts and circumstances in each particular case. *Ins. Co. of N. Am. v. Asarco, Inc.*, 562 S.W.2d 557, 561 (Tex. Civ. App. 1978), *writ refused NRE* (July 5, 1978); *Nat'l Union Fire Ins. Co. v. Bourn*, 441 S.W.2d 592, 595 (Tex. Civ. App. 1969), *writ refused NRE* (Oct. 1, 1969).

IV. Notice to Claimant/Plaintiff

Some jurisdictions have a statutory requirement that the insurer provide the reservation of rights letter to the claimant/plaintiff, and any other party that may qualify as an insured.

New York

New York Insurance Code §3420 provides that in *bodily injury cases,* the insurer must provide a copy of the reservation of rights letter to the claimant or the claimant's attorney. Section 3420(d)(2) states:

> If under a liability policy issued or delivered in this state, an insurer shall disclaim liability or deny coverage for death or bodily injury arising out of a motor vehicle accident or any other type of accident occurring within this state, it shall give written notice as soon as is reasonably possible of such disclaimer of liability or denial of coverage to the insured and the injured person or any other claimant.

Thus the insurer must give prompt written notice of a disclaimer of liability or denial of coverage to any party that has a claim against the insured arising under the policy. *Bovis Lend Lease LMB, Inc. v. Royal Surplus Lines Ins. Co.*, 27 A.D.3d 84, 90, 806 N.Y.S.2d 53 (2005)

Failure to give such notice renders the disclaimer under the statutory scheme ineffective. *Hartford Ins. Co. v. Nassau Cnty.*, 46 N.Y.2d 1028, 1030 (1979).

Recent New York authority has suggested that this statutory section can be applied to situations where the policy was not issued or delivered in New York but the accident occurred there. The Court of Appeals of New York in *Carlson v. American Intl. Group, Inc.*, 2017 N.Y. LEXIS 3280, No. 47, (N.Y. Nov. 20, 2017) overturned the lower court's determination that N.Y. Insurance Law § 3420, governing certain liability insurance "issued or delivered" in New York did not apply to a policy issued to and received by the insured outside of New York. The high court found that because it covered risks within the State of New York, that qualified as "issued or delivered in this state."

Virginia

Virginia has a similar requirement. Under Virginia Code § 38.2-2226:

> Whenever any insurer on a policy of liability insurance discovers a breach of the terms or conditions of the insurance contract by the insured, the insurer shall notify the claimant or the claimant's counsel of the breach. Notification shall be given within forty-five days after discovery by the insurer of the breach or of the claim, whichever is later. Whenever, on account of such breach, a nonwaiver of rights agreement is executed by the insurer and the insured, or a reservation of rights letter is sent by the insurer to the insured, notice of such action shall be given to the claimant or the claimant's counsel within forty-five days after that agreement is executed or the letter is sent, or after notice of the claim is received, whichever is later. Failure to give the notice within forty-five days will result in a waiver of the defense based on such breach to the extent of the claim by operation of law.
>
> Section 38.2-2226 also provides:
>
> Notwithstanding the provisions of this section, in any claim in which a civil action has been filed by the claimant, the insurer shall give notice of reservation of rights

> in writing to the claimant, or if the claimant is represented by counsel, to claimant's counsel not less than thirty days prior to the date set for trial of the matter. The court, upon motion of the insurer and for good cause shown, may allow such notice to be given fewer than thirty days prior to the trial date. Failure to give the notice within thirty days of the trial date, or such shorter period as the court may have allowed, shall result in a waiver of the defense based on such breach to the extent of the claim by operation of law.

In *National Casualty Insurance Company v. Solomon,* No. 20-699 (D.D.C. Nov. 24, 2020), Solomon was sued for legal malpractice. National Casualty provided Solomon a defense under a reservation of rights but asserted the insured violated the notice provision by failing to provide a notice of circumstance as required under the policy. National Casualty issued several reservation of rights letters but never provided them to the underlying plaintiff, Atlanta Channel Company. Atlanta Channel then argued that because National Casualty violated Virginia Code § 38.2-2226, the insurer waived its right to deny coverage to Solomon. The District Court for the District of Columbia agreed and held coverage was waived. This punitive result is limited to situations where the insured breaches the policy:

> Courts have therefore rightly held that the statute (or its precursor) doesn't apply when an insurer denies coverage because the claim falls outside the scope of policy coverage. (citations omitted) The argument that a claim is outside the scope of coverage is not about an insured's 'breach' of contract. A 'breach' assumes a legal duty on the insured's part, but the insured obviously has no legal duty to incur covered claims. Likewise, a denial based on scope of coverage is not a 'defense,' as a 'defense' presupposes the insurer's existing obligation to provide coverage.

Gateway Residences at Exchange, LLC v. Illinois Union Insurance Company, 917 F.3d 269, 274 (4th Cir. 2019)

V. What Counsel for Policyholders Look For In Reservation of Rights Letters

A. The Policyholder's Perspective

General Boilerplate Disclaimer Language Won't Work. The most common complaint from the policyholder perspective is about reservation of rights letters that lack specificity. For reasons of fairness, an effective reservation of rights letter must pinpoint the reasons why the insurer, even if it is providing a defense, believes that it may not be obligated to provide coverage.

An example of a bad reservation of rights letter is one that begins with a brief —often lopsided—summary of the facts followed by several pages of policy language—much of it totally irrelevant—and then a concluding statement that the insurer reserves its rights for many reasons.

What is missing is a cogent explanation why actually, fairly considering the claim from the policyholder's perspective, the insurer believes that it has the right to deny coverage. Policyholders are often left wondering which of the reasons are important ones, and sometimes even bewildered by why the insurer is providing a defense if there are so many reasons that it believes it does not have to. What is a policyholder to make of it? Can the reasons for denial be explained away or cured? Is the purpose of the ROR letter to properly preserve coverage defenses, or is it to let the policyholder know what is actually going on?

It is somewhat understandable why an insurer would take a throw-in-everything-but-the-kitchen-sink approach. It is human nature, or perhaps simply lawyers' nature, to try to cover every possible base. Insurers often seem to be motivated by a fear of leaving some possible defense out, more so than fairly letting the policyholder know what defenses it truly believes it can rely upon. However, cases like *Hoover v. Maxum Indem. Co*., 730 S.E.2d 413 (Ga. 2012) and *Harleysville Group Ins. v. Heritage Group Cmtys., Inc.*, 803 S.E.2d 288 (S.C. 2017) discussed in detail below demonstrate that insurers may not rely on general or boilerplate reservation of rights to avoid coverage.

There are several reasons why it is important for insurers to state which policy defenses it actually is relying upon in a reservation of right letter. From a fairness perspective, the policyholder needs to know what facts or theories that it needs to rebut. "If the insured does not know the grounds on which the insurer may contest coverage, the insured is placed at a disadvantage because it loses the opportunity to investigate and prepare a defense on its own." *Desert Ridge Resort LLC v. Occidental Fire & Cas. Co. of N.C.*, 141 F.Supp.3d 962, 967 (D. Ariz. 2015).

Many courts have concluded that a reservation of rights letter is not valid if it does not fairly inform the policyholder the insured's position. Below is a discussion of four recent major decisions:

In *Hoover v. Maxum Indem. Co*., 730 S.E.2d 413 (Ga. 2012), the Georgia Supreme Court held that the insurer waived its right to assert a defense based on untimely notice because it did not properly alert the policyholder that the delay in notice would be a potential bar to coverage. The court further held that since the insurer waived its right to assert the untimely notice defense, timely notice was not a prerequisite to the insurer's duty to defend. In reaching this decision, the Court noted that under Georgia law, an insurer cannot both deny a claim outright and attempt to reserve the right to assert a different defense in the future. Additionally, for a reservation of rights letter to be effective and valid, it "must be unambiguous" and must "fairly inform the insured of the insurer's position." *Id*. at 417 (internal citation omitted). "If it is ambiguous, the purported reservation of rights must be construed strictly against the insurer and liberally in favor of the insured." *Id*. The court found that the insurer's general boilerplate disclaimer language reserving "the right to disclaim coverage on any other basis that may become apparent as this matter progresses and as [insurer] obtains additional information" did not unambiguously inform the policyholder of the specific defense the insurer intended to pursue and was therefore invalid. *Id*.

The *Hoover* decision is not an outlier. In *Advantage Builders & Exteriors, Inc. v. Mid-Continent Casualty Co.*, 449 S.W.3d 16 (Mo. Ct. App. 2014), the insurer sent two letters to the policyholder with general boilerplate reservation of rights language stating that "[t]he above analysis constitutes our best efforts to inform you of all factors, which we are currently aware of, that may affect our ultimate responsibility to provide a defense and/or indemnification for damages that may be imposed against you in this litigation." *Id.* at 24. Similar to the requirements set forth

in *Hoover*, the Court highlighted that a proper reservation of rights letter "should be specific and unambiguous," should fully explain the insurer's coverage position, and "must avoid any confusion." *Id*. at 23 (internal citation and quotation omitted). Since both letters only "generally discussed the nature of the underlying lawsuit and set forth various provisions" and did not "actually analyzing anything or explaining what coverage issues might exist," the Court ultimately held that both letters were ineffective and the insurer was estopped to deny coverage. *Id*. at 23.

In *Harleysville Group Ins. v. Heritage Group Cmtys., Inc.*, 803 S.E.2d 288 (S.C. 2017), the Court held that even though the insurer issued multiple letters to its insureds, these letters were insufficient to reserve the insurer's right to contest coverage. The letters explained that the insurer would provide a defense in the underlying suites, listed the name contact information for the defense attorney the insurer had selected, identified the particular insured entity and lawsuit at issue, summarized the allegations in the complaint, identified the policy numbers and policy periods for policies that potentially provided coverage, and "through a cut-and-paste approach" incorporated various policy terms and provisions. *Id.* at 293. Despite these policy references, the Court pointed out that these letters: (1) "gave no express reservation or other indication that it disputed coverage for any specific portion or type of damages," (2) did not indicate that the insurer intended to file suit to contest various coverage issues in the event the policyholder was found liable in the underlying lawsuit, (3) did not "inform the insureds that a conflict of interest may have existed or that they should protect their interests by requesting an appropriate verdict." *Id*. at 300. The Court concluded, the insurer's reservation "was no more than a general warning" and "too imprecise to shield [the insurer]." *Id*. (internal quotation omitted).

Moreover, it is worth noting that even under a reservation of rights, an insurer still owes its policyholder an obligation to provide a defense. In *National Indemnity Co. v. State*, among other

issues, the Montana Supreme Court affirmed the lower court's holding that the insurer "breached the duty to defend by its many-year delay in seeking judicial resolution of its reserved coverage issues." 499 P.3d 516, 536 (Mont. 2021). In this case, the policyholder rejected the insurer's offer of a defense subject to a reservation of rights for reimbursement of defense costs. The insurer did not initiate a declaratory action to resolve coverage issues until six years after the rejection, almost ten years after the policyholder's notice of claims, and four years after the insurer acknowledged to the policyholder there was a "need for a judicial determination." *Id*. While acknowledging "there is no categorical rule imposing an obligation on an insurer to file a declaratory judgment action within a certain amount of time," the Court affirmed lower court's holding that "it is even more imperative for an insurer to file a declaratory judgment action where its insured has exercised the right to refuse a defense subject to a reservation of rights." *Id*.

Independent Counsel Rights. Although specific requirements vary from state-to state, a reservation of rights letter may create a conflict of interest, thereby permitting the policyholder to retain independent counsel, paid by the insurer. *See, e.g.*, *Great Divide Ins. Co. v. Carpenter*, 79 P.3d 599, 604 (Alaska 2003) ("Alaska decision and statutory law require an insurance company to provide independent counsel selected by the insured at the company's expense in cases where the company defends under a reservation of rights."); *Watts Water Techs., Inc. v. Fireman's Fund Ins. Co.*, 2007 WL 2083769 at *10, 2007 Mass. Super. LEXIS 266 at *31(Mass. Super. July 11, 2007) (explaining that "[t]hrough its reservation of rights, the insurer's duty to defend is transformed into a duty to reimburse its insured for reasonable attorney's fees incurred by the insured's chosen counsel").

Without sufficient detail as to the bases for the insurer's reservations, a policyholder is stripped of its ability to make an informed decision as to whether to accept supplied defense counsel.

Do I Have To Respond? One question policyholders frequently have is: should respond to the reservation of rights letter? This is an issue where the trend seems to have moved from "not really" to "probably." And it also depends greatly on the content of the letter itself. If the insurer has misstated or overlooked facts for example, the policyholder should respond and make those corrections, particularly if they are key facts in support of coverage.

The same is true if the insurer has overstepped its rights defined under the policy. For example, the insurer may assert the "right" to select defense counsel. While some policies do provide such a right, others do not. And if the insurer's reservation of rights creates a conflict of interest as described above, the policyholder should respond and enforce its right to the counsel of its choosing. Further, if there are practical reasons to retain the policyholder's chosen counsel, the policyholder certainly should voice those reasons and try to persuade the insurer to consent. For example, the policyholder may have counsel with a long relationship who is already equipped with a deep understanding of the policyholder's business. Or in cases of multistate, mass tort liability, the policyholder may already have a network of counsel in place making it less efficient and uneconomical to bring new counsel up to speed. Likewise, if the policyholder's chosen counsel already has invested time and effort in the particular case at issue, changing horses will only result in lost time and money. The issue of the rates may need to be worked out, but in circumstances like these it makes sense for the policyholder to respond on this issue.

A trend in the past few years, and one of the most important things policyholders need to look for and address in a reservation of rights letter, is a reservation of the "right" to recoup costs

for uncovered claims. While some policies do in fact have a provision allowing an insurer to recoup costs advanced for what are uncovered claims, most do not. Most liability policies do not grant the insurer any "right" to recoup defense fees. And this makes good sense because the duty to defend is broad and applies whenever any part of the allegations in a complaint are potentially covered.

Absent an express policy provision, jurisdictions vary on whether an insurer may enforce a reservation of the right to recoup defense costs and this issue continues to be hotly contested. Some jurisdictions hold that there is no right of recoupment of defense costs, even if an insurer attempts to reserve one. *See, e.g.*, *General Agents Ins. Co. of Am., Inc. v. Midwest Sporting Goods Co.,* 828 N.E.2d 1092, 1102 (Ill. 2005) (Illinois Supreme Court rejected an insurer recoupment claim ruling that an insurer may not unilaterally reserve a right to seek reimbursement). At the other end of the spectrum, a few jurisdictions allow an insurer to unilaterally reserve the right to recoup defense costs – no action is needed by the policyholder for the insurer to enforce it. The most well-known case on this issue is *Buss v. Superior Court*, 939 P.2d 766, 778 (Cal. 1997), which still remains in the minority but has been followed recently by the Nevada Supreme Court in *Nautilus Ins. Co. v. Access Med., LLC*, 482 P.3d 683, 690 (Nev. 2021). The Nevada Supreme Court determined that Nevada law would permit recoupment where an insurer reserved its right to seek reimbursement in writing after defense had been tendered. Finally, there are some jurisdictions that hold that where an insurer reserves the right to reimbursement, if the policyholder does not object and accepts the defense being offered, a new implied-in-fact contract is created. *See, e.g., United National Ins. Co. v. SST Fitness Corp*., 209 F.3d 914, 921 (6th Cir. 2002). Consequently, objecting to the reservation in these jurisdictions becomes critical.

VI. Recent Trends in Reservation of Rights Letters Decisions

A. *Selective v. MAK - Pennsylvania*

In *Selective Way Ins. Co. v. MAK Servs., Inc.*, 232 A.3d 762 (Pa. Super. 2020), the Pennsylvania Superior Court held that an insurer's lack of specificity in a reservation of rights letter, where the insurer had knowledge of a basis to exclude coverage, evidenced a deficient investigation on the part of the insurer and therefore prejudiced the insured. As such, *Selective Way* increased the specificity that insurers must provide in reservation of rights letters to effectively preserve defenses to claims in the state of Pennsylvania.

In *Selective,* the insured, a snow and ice removal company, faced a claim brought against it asserting negligence in the removal of snow and ice from a parking lot. The insurer, Selective Way Insurance Company ("Selective Way"), issued a reservation of right letter to the insured that generally reserved all of its rights under "applicable law, insurance regulations and policy provisions," including the right to deny coverage. *Id.* at 768. The letter failed to specifically identify any "emergent coverage issues." Instead, the letter purported to cover any and all issues "that may become relevant as this matter continues to develop." *Id.*

While the reservation letter Selective Way issued may have sufficiently apprised the insured of future exigencies that might impact coverage, it provided no notice of the existing coverage issues appearing on the face of the policy—specifically the snow and ice removal exclusion. Had Selective Way specifically identified that the snow and ice removal exclusion applied to vitiate its obligation to defend or indemnify the insured, the insured could had secured back-up counsel. *Id.* at 770.

The court in *Selective* specifically stated that it was not "announcing some new paradigm by which Pennsylvania insurance companies must prophylactically raise all potential coverage

defenses in order to preserve them." *Id.* The sticking point for the court, however, was the fact that the snow and ice exclusion was evident on the face of the policy and the record indicates that Selective Way had actual knowledge of the exclusion from the outset, and despite this fact, inexplicably failed to identify the exclusion in the reservation of rights letter. Instead, Selective Way waited eighteen months to inform the insured of the exclusion. The lack of specificity in the reservation of rights letter, despite the insurer's knowledge of the basis to exclude coverage, evidenced a deficient investigation and resulted in prejudice to the insured. Accordingly, the Court found that Selective Way was estopped from asserting the snow and ice exclusion in defense of its defense and indemnity obligations. This is consistent with prior Pennsylvania precedent where insurance companies were estopped from disclaiming coverage where learning of facts to support the exclusion one year prior to asserting the exclusion. *Basoco v. Just*, 35 A.2d 564, 565-66 (Pa. Super. 1944).

After *Selective* was decided, several federal district courts in the Eastern District of Pennsylvania had interpreted the case to require insurers to "conduct a timely and adequate investigation of the insured's claim and 'clearly communicate' to the insured any basis for disclaiming coverage evident on the face of the insurance policy." *State Farm Mut. Auto. Ins. Co. v. Dabbene*, No. CV 20-1938, 2021 WL 37508, at *13 (E.D. Pa. Jan. 5, 2021). Thus, broad or general reservations are insufficient under Pennsylvania law. In the case new grounds for reservation or potential disclaimer are discovered, the court in *Selective* advised it is a "best practice" to "sent multiple reservation of rights letters during the evolution of a case." *Selective Way Ins. Co. v. MAK Servs., Inc.*, 232 A.3d 762, 770 (Pa. Super. 2020).

An interesting contrast is the federal case in New York, *Lugo v. AIG Life Ins. Co.*, 852 F. Supp. 187, 192 (S.D.N.Y. 1994), which found that it was "obvious" that the insurer did not intend

to abandon or waive any of its defenses when it issued a disclaimer letter stating that the letter "is not to be interpreted as a waiver of any and all other rights and defenses that AIG Life Insurance Company have under the policy provisions, all of which are hereby expressly reserved." But it appears that the trend is moving away from this judicial philosophy.

B. *Harleysville v. Heritage – South Carolina*

In *Harleysville Group Ins. v. Heritage Group Cmtys., Inc.*, 803 S.E.2d 288 (S.C. 2017), the Court held that even though the insurer issued multiple letters to its insureds, these letters were insufficient to reserve the insurer's right to contest coverage. The letters explained that the insurer would provide a defense in the underlying suites, listed the name contact information for the defense attorney the insurer had selected, identified the particular insured entity and lawsuit at issue, summarized the allegations in the complaint, identified the policy numbers and policy periods for policies that potentially provided coverage, and "through a cut-and-paste approach" incorporated various policy terms and provisions. *Id.* at 293. Despite these policy references, the Court pointed out that these letters: (1) "gave no express reservation or other indication that it disputed coverage for any specific portion or type of damages," (2) did not indicate that the insurer intended to file suit to contest various coverage issues in the event the policyholder was found liable in the underlying lawsuit, (3) did not "inform the insureds that a conflict of interest may have existed or that they should protect their interests by requesting an appropriate verdict." *Id*. at 300. The Court concluded, the insurer's reservation "was no more than a general warning" and "too imprecise to shield [the insurer]." *Id*. (internal quotation omitted).

C. *National Indemnity v. State of Montana – Montana*

In *National Indemnity Co. v. State*, among other issues, the Montana Supreme Court affirmed the lower court's holding that the insurer "breached the duty to defend by its many-year

delay in seeking judicial resolution of its reserved coverage issues." 499 P.3d 516, 536 (Mont. 2021). In this case, the policyholder rejected the insurer's offer of a defense subject to a reservation of rights for reimbursement of defense costs. The insurer did not initiate a declaratory action to resolve coverage issues until six years after the rejection, almost ten years after the policyholder's notice of claims, and four years after the insurer acknowledged to the policyholder there was a "need for a judicial determination." *Id*. While acknowledging "there is no categorical rule imposing an obligation on an insurer to file a declaratory judgment action within a certain amount of time," the Court affirmed lower court's holding that "it is even more imperative for an insurer to file a declaratory judgment action where its insured has exercised the right to refuse a defense subject to a reservation of rights." *Id*.