RESERVATION OF RIGHTS LETTERS
FOR CASUALTY CLAIMS

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RESERVATION OF RIGHTS CHECKLIST*

I. Timeliness

1. Ideally: Before answer due

2. Realistically: Call with questions of coverage, identify coverage issues, discuss with insured and follow with a reservation of rights letter as soon as possible, and assign defense counsel

II. Necessary Matters

1. Identify policy
   • Correct policy number
   • Policy period
   • Claim information

2. Purpose of letter
   • Defending pursuant to a reservation of rights
   • No denial language, be clear

3. Summarize pleadings
   • Essential facts and allegations

4. Specific policy language
   • Latest amended petition
   • Quote policy language, don’t paraphrase
   • Relate to allegations
   • Use words like may result

5. Clear and unambiguous
   • No words like unqualified or qualified defense
   • Avoid legal terms

6. Insured’s continued cooperation
   • Tell insured to provide new pleadings in order to reevaluate

7. Insured’s right to own counsel at own expense

8. Insurer’s right to file declaratory judgment action

9. Insurer’s right to assert other policy defenses
10. Insurer’s right to reimbursement of defense or settlement costs for non-covered claims (if allowed)

11. Avoid extraneous information

III. Address and Carbon Copy

1. Always send to insured directly
2. Can send to personal attorney, copying insured
3. Send to defense counsel (?)
4. Never copy underlying plaintiff
5. Can send Certified Mail with receipt
6. Should also send regular mail

IV. Remember to Supplement

1. New petitions
7. New facts developed

*Disclaimer: Different rules of law may apply in different jurisdictions. This outline and paper only offer an overview of the law. Always consult the applicable law of the state at issue for definitive guidance.
RESERVATION OF RIGHTS LETTERS

I. Introduction

Writing an effective reservation of right letter is a crucial tool for a claims professional, as it can mean the difference between preserving policy defenses or paying thousands of dollars on uncovered claims. The purpose of this seminar is to outline the law in the various states regarding the requirements for reservation of rights letters, and to provide a valuable checklist on how to write a clear and effective letter. The course will focus on reserving rights on liability policies, and provide advice on what to do when an insured rejects a reservation of rights.

II. What is a Reservation of Rights Letter?

A. A reservation of rights is a written communication to the policyholder setting forth the company’s assumption of the defense subject to coverage reservations. See Western Cas. & Sur. Co. v. Newell Mfg. Co., 566 S.W.2d 74 (Tex. Civ. App. – San Antonio 1978, writ ref’d n.r.e.). The primary reason for providing a reservation of rights letter is to inform the insured of the coverage and policy defenses and preserve the insurer’s right to assert such defenses. In many jurisdictions, the reservation of rights may allow the insurer to withdraw from the defense once it is able to establish there is no potential for coverage under the policy. The reservation of rights letter also allows the insurer to decline to indemnify the insured for any portion of a judgment that is not covered under the policy, as long as the grounds for non-coverage are raised in the reservation of rights letter.

Reservation of rights or non-waiver agreements should be used when an insurer identifies either coverage defenses or policy defenses.

(1) Coverage Defense – A coverage defense is one by which the liability insurer asserts that a given claim is or may not be covered by its policy. Continental Ins. Co. v. Bayless & Roberts, Inc., 608 P.2d 281, 288-89 (Alaska 1980).

(2) Policy Defense – A policy defense is one by which the liability insurer admits coverage of the claim but asserts that the policy is not enforceable due to the breach of a policy condition by the insured. Continental Ins. Co. v. Bayless & Roberts, Inc., 608 P.2d 281, 288-89 (Alaska 1980). An example would be a breach of a policy condition such as late notice or voluntary payments.

(3) Right to Reimbursement for Defense Fees - The reservation of rights letter may provide the insurer with the right to seek reimbursement for defense costs it pays if it later establishes that those costs were incurred in defending non-covered claims, although whether such a provision is
enforceable varies from jurisdiction to jurisdiction.¹ In many jurisdictions, a reservation of rights to recoup defense costs is only enforceable if it is later determined that there was no duty to defend; courts in those jurisdictions will not allow apportionment of defense costs between covered and non-covered claims. See, for example, United Nat. Ins. Co. v. SST Fitness Corp., 309 F.3d 914 (6th Cir. 2002).

(4) Right to Reimbursement of Amounts Paid to Settle - Likewise, in some states an insurer that settles an action against its insured may be entitled to reimbursement of that portion of the settlement payment that is attributable to noncovered claims. See Blue Ridge Ins. Co. v. Jacobsen, 25 Cal.4th 489 (2001); Nobel Ins. Co. v. Austin Powder Co., 256 F. Supp. 2d 937, 940 (W.D. Ark. 2003) (applying Arkansas law). To be entitled to reimbursement of settlement payments, the insurer must specifically reserve its right to do so. And while the insured’s agreement to reimbursement – and to the settlement – is generally not required, the insurer will need to establish that the amount paid to settle the noncovered claims was reasonable. Blue Ridge Ins. Co., supra, at 502-503. In some jurisdictions, the insurer is required to notify the insured before entering into a settlement and allow the insured to assume its own defense if it is opposed to settlement.

B. Differences Between a Reservation of Rights Letter and a Non-Waiver Agreement

A reservation of rights letter is generally a unilateral letter from the insurer to the insured. By contrast, the term “non-waiver agreement” is sometimes used to refer


Courts in Hawaii, Illinois, Wyoming and the U.S. Court of Appeals for the Third Circuit have refused to enforce a reservation of rights for reimbursement of defense costs. See First Ins. Co. of Hawaii, Inc. v. State by Minami, 66 Haw. 413, 665 P.2d 648, 654 (Hawaii 1983); General Agents Ins. Co. of America, Inc. v. Midwest Sporting Goods Co., 828 N.E.2d 1092, 1099 (Illinois 2005); Shoshone First Bank v. Pacific Employers Ins. Co., 2 P.3d 510, 516 (Wyo. 2000) (reimbursement not permitted where at least one of the claims alleged is covered); Terra Nova Ins. Co. Ltd. v. 900 Bar, Inc., 887 F.2d 1213, 1220 (3rd Cir. 1989) (applying Pennsylvania law). The reason behind this rule is that the insurer should not be permitted to unilaterally amend the policy, especially when the insured may be unschooled in the issues. Also reservation on this issue places insured in position of making Hobson choice between accepting conditions on defense or losing right to defense.

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to a bilateral agreement (signed by both parties) between the insurer and the
insured that the insurer’s defense of the action against the insured will not result
in a waiver of any rights by the insurer to later assert some defense to coverage.
See Western Casualty & Surety Co. v. Newell Mfg. Co., 566 S.W.2d 74, 76 (Tex. Civ. App. – San Antonio 1978, writ ref’d n.r.e.). Other insurers use the term
“non-waiver agreement” when referring to a letter sent to the insured immediately
after the claim is tendered but before the insurer assumes the defense, to advise
that any acts taken by the insurer in investigating the claim will not result in a
waiver of coverage or policy defenses.

III. How to Draft an ROR

To fulfill its intended purpose, the reservation of rights letter must contain certain
information. Some of the specific information that should be included is listed below. In
drafting a reservation of rights letter, specificity, comprehensibility, and timeliness
should be foremost in your thinking. A well drafted reservation of rights letter should
address the following:

A. Timeliness

Whenever it becomes evident to the insurer that a coverage defense or policy
defense may exist, a reservation of rights must be sent. Timeliness is important,
although there is generally no specific deadline for sending a reservation of rights
letter. Much depends on the issue of prejudice, discussed in section IV. If there
is a justifiable reason for a delay in sending a reservation of rights letter, that
reason should be documented in the claim file and, perhaps, in the reservation of
rights letter itself.

Untimely sent

In Collins v. Grange Mut. Cas. Co., 124 Ohio App.3d 574, 579, 706 N.E.2d 856,
859-860 (1997), the court of appeals held that a sixteen-month lapse between
assuming defense and providing a reservation of rights constituted a waiver of the
policy defenses, especially because the insured’s principal did not actively
participate in the defense during that time.

In Dietz-Britton v. Smythe, Cramer Co., 139 Ohio App.3d 337, 348-349, 743
N.E.2d 960 (2000), the court held that reservation of rights was untimely and
created a waiver where the insurer, instead of taking prompt action to reserve its
rights at the time, waited until four weeks before trial, more than two years after
assuming defense of the lawsuit, to reserve its rights.

In Hiser v. Rajki, 700 So.2d 1302 (La.App. 1st Cir. 1997), the court determined
that nonwaiver agreement and coverage letter untimely when asserted 22 days
before trial.

In Meirthew v. Last, 135 N.W.2d 353, 355 (Mich.1965), the court held that the
insurance company's reservation of rights letter sent several years after action was
commenced came too late to avoid presumptive prejudice of both the insured's and, consequently, the plaintiff's rights especially considering the lack of loyalty suggested by such delay.

In *Turner Liquidating Co. v. St. Paul Surplus Lines Ins. Co.*, 93 Ohio App.3d 292, 300, 638 N.E.2d 174, 180 (1994), the court held that providing a defense for nearly one year without reserving rights may give rise to a claim of estoppel.

**Timely sent**

In *Board of County Comm'r's v. Guar. Ins. Co.*, 90 F.R.D. 405, 408-409 (D.Colo.1981), the court held that where the insurer gives timely notice of its disclaimer and the grounds therefore, there is no presumption of prejudice, and the insured must carry its burden of showing reliance to its detriment before estoppel can bar a defense of noncoverage; mere delay in making a disclaimer is not enough.

In *Cassey v. Stewart*, 727 So.2d 655, 658 (La.App.2d.Cir. 1999), a reservation of rights letter to insured was timely when sent one year and eight months after lawsuit was filed against insurer.

In *Delmonte v. State Farm Fire and Cas. Co.*, 90 Hawai'i 39, 51, 975 P.2d 1159 (1999), there was a two-month span between State Farm's assumption of the Delmontes' defense and the issuance of a reservation of rights. The court held that this was not unreasonable and recognized that the insurer may initially assume an unconditional defense while it conducts its own reasonable investigation as to coverage. At the time the Delmontes tendered the defense of the case to State Farm, the litigation had been ongoing from May 1991 until November 1992. A two-month delay therefore was not unreasonable. Moreover, the Delmontes were represented by independent counsel and exercised some control over the defense during that time.

In *General Agents Ins. Co. of America, Inc. v. Midwest Sporting Goods Co.*, 215 Ill.2d 146, 166 828 N.E.2d 1092 (2005), a reservation of rights was considered timely three months after the tender of the lawsuit by the insured, but the court denied the insurer’s claims for reimbursement of defense costs on other grounds.

In *Lextron, Inc. v. Travelers Cas. & Sur. Co.*, 267 F.Supp.2d 1041, 1048 (D.Colo.2003), the insurer's brief assumption of defense in action against its insured, without notifying insured in writing of its reservation of rights, did not bar, on estoppel grounds, insurer's later assertion of defense of noncoverage where insured did not prove prejudice from the assumption of defense because insurer notified insured of intention to withdraw approximately two months after assuming defense and less than four months after underlying litigation commenced.
In Paradigm Ins. Co. v. Texas Richmond Corp., 942 S.W.2d 645, 652 (Tex.App.-Houston [14th Dist.] 1997, writ denied), the court held that issuing a reservation of rights letter 15 days after the answer was due was timely.

In Peters v. State Farm Fire and Cas. Co., 100 N.Y.2d 634, 636, 801 N.E.2d 416, (N.Y. 2003), the court held that State Farm, which learned of the claim in January 1992 and issued reservation of rights letters in February, concluded its investigation and timely disclaimed coverage based on the policy exclusion on April 9, 1992.

In Pennsylvania National Mutual Cas. Ins. Co. v. Kitty Hawk Airways, Inc., 964 F.2d 478, 481, 482 (5th Cir. 1992), the insurer defended for over a year before issuing a reservation of rights. The court held that this was timely, but only after determining that the insurer had defended the insured for over two years under the reservation of rights before going to trial.

In Travelers Casualty and Surety Company v. Ribi Immunochem Research, Inc., 326 Mont. 174, 189, 108 P.3d 469 (2005), the court held that Travelers timely reserved its right to recoup defense costs after the insured was sued in 1993 when Travelers notified the insured of the reservation prior to payment of defense costs in letters sent in February of 1994, January of 1996 and again in March of 1999.

In Village of Waterford v. Reliance Insurance Company, 226 A.D.2d 887, 891, 640 N.Y.S.2d 671 (1996), the court held that reservation of rights letter sent three months after notice of lawsuit given by the insured was timely.

**B. Necessary Matters**

1. **Identify Policy and Purpose of Letter** – The reservation of rights letter should identify the policy under which the defense – and the reservation – is provided. The policy should be identified by policy number and type. This will aid in avoiding confusion where the insured has multiple policies. The letter should also include the date of loss and claim number, again to avoid confusion. Near the beginning of the letter, the insurer should state that the purpose of the correspondence is to reserve the insurer’s rights. This statement should be made in plain language, using the familiar phrase “reservation of rights” so there can be no argument that the insured did not understand the purpose of the letter.

2. **Summarize Pleadings and Facts** – The reservation of rights letter should contain a summation of the complaint and other pleadings that are pertinent to the coverage or policy defense as well as facts relied upon from sources outside the pleadings if you are in a jurisdiction where extrinsic evidence may be considered in determining whether the insurer has a duty to defend.
(3) **Policy Language** - The reservation of rights should quote verbatim the specific policy provisions relied upon. The letter should not quote policy provisions that are clearly not implicated, but if there is some basis to believe that a policy provision may apply, the letter should quote the provision and state that it may also apply to preclude or limit coverage. *Cowan v. Insurance Company of North America*, 22 Ill.App.3d 896, 318 N.E.2d 315 (1974) (reservation of right letter insufficient unless it makes specific reference to the policy defense(s) that may ultimately be asserted). When quoting a policy exclusion, any exception or qualification to that exclusion should also be quoted, unless clearly inapplicable.

(4) **Identify Coverage and Policy Defenses Reserved** - A general reservation of rights letter that does not adequately specify the coverage defenses may be inadequate. *Weber v. Biddle*, 4 Wash. App. 519, 525, 483 P.2d 155, 159 (Wash. App. 1971); *Meirthew v. Last*, 376 Mich. 33, 39, 135 N.W.2d 353, 356 (1965) (insurer’s reservation of right to rely upon “any defense” it might have under the policy was legally insufficient); *Bogle v. Conway*, 199 Kan. 707, 433 P.2d 407 (Kan. 1967) (reservation letter that did not mention any exclusions or the purported factual basis of potential coverage defenses was insufficient); *Dale Osburn, Inc. v. Auto Owners Ins. Co.*, 2003 WL 22718194 (Mich. App. 2003) (unpublished opinion) (agreement to defend "under a full Reservation of Rights pending any factual information that may show that [specific coverage defense applied] and/or that other policy exclusions apply" was insufficient because it left the insured "in the dark as to the nature of the policy defense or defenses that the insurer had in mind").

The reservation of rights must adequately inform the insured of the rights the insurer intends to reserve so that the insured can intelligently choose between retaining his/her own counsel or accepting the tender of defense counsel from the insurer. *Popovich v. Gonzales*, 4 Ill.App.3d 227, 280 N.E.2d 757 (1972). The letter should mention that the insurer reserves its right to withdraw from the defense if it later determines there is no coverage.

The letter should also specifically note whether the insurer is reserving its right to seek reimbursement of defense costs expended in defending claims that are not covered. This will make clear that the insurer is not denying coverage by virtue of the letter and will help defeat any argument by the insured to the contrary. *See Cay Divers, Inc. v. Raven*, 812 F.2d 866 (3d Cir. 1987) (an insured sought to preclude an insurer from asserting a breach by the insured as a bar to the insurer's duty to indemnify by claiming that a reservation of right to contest coverage constituted a denial of coverage).

The drafting should be in a form comprehensible to the insured and should be free from ambiguities. *See Richards Mfg. v. Great American Ins. Co.*,
773 S.W.2d 916 (Tenn.App.1988) (the insurer's conclusion regarding the existence or non-existence of certain coverage defenses must be "clearly and fairly communicated to the insured"); *Farmers Texas Casualty Mut. Ins. Co. v. Wilkinson*, 601 S.W.2d 520 (Tex. Civ. App. – Austin 1980, writ ref’d n.r.e.) (insurer created ambiguity rendering its reservation of rights unenforceable where it sent out two letters on the same day, the first advising that it would provide an unqualified defense to the insured and the second a reservation of rights); *Western Casualty & Surety Co. v. Newell Mfg. Co.*, 566 S.W.2d 74 (Tex. Civ. App. – San Antonio 1978, writ ref’d n.r.e.) (no right to deny indemnity of settlement where insurer reserved right to withdrawal from defense and raised only late notice issue); *Knowx-Tenn Rental Co. v. Home Ins. Co.*, 2 F. 3d 678 (6th Cir. 1993) (Tennessee law) (reservation of rights letter sent to corporate insured was not sufficient to reserve rights as to individually named employee of insured where letter made no reference to the employee).

The letter should include an offer to the insured to review any additional information that they may be aware of, and should include a phrase that will “catch all” other defenses that could become pertinent. This will allow further supplementation of the reservation of rights letter.

(5) **Continued Cooperation** – The reservation of rights should request the continued cooperation of the policyholder, especially if any further facts come to light or if new or amended pleadings are served on the policyholder. This will allow the insurer to continue to reevaluate coverage.

(6) **Insured’s Right to Own Counsel** – The reservation of rights letter should set forth the policyholder’s right to retain personal counsel at the policyholder’s own expense. *See McGuire v. Texas Farmers Ins. Co.*, 727 S.W.2d 1 (Tex. App.—Beaumont 1987), rev’d, 744 S.W.2d 601 (Tex. 1988) (failure of a non-waiver agreement to advise the insured of his right to employ his own counsel rendered the non-waiver agreement invalid); *Aetna Casualty & Sur. Co. v. Dimino*, 339 N.Y.S.2d 218 (1972) (reservation of rights letter instructing the policyholder “not to discuss the matter with anyone other than a representative of the [insurance company] or the [law firm designated by the insurer]” foreclosed the insured from obtaining his own counsel and thereafter estopped the insurer from disclaiming coverage).

(7) **Insurer’s Right to File Declaratory Relief Action** – It is a good idea to inform the insured of the possibility that the insurer may file a declaratory relief action. This puts the insured on notice that it may be faced with a second action to determine coverage and allows the insured to appropriately assess its risks.
(8) **Insurer’s Right to Assert Other Policy Defenses** - Although an insurer generally doesn’t waive coverage defenses of which it is unaware, it is always a good idea to reserve the right to assert other defenses as they become known. The insured may be aware of a coverage or policy defense that is not asserted and this will alert the insured that such a defense is not waived simply because the insurer is not yet aware of it.

(9) **Insurer’s Right to Reimbursement** – In jurisdictions where an insurer is entitled to seek reimbursement of defense costs or indemnity/settlement payments, the insurer must specifically reserve its right to do so or reimbursement will generally be precluded. *See Blue Ridge Ins. Co. v. Jacobsen*, 25 Cal.4th 489 (2001).

(10) **Conflict Triggering Right to Independent Counsel** – Some states, such as California, have statutory provisions, mandating that if and when a potential conflict of interest arises between the insured and the insurer, the insurer must inform the insured of its right to independent counsel and must provide independent counsel to the insured, unless the insured expressly waives, in writing, its right to independent counsel. *See California Civil Code § 2860 (a).* In these states, the insurer should advise the insured of its right to independent counsel if the reservation of rights gives rise to a conflict of interest between the insurer and the insured. *See Popovich v. Gonzales*, 4 Ill. App. 3d 227, 280 N.E. 2d 757 (1972) (no right to rely on coverage defense where insured was not advised that reservation created a conflict of interest).

C. **What Not to Include**

Do not include extraneous information that is not relevant to the reservation of rights. Set forth only those facts and policy provisions that are germane to the reservation of rights to avoid “burying” the coverage defenses in the letter.

Never advise an insured to refrain from seeking advice from counsel.

The insurer should generally refrain from expressly waiving a policy or coverage defense, unless there is a tactical reason for doing so. One such tactical reason for waiving a defense is to avoid a conflict of interest that will trigger an insured’s right to independent counsel in states where applicable.

D. **Who to Send it To**

The reservation of rights letter should be sent by certified mail, return receipt requested, to the insured’s address set forth on the policy. If you are aware of any address change, send it to the new address as well. If there is more than one insured, send each insured a separate copy of the reservation of rights letter. Only copy those parties who absolutely must be informed of the coverage defenses (i.e., the insured’s personal counsel). Do not copy the plaintiff’s attorney. Blind copy coverage counsel.
There is a difference of opinion among insurers and coverage counsel regarding whether defense counsel retained by the insurer should receive a copy of the reservation of rights letter. The argument for providing the letter to defense counsel is that it assists enables counsel to more effectively represent the insured, and there is an argument that defense counsel must know about any reservations to properly represent the insured. Others argue that advising the defense counsel of the coverage issues may create the appearance of a conflict of interest.

E. Who Should Author

The reservation of rights letter should be on insurance company letterhead and should be signed by a representative of the company. The person who signs the reservation of rights letter may be deposed in any litigation between the parties. For that reason, the person who signs the letter should be familiar with the claim and coverage issues at the time he/she signs the letter. This will help protect the insurer from a claim of bad faith. Many insurers prefer that reservation of rights letters go out under the signature of a management-level employee. To avoid potential argument of waiver of the attorney-client privilege, reservation of rights letters should not be signed by coverage counsel.

IV. Effect of Failure to Provide ROR or Deficient ROR – Waiver/Estoppel

An insurer generally does not have a duty to reserve its rights on coverage and policy defenses of which it is not aware, but a reservation of rights letter should be sent as soon as the insurance carrier becomes aware of a coverage or policy defense. There is generally no specific time by which an insurer must provide a reservation of rights letter to the insured. But an insurer runs the risk of waiving, or being estopped from asserting, its coverage and policy defenses if its reservation of rights letter is untimely.2

It is the general rule in most states that the doctrines of waiver and estoppel cannot be used to create insurance coverage where none exists under the terms of the policy. Many states recognize an exception to this rule, however, where an insurer conducts an insured’s defense without timely reserving its right to deny coverage. In this situation, the insurer cannot later disclaim coverage based on a policy defense. “If an insurer assumes an insured’s defense without declaring a reservation of rights or obtaining a non-waiver agreement, and with knowledge of facts indicating non-coverage, all policy

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2 Waiver is generally defined as the intentional relinquishment of a known right. It requires only that the insurer know of its coverage/policy defense and intend to waive it, and the intent element may be inferred by the circumstances. Estoppel, on the other hand, requires words or conduct on the part of the insurer intended to induce reliance on behalf of the insured; the insurer must know the true state of the facts and the insured must not; the insured must rely on the insurer’s words or conduct to his/her detriment. In reality, an insurer generally does not intend to waive its rights. Moreover, almost all jurisdictions require that an insured show detrimental reliance to defeat an untimely reservation of rights. Thus, although the terms waiver and estoppel are often used interchangeably in this context, the rule is generally one of estoppel. See Waller v. Truck Ins. Exch., 11 Cal.4th 1, 33-34, 900 P.2d 619, 637, 44 Cal. Rptr.2d 370, 388 (1995).
defenses, including those of non-coverage, are waived, or the insurer may be estopped from raising them.” *Farmers Texas County Mut. Ins. Co. v. Wilkinson*, 601 S.W.2d 520, 521-522 (Tex. Civ. App.—Austin 1980, writ ref’d n.r.e.); see, e.g., *Stone & Webster Engr. Corp. v. American Motorist Ins. Co.*, 458 F. Supp. 792, 797 (E.D. Va. 1978), aff’d, 628 F.2d 1351 (4th Cir 1980); *Miller v. Elite Ins. Co.*, 100 Cal. App.3d 739, 161 Cal. Rptr. 322 (1980); *Gibraltar Ins. Co. v. Varkalis*, 46 Ill.2d 481, 487, 263 N.E.2d 823, 827 (1970); *DiMarzo v. American Mut. Ins. Co.*, 389 Mass. 85, 99, 449 N.E.2d 1189, 1199 (1983) (waiver); *Cigarette Racing Team, Inc. v. Parliament Ins. Co.*, 395 So. 2d 1238 (Fla. 4th DCA 1981). In Florida, insurers are statutorily prohibited from denying coverage based on known but unasserted coverage defenses. See Florida Statute Section 627.426(2)(a) (“A liability insurer shall not be permitted to deny coverage based on a particular coverage defense unless: (a) Within 30 days after the liability insurer knew or should have known of the coverage defense, written notice of reservation of rights to assert a coverage defense is given to the named insured . . . .”). This statute appears limited to insurers that initially accept coverage and will not preclude an insurer that denies coverage from later clarifying grounds for denial after the 30 day period has lapsed. *See Ohio Cas. Ins. Co. v. Garden of Eat’n of Tampa, Inc.*, 2011 U.S. Dist. LEXIS 99342.


### A. Factors for Determining Waiver/Estoppel

In determining whether the insured has detrimentally relied on the absence of a reservation of rights by the insurer, courts look at many factors, including:
(1) **Length of Time Before Tender** - *Delmonte v. State Farm Fire and Cas. Co.*, 90 Hawai'i 39, 975 P.2d 1159, 1171 (1999) (two-month period between insurer’s assumption of defense and issuance of a reservation of rights letter did not give rise to waiver of coverage defenses where the insured did not tender defense until approximately 18 months after being sued; insured was represented by counsel and exercised some control over case).

(2) **Length of Time Between Tender and Reservation** – See *Dietz-Britton v. Smythe, Cramer Co.*, 139 Ohio App.3d 337, 743 N.E.2d 174, 179-180 (1994) (providing a defense for nearly one year without reserving rights may give rise to a claim of estoppel where, in reliance on defense, insured does not conduct its own investigation of claim, control its defense or attempt settlement); *Meirthew v. Last*, 135 N.W.2d 353, 355 (Mich.1965) (reservation of rights letter sent several years after action was commenced gave rise to estoppel defense where insurer knew about coverage defenses during this time); In *City of Grosse Point Park v. Michigan Municipal Liability and Property Pool*, 473 Mich. 188, 702 N.W.2d 106 (Mich. App. 2005) (no estoppel where insurer notified insured of specific reservation of rights at time the defense was assumed).

(3) **Length of Time Insurer Defends Without Reservation vs. Length of Time Insurer Defends With Reservation** - See *Turner Liquidating Co. v. St. Paul Surplus Lines Ins. Co.*, 93 Ohio App.3d 292, 300, 638 N.E.2d 174, 179-180 (1994) (providing a defense for nearly one year without reserving rights may give rise to a claim of estoppel where, in reliance on defense, insured does not conduct its own investigation of claim, control its defense or attempt settlement); *Pennsylvania National Mutual Cas. Ins. Co. v. Kitty Hawk Airways, Inc.*, 964 F.2d 478, 482 (5th Cir. 1992) (although insurer defended insured for over one year before issuing a reservation of rights, there was no estoppel where insurer defended insured for over two years – and through trial - under the reservation of rights before refusing to indemnify judgment; appointed counsel had no opportunity to manipulate case to support coverage defense); *Long Island Ins. Co. v. Graziano*, 64 A.D.2d 944, 945 (N.Y. 1978)(insurer waived right to rely on late notice defense where it defended for nine months before issuing a reservation of rights and an additional seven months before filing a declaratory relief action).

(4) **Stage of Litigation When Insurer Issues Reservation** - See *Lextron, Inc. v. Travelers Cas. & Sur. Co.*, 267 F.Supp.3d 1041 (D.Colo.2003) (no prejudice where insurer accepted defense without reservation of rights two months after action commenced and withdrew two months later); *Paradigm Ins. Co. v. Texas Richmond Corp.*, 942 S.W.2d 645, 652-653 (Tex.App. – Houston [14th Dist.] 1997, writ den.) (no detrimental reliance where reservation of rights letter sent 15 days after answer was due); *Dietz-Britton v. Smythe, Cramer Co.*, 139 Ohio App.3d 337, 743 N.E.2d
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960 (2000) (insurer waived coverage defenses by waiting until four weeks before trial, and more than two years after notice of the lawsuit, to reserve its rights); *Hiser v. Rajki*, 700 So.2d 1302, 1303 (La.App. 1st Cir. 1997) (nonwaiver agreement and coverage letter provided 22 days before trial was untimely). Where there is a claim against the insured but a lawsuit has not been filed, it will be more difficult for the insured to show prejudice from the delay or failure to provide a reservation of rights.

(5) **Insurer’s Diligence in Discovering Facts Giving Rise to Coverage and Policy Defenses** - *See Village of Waterford v. Reliance Insurance Company*, 226 A.D.2d 887, 892, 640 NY.S.2d 671, 674 (N.Y.A.D. 1996) (reservation of rights letter sent only a few days before trial was timely where insurer who had been monitoring litigation did not receive information regarding coverage defense until that time; insured was represented by independent counsel). Thus it would seem that the nature of the coverage or policy defense and the investigation necessary to discover them would factor into the waiver/estoppel analysis, as would the fact of whether the insurer hired coverage counsel if necessary to assist with a complicated coverage analysis.

(6) **Whether Insured Represented by Counsel** - *Delmonte v. State Farm Fire and Cas. Co.*, 90 Hawai'i 39, 975 P.2d 1159 (1999) (insured’s who were represented by personal counsel while insurer investigated coverage were not prejudiced by two month delay in issuing reservation of rights).

(7) **Whether Insured Exercised Control Over Defense** - *See Young Men’s Christian Ass’n of Metropolitan Fort Worth v. Commercial Standard Ins. Co.*, 552 S.W.2d 497, 503-504 (Tex. Civ. App. – Fort Worth 1977, writ refused, n.r.e. per curiam) *Commercial Standard Ins. Co. v. Young Men’s Christian Assoc. of Metropolitan Fort Worth* (Tex. 1978) (estoppel applied where insurer defended for four years under general reservation of rights but did not notify insured of specific reservation based on late notice until summary judgment reversed by state supreme court and case remanded); *Textile Mach., Inc. v. Continental Ins. Co.*, 87 Ill.App.3d 154, 157, 409 N.E.2d 1, 3 (Ill. App. 1980) (estoppel applied where insured defended without reservation of rights for two and a half years before tendering defense back to insured and insured surrendered control of case, even though insured had no complaints about appointed counsel and was offered the chance to participate in the defense); *Knox-Tenn. Rental Co. v. Home Ins. Co.*, 2 F.3d 678, 685 (6th Cir. 1993) (conclusive presumption of prejudice where insurer exerted complete control of defense through trial and entry of judgment); *Am. Cas. Co. v. Shely*, 234 S.W.2d 303, 305 (Ky. App. 1950) (loss of opportunity to engage separate counsel and manage defense was prejudicial regardless of effect on outcome of litigation); *Delmonte v. State Farm Fire and Cas. Co.*, 90 Hawai'i 39, 975 P.2d 1159 (1999) (insured’s exercise of some control over the defense while the
carrier was investigating coverage supported finding that insurer did not waive coverage defenses); *Collins v. Grange Mut. Cas. Co.*, 124 Ohio App.3d 574, 579, 706 N.E.2d 856, 859-860 (1997) (waiver found where there was a sixteen-month period between insurer’s assumption of defense and reservation of rights and insurer knew facts giving rise to coverage defenses during this time; insurer assumed control of the defense and insured relinquished control believing there was coverage). Under this factor, the court may also consider whether the insured lost the opportunity to resolve the claim or suit.

V. Other Issues Arising From an ROR

A. Insured’s Right to Independent Counsel When Reservation of Right Creates a Conflict of Interest

There is an inherent conflict between the interests of an insurer and the interests of its insured, given that the insurer is required to pay for a benefit to the insured. It might be in the insurer’s interest to pay as little as possible for both defense costs and indemnity, while the insured’s interests might warrant a more rigorous defense, especially if there is some uncertainty that the insured will be indemnified for any eventual judgment. This conflict is also present with defense counsel hired by the insurer to represent the insured. Defense counsel owes a fiduciary duty to both the insurer and insured but generally has an ongoing, and potentially dependent, relationship with the insurer.


In some states, assumption of a defense under a reservation of rights automatically gives rise to a conflict of interest which entitles the insured to independent counsel. *See, for example, Union Ins. Co. v. Knife Co., Inc.*, 902 F.

In these latter states it thus becomes important to determine whether a particular reservation of rights creates an actual conflict of interest. The key question is whether counsel retained by the insurer has the ability to manipulate the outcome of the issues upon which coverage depends. This typically occurs when the dispute between the insured and third party will require resolution of an issue that will bear directly on the outcome of the coverage dispute. See Long v. Century Indem. Co., 163 Cal.App.4th 1460 (2008). A classic example is where the complaint against the insured alleges both intentionally and negligently caused property damage or bodily injury and the insurer reserves its rights to deny coverage for any intentionally-caused damage or injury. This creates a potential conflict of interest because the insurer-retained defense counsel may be able to control the insured’s defense in such a way as to affect the outcome of the coverage issue. In Texas the test is stated as follows: A conflict of interest triggering a right to independent counsel exists where “the facts to be adjudicated in the liability lawsuit are the same facts upon which coverage depends.” N. county Mut. Ins. Co. v. Davalos, 140 S.W.3d 685, 689 (Tex. 2004). In a recent case, the United States District Court for the Southern District of Texas applied this rule very narrowly to coverage for a copyright infringement case. In Partain et al. v. Mid-continent Specialty Insurance Services, Inc., 2012 U.S. Dist. LEXIS 7530, *46, the court noted that to succeed on a copyright infringement claim, the underlying claimant had to prove only that it had ownership of a valid copyright and the copying of constituent elements of the work that are original. It thus found that an insurer’s reservation of rights on five potential exclusions did not trigger a right to independent counsel where they involved issues that were raised in the underlying action but not crucial to the determination of the underlying copyright infringement claim. Id.

Some jurisdictions have adopted a rule requiring an insurer to pay for independent counsel based upon the mere presence of both covered and non-covered claims. See First Ins. Co. of Hawaii v. State, 66 Haw. 413, 665 P.2d 648 (1983). Other jurisdictions hold that the mere presence of both covered and non-covered claims, and even the insurer’s reservation of its right to seek reimbursement for the cost of defending the non-covered claims, does not create a conflict requiring the appointment of independent counsel. See Dynamic Concepts, Inc. v. Truck Ins. Exch., 61 Cal.App.4th 999, 1007 (1998); James 3 Corp. v. Truck Ins. Exch., 91 Cal.App.4th 1093, 1109 (2001). And where the reservation of rights is based on a
coverage issue which has nothing to do with the issues being litigated in the underlying action, there is often no duty to provide independent counsel. For instance, where the issue is whether the person suing the insured in a personal injury action is a “resident relative” whose claims are thus excluded from coverage, no true conflict exists because that issue will not be decided in the underlying action. See McGee v. Sup. Ct., 176 Cal.App.3d 221, 228 (1985). Similarly, the fact that the damages sought against the insured may exceed policy limits, or the mere existence of a punitive damage claim in a state that does not permit insurance coverage for punitive damages, does not create a conflict of interest in some jurisdictions because the interests of both the insurer and the insured are aligned: both want to minimize any award against the insured. See Blanchard v. State Farm Fire & Cas. Co., 2 Cal.App.4th 345, 350 (1991); Foremost Insurance Co. v. Wilks, 206 Cal.App.3d 251, 261 (1988). In other jurisdictions, these situations would entitle the insured to independent counsel. See St. Paul Fire & Marine Ins. Co. v. Thompson, 150 Mont. 182 (1967). And even in jurisdictions where the mere existence of a damage claim in excess of policy limits does not trigger a duty to provide independent counsel, such a duty will arise if the insurer seeks to settle the action for an amount in excess of the policy limit and either require the insured to pay the difference or seek reimbursement from the insured for the difference. See Golden Eagle Ins. Co. v. Foremost Ins. Co., 20 Cal.App.4th 1372 (1993).

A potential conflict of interest may also arise where the insurer is defending multiple insureds with antagonistic interests and, possibly, where there insurer is providing a defense to both parties to a dispute. See Battista v. Olson, 250 N.J.Super. 330 (1991); First Ins. Co. of Hawaii v. State, 66 Haw. 413, 665 P.2d 648 (1983); Hammer v. McIntyre, 114 Cal.App.2d 148 (1952); O’Morrow v. Board, 27 Cal.2d 794 (1946).

Although some courts will allow an insurer to continue to defend with its chosen counsel if the insurer offers some reassurance that it won’t interfere with the case, the wisdom of these cases is dubious as the insured will likely continue to perceive a conflict. See Johnson v. Continental Cas. Co., 57 Wash.App. 359 (1990); Native Sun Invest. Group v. Ticor Title Ins. Co. of Ca., 189 Cal.App.3d 1265, 1277 (1987) (instructions to insurer-retained defense counsel not to let coverage defenses “interfere with his handling of the case” sufficient to avoid duty to provide independent counsel.

An insurer may decide that it is best to waive a particular coverage defense that will trigger a right to independent counsel in favor of maintaining control of the defense. This generally involves a consideration of the nature of the coverage defense, the likelihood of successfully avoiding indemnification based on the defense, other coverage defenses that are available and do not trigger the duty to provide independent counsel, and the perceived benefit to the insurer of maintaining control of the defense.

B. Filing a Declaratory Judgment Action
A dispute between the insurer and insured over coverage or the duty to defend may be resolved in a separate declaratory judgment action. Problems may arise, however, where the resolution of the coverage issue involves a determination of issues that are disputed in the underlying action against the insured – for instance, whether the insured intentionally harmed the third party plaintiff. Additionally, an insured – especially one with limited financial means - may be prejudiced by having to defend two lawsuits simultaneously. Where such a conflict or prejudice exists, the court may stay the declaratory judgment action pending the resolution of the underlying third party action. See Montrose Chem. Corp. v. Sup. Ct., 6 Cal.4th 287, 301-302 (1993); Western Nat’l Assur. Co. v. Hecker, 719 P.2d 854 (Wash. App. 1986).

This sometimes occurs where an insured is facing criminal charges arising from the same conduct at issue in the tendered civil action and claims that his Fifth Amendment Rights will be violated if he is forced to participate in coverage litigation. But concurrent criminal proceedings do not result in an automatic stay of a declaratory judgment action. See, for example, State Farm Fire and Cas. Co. v. Bonetti, 2011 U.S. Dist. LEXIS 148346, *8 (prior discovery in state tort action and anticipated discovery in related state criminal action led court to conclude that Fifth Amendment rights were not implicated, noting also that insurer faced “substantial [defense] costs . . . in civil action” and has interest in timely declaration of rights and obligations).

C. What to do when Insured Rejects


627.426(2)(b)(3) interpreted to prevent liability insurer from denying coverage unless insurer obtained insured’s approval to independent counsel retained by the insurer to defend the insured).


If consent to the reservation of rights is required – but rejected – by the insured, the insurer is then faced with the following options:

1. **Offer an unqualified defense** - This is a business decision the insurer may choose to make after weighing the likelihood of success in litigating the coverage issues, the possibility of extracontractual damages, and the likelihood of a successful resolution of the underlying litigation. An unqualified offer to defend generally results in a waiver by the insurer of all policy and coverage defenses, but the insurer will have control of the defense, including control of settlement. This helps prevent against collusion between the insured and claimants.

2. **Continue to defend** - If the insurer continues to defend after the rejection of an offer of a defense subject to a reservation of rights, the insurer will be found to have waived all coverage defenses. *See, e.g., Pacific Indem. Co. v Acel Delivery Serv., Inc.*, 485 F.2d 1169, 1174 (5th Cir. 1973) (Texas law); *Schmidt v. National Auto & Cas. Ins. Co.*, 207 F.2d 301, 303-04 (8th Cir. 1953) (Missouri law); *Weaver Metal & Roofing Co. v Continental Ins. Co.*, 58 A.D.2d 1037, 397 N.Y.S.2d 505, 506 (1977).

3. **Withdraw from defense** - If the insurer decides to stand by its offer to defend subject to a reservation of rights, the insurer must immediately withdraw from the defense after the insured’s rejection to avoid waiver of


VI. **Conclusion**

The most important thing to do when offering to defend under a reservation of rights is to remember what the letter is accomplishing for you: the letter is preserving your right to assert coverage defenses and, possibly, seek reimbursement. Thus it is important to do what you say you will do in the letter, and to follow up with all promises, actions, etc. If new pleadings are filed against the insured, always analyze whether the current reservation of rights letter adequately addresses the new allegations. If not, then you...
must issue a supplemental reservation of rights letter or else risk waiving that policy defense. Likewise, in states in which evidence extrinsic to the complaint may be considered, regularly monitor the information provided by counsel and if new information gives rise to additional policy or coverage defenses, supplement your reservation of rights letter accordingly.