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To Reserve or Not to Reserve

I. Determination of Reservation of Rights:

A Carrier has a duty to place its insured's interests, but it is not required to provide coverage when coverage does not exist. The purpose of the insurance company is three-fold:

- Provide protection for the insured.
- Be financially viable.
- By providing insurance, a public service is provided that allows people to undertake certain activity with the security of being protected in case of a negative incident regarding an insurable interest.

When a claim is presented, the Carrier must examine the existence of coverage in additional to evaluating liability and damages. During this evaluation, multiple issues are examined. In cases where liability defenses are strong and damages are small, the decision the Carrier may decide that it is not worth raising a coverage issue and defending under a reservation of rights. If the Carrier determines that the insured should be defended under a reservation of rights, it must be certain its analysis and procedures protect itself and the insured to the extent the insured is allowed. The way these claims are handled could have significant repercussions for the Carrier if not done properly.

It is not an unusual circumstance that when the Carrier receives a policy limit demand with a short time to reply it may not have had a chance to evaluate pertinent information. As a result, the Carrier can find itself in a precarious because if it does not respond within the proscribed timeframe, Plaintiffs' attorneys will threaten to recover from the insured personally if the demand is not met. Such tactics often act to prevent a full and detailed investigation of a claim. This makes it even more difficult when the existence of coverage is an issue.

The Carrier should not be obligated to provide coverage when coverage does not exist. Premiums are meticulously calculated to provide coverage at a certain level when coverage is appropriate. No business can survive if they are regularly forced to cover expenses or losses that were not contemplated at the origin of a business plan. Insurance coverage is no different.

Inexplicably, despite the services Carriers provide to the public, they are not looked on favorably in the public eye. Without them, much of how the world operates would be adversely affected. Despite that, there is a mindset that the Carriers and their attorneys are only concerned about money. In addition, this is a trying political time, once favorable jurors now have different tendencies and express anger on issues that have no bearing on a particular case through their verdicts. The same can be said for judges in many jurisdictions when ruling on a declaratory judgment action regarding the existence of coverage.

Courts like to claim that here is only one duty when evaluating a case and that is the duty to the insured. The Carrier must not place its insured's financial interest at risk in the hopes of a defense verdict or a verdict below the policy limits. That does not mean a Carrier is always putting the insured's financial interests at risk simply because it is defending a case with significant damages. It certainly does not mean that an insured is owed coverage for a risk that it did not bargain for when it purchased a policy.

When a Carrier is deciding to defend under a reservation of rights, it must look at factors that go beyond just the policy and whether to issue the reservation of rights. Carrier's have become a target of many, so a broad analysis is required.

A. The insured

This is critically important. Whether the carrier is dealing with a simple individual insured, or a sophisticated businessperson or a large commercial business. Simply analyzing a claim without any thought as to the individual needs of the insured could lead to a path that a Plaintiff's attorney will attach to in establishing the insured's needs were not met if a bad faith action is pursued after an adverse outcome.

1. The insured's expectations

It is important to remember that the relationship between the Carrier and the Insured is a contractual one. As a result, the Insured's expectations are extremely important. Most Courts are going to find that the Carrier is an advantageous position when compared to the insured. As a result, the insured's belief as to whether coverage exists under the policy is of great importance. Obviously, many insured's do not consider this when the insurance contract is entered to, but this can become a significant issue later.

2. The Claimant

This seems simple enough, but it is truly amazing how many times this does not go into the analysis. It is also just as important to collect knowledge on the plaintiff and his/her injuries as early as possible. Social media is such a powerful tool and is often not taken advantage off. ISO hits, prior lawsuit filings and social media posts is essential in evaluating who is making the claim. Sometimes this analysis may not be sufficiently completed until the time of the deposition. Nonetheless if an evaluation to issue a reservation of rights with potential exposure without a thorough picture of the Plaintiff may lead to regret at the end of the road. Will the Plaintiff require future surgery or other medical treatment? Are there permanent issues related to the injury? Are the injuries easily quantifiable? Is the Plaintiff sophisticated enough to truly understand the policy language?

B. Liability Defenses:

1. Facts of the Case

How strong are the liability defenses? Is the claim one of zero liability, doubtful liability, questionable liability, or probable liability? Has the adjuster contacted the insured, witnesses, and claimant (before representation)? Is the case basis enough that it is not worth the potential risk of defending under a reservation of rights.

2. Venue

The venue is as important in determining whether the case will be defended with or without reservation. Recognizing where the case will be tried has a tremendous impact on the result. An analysis of the judiciary and the jury is critical. Even if a file is not open, a quick call to defense counsel in the area will provide you with the information need in the event the claims handler is unfamiliar with the venue.

3. File Documentation

Once you make your own evaluation of coverage and if you have outside counsel, remember your claim notes. Claims notes are critically important in documenting your evaluation and analysis. The Carrier must decide on whether it should split the file; is the right claims specialist handling the coverage issues, etc.

II. Communications with Insured

It is critical to keep the insured advised of the process in states like Missouri, it is almost considered *per* se bad faith if the insured is not kept advised of negotiations; especially if coverage is in question. Depending on how sophisticated the insured is, many times the insured may not truly understand the reservation of rights and go on if he/she has coverage. However, more sophisticated insureds may decide to reject the defense under a reservation.

Often a Carrier sends the standard letter at the beginning of a case regarding the right to have outside counsel, but it is in the Carrier's interest to clearly set out the reasons as to why coverage is in question. If the insured is PROPERLY advised and understands the reasons for defending under a reservation, the Carrier is solidifying its course of action.

Ultimately the litigation of coverage through a declaratory judgment action comes with risk. While this goes on, the underlying claim is proceeding as well. It is imperative that the Carrier effectively monitors both sides of the litigation so it can adapt and change a course of action if the process requires.

In some instances, the insured is just not willing to accept the defense under a reservation. This tends to happen with more sophisticated insureds. Different states have different requirements at this point, but many times the case has been completely worked up at this point and both counsel and the Carrier are confident in a positive result. A sophisticated insured or skilled plaintiff's attorney will use the financial risk to the insured in a reservation scenario as leverage against the insured. This could potentially put the Carrier in a precarious position and may cause it to make an about-face. Obviously, this is not something a Carrier wants to do as there are limits as to what an insurance company is willing to cover.

III. Consent Judgment and Bad Faith Implication Associated with the Issuance of a Reservation of Rights.

Traditionally, Plaintiffs' attorneys will focus on the following when it came to prosecuting a bad faith cases against a carrier:

1) Denying indemnity without doing a proper investigation.

2) failure to provide the insured with the specific reasons for the issuance of coverage; and

3) will depose the front-line adjuster, focusing on the specific way the front-line adjuster handled the file, made coverage decisions while facing substantial scrutiny on the individual decision-making process irrespective of the larger broader policies of the Carrier.

There is a growing trend for Plaintiffs to target the policy and procedures of the Carrier rather than the adjuster that handles the claim. Plaintiffs' attorneys place a microscope on all the Carrier's policies and guidelines, suggesting that adjusters are provided strong incentives to or even force claims staff to deny policyholders the benefits of their policies. Specifically, it focuses on any incentives to claims handlers to deny coverage and general policies that are geared toward increasing profits by doing so. Therefore, keeping the insured advised is particularly important.

In recent years, top level executives are also being deposed more often at length and forced to provide justification for almost every guideline surrounding claims handling, settlement determinations and decisions that lead to POTENTIAL exposure to the insured. Failure to promptly assert the reservation of rights can have different impacts based on state but generally the reservation must be done in a reasonable time. What is reasonable will vary widely depending on the circumstances but is largely premised on the extent to which the timing has a prejudicial impact on the insured. What is clear is that best practice in every state is to assert the reservation as quickly as possible upon discovery that there may exist some coverage issue.

It is unfair for any entity, to suggest that insurance companies do not have the right to deny coverage when coverage does not exist. It is worthwhile to look at how various states address what the black letter law is for a Carrier to defend under a reservation of rights.

A. California:

California requires that insurer must "adequately" reserve its right to deny coverage. An insurer can "adequately" and unilaterally reserve its right to assert non-coverage by merely giving notice to the insured. By accepting the insurer's defense under these circumstances, the insured is deemed to have accepted this condition. *Val's Painting & Drywall Inc., v. Allstate Ins. Co*., 53 Cal. App. 3d 576, 126 Cal. Rptr. 267 (1975).

California proscribes specific windows within which the insurer must give notice. An insurer must accept or deny a claim within 40 days of receiving proof of a claim. Cal. Code Regs. tit. 10, § 2695.7(b). If more time is needed to investigate a claim, the insurer must notify the insured of that fact within 40 days of its receipt of a proof of loss, setting forth the reasons that additional time for investigation is required and every 30 days thereafter until the determination is made or legal action is served. Cal. Code Regs. tit. 10, § 2695.7(c)(1).

California does not mandate that an insurer waives potential insurance coverage defenses by failing to include it explicitly in a reservation of rights letter. *Waller, Jr. v. Truck Ins. Exch. Inc.,* 11 Cal 4th 1 (1995).

B. Missouri:

Notice to an insured that its defense of an action should not be construed as a waiver of any policy defense and the insured accepts the defense of the action without protest and with full knowledge of the position of the insurance company of its right to assert non-liability. Missouri requires reservation of rights letters to be timely, clear, and fully inform the insured of its position. *Kinnamen-Carson v. Westport Ins. Corp*, 283 S.W.3d 761, 765 (Mo. Banc 2009).

Similarly, in Missouri an insurance company is not automatically estopped by defending without a reservation of rights, particularly in circumstances where it does not have knowledge of the non-coverage facts under the policy. *Mistele v. Ogle*, 293 S.W. 2d 330 (Mo. 1956).

C. Texas:

Prior to 2008 courts in Texas recognized the *Wilkenson* rule under which if an insurer assumes the insured's defense without obtaining a reservation of rights and with knowledge of facts indicating non-coverage, all policy defenses including those of non-coverage were waived. *Farmers Tex. County Mut. Ins. Co. v. Wilkinson*, 601 S.W.2d 520, 521 (Tex. Civ. App. Austin 1980). Under the *Wilkenson* rule the letter of reservation of rights was essential because failure to provide the letter could result in the creation of rights for the insured where none otherwise existed. However, in 2008, the Texas Supreme court abrogated *Wilkenson* and replaced it with *Ulico*. Under *Ulico* the question becomes whether an insured is prejudiced because of the

conflict, an inadequate disclosure, or other actions of the insurer. *Ulico Cas. C. v. Allied Pilots Ass'n*, 262 S.W.3d 773, 786-787 (Tex. 2008)

The Texas Insurance Code requires an insurer to submit a reservation of rights to a policyholder within a reasonable time. Tex. Ins. Code Ann. § 541.060(a)(4)(B). The statute does not define "reasonable," and Texas has not implemented any rules providing specific timelines for issuing a coverage position. *Ulico* and the issue of prejudice guide the determination of timeliness.

D. Florida:

An insurer does not waive its rights to coverage defenses if a reservation of rights letter is sent to the insured, via hand delivery or certified mail, within 30 days of when the insurer knew, or should have known of the coverage defense. As the Florida Supreme Court explained in AIU Insurance Company, the notice requirement only applies where coverage exists under an insurance policy, but the insurer seeks to assert a coverage defense. Danny's Backhoe Service, LLC, 116 So. 3d at 511.

Bad faith under Florida starts with the basic proposition that when an insurer is handling claims against its insured, it "has a duty to use the same degree of care and diligence as a person of ordinary care and prudence should exercise in the management of his own business." *Berges v. Infinity Ins. Co.,* 896 So.2d 665, 668 (Fla.2004) (quoting *Boston Old Colony Ins. Co. v. Gutierrez,* 386 So.2d 783, 785 (Fla.1980)). This duty includes an obligation to settle "where a reasonably prudent person, faced with the prospect of paying the total recovery, would do so." *Boston Old Colony Ins. Co.,* 386 So.2d at 785. Breach of this duty may give rise to a cause of action for bad faith against the insurer. *Cunningham* agreements under Florida law. These agreements involve the situation where there is not a previous excess judgment, but an insurer and a third-party claimant enter into an agreement and stipulate to try the bad-faith issues first. The parties further stipulate that if no bad faith is found, the third-party claimant will settle for the policy limits, thus protecting the insured from exposure to an excess judgment. *Cunningham* agreements have been held by this Court to be the "functional equivalent" of an excess judgment. *Cunningham,* 630 So.2d at 182. This Court has explained:

In *Cunningham,* the court approved a procedure in which the parties could avoid the time and expense of going through a trial to obtain a final judgment. In following that procedure, the parties agree, and the courts recognize that a stipulated final judgment has the same force and effect as a final judgment reached through the usual judicial labor of a trial when the parties agree that it shall. *United Servs. Auto. Ass'n v. Jennings,* 731 So.2d 1258, 1260 (Fla.1999). Under a *Cunningham* agreement, the insurer's actions protect the insured against an excess judgment.

A fourth recognized circumstance involves a claim not of the insured or the third-party claimant, but of the excess carrier, which may bring a bad faith claim against a primary insurer by virtue of equitable subrogation under certain circumstances where the primary insurer has not acted in good faith. Under the doctrine of

equitable subrogation, an excess insurer has the right to “maintain a cause of action ... for damages resulting from the primary carrier's bad faith refusal to settle the claim against their common insured.”

V. Conclusion:

A Carrier must have the right to defend under a reservation of rights when coverage is in question. This right has not been completely eroded, but it is becoming more difficult and the scrutiny on the decision-making process is strict. As a result, the Carrier must have a thorough detailed evaluation process that takes all potential outcomes into question. Every case must be evaluated on an individual basis, but the Carrier must feel comfortable when it defends under a reservation of right following a careful analysis.