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No Reservations: Crafting a Reservation of Rights Letter After Harleysville v. Heritage

When an insured's defense of a claim is handed over to the insurer, the insurer generally will respond by doing one of four things: (1) refusing to defend the claim, (2) defending the claim without raising any possible coverage defenses, (3) defending the claim under a reservation of rights letter, or (4) filing a complaint for declaratory relief. Insurers often choose the third option—a defense under a reservation of rights letter. A reservation of rights letter allows the insurer to defend the policyholder as the insurance policy requires while preserving its ability, or "reserving its right," to later deny coverage. Essentially, the letter signals that the insurer does not have enough facts to warrant an outright denial of coverage at that particular time, but the facts known suggest there may not be coverage and as the lawsuit proceeds, additional information may be discovered that warrants denying coverage.

Courts have taken note of various policy concerns when formulating requirements for proper reservation of rights letters. For example, courts have noted that the insurer is typically in the best position to understand the complexities of litigation and, as such, they owe a fiduciary duty to the insured to timely and specifically communicate policy defenses and potential conflicts when dealing with the claim. Different states have imposed their own requirements for proper reservation of rights letters, and while there are overarching principles consistent among them, many requirements are specific to claims within their borders.

South Carolina

The 2017 case of *Harleysville Group Insurance v. Heritage Communications* greatly refined and clarified the parameters for reservation of rights letters in South Carolina. The case provides that an insured in South Carolina "must be provided sufficient information to understand the reasons the insurer believes the policy may not provide coverage." *Harleysville Group Ins. v. Heritage Comms., Inc.,* Op. No. 27698 (S.C. Sup.Ct. filed Jan. 11, 2017). "Generic denials" paired with "verbatim recitation[s] of all or most of the policy provisions (through a cut-and-paste method) are not sufficient." *Id.* Moreover, the South Carolina Supreme Court stated that the reservation must be unambiguous—if the court finds the letter to be ambiguous in any way, "the purported reservation of rights must be construed strictly against the insurer and liberally in favor of the insured." *Id.* (quoting *World Harvest Church, Inc. v. GuideOne Mut. Ins. Co.*, 695 S.E.2d 6, 10 (Ga. 2010)).

Fair notice must be given to the insured as to the defenses to coverage the insurer intends to argue. *Id.* Simply put, the letter must "specify in detail any and all bases upon which it might contest coverage in the future." *Id.* Further, the court found there to be a duty to inform, a duty to disclose, and a duty not to prejudice the insured. There is a duty to inform the insured of "the need for an allocated verdict as to covered versus noncovered damages," a duty to "disclose to its insured the insured's interest in obtaining a written explanation of the award that identifies the claims or theories of recovery actually proved," and a "'duty not to prejudice the insured's rights by failing to request special interrogatories or a special verdict in order to clarify coverage of damages.'" *Id.* (quoting *Magnum Foods, Inc. v. Cont'l Cas. Co.*, 36 F.3d 1491, 1498 (10th Cir. 1994)).

While neither party raised the issue of timeliness of the reservation of rights, the Court in *Harleysville* still referenced the six-month delay between notice of the suit and the issuance of the reservation of rights letter. *Id.* By drawing attention to this issue, the court highlighted that the time frame could have been an issue had it been preserved for review— "[p]roviding *timely* and specific policy defenses and disclosing actual or potential conflicts are important fiduciary duties of the insurer." *Id.*

Just as the court indicated that timeliness could be an issue, oral reservations could be an issue as well. The Court in *Harleysville* stated that while the insurer relied on an oral reservation of rights, those actions "fall short of the specificity [required] and are ambiguous at best" even if oral reservations were permitted in South Carolina. *Id.* While the letters did identify the insured entities, the lawsuits, the allegations against the insured, the policy numbers, the policy periods, numerous pages of policy terms, the insurer's duty to defend the suit, and a number of exclusions, the reservation of rights letters still lacked the requisite specificity. *Id.* The letters were simply a "general warning" and were "to imprecise to shield" the insurer from performing its duties to the policyholder. *Id.*

North Carolina

Similar to South Carolina law, North Carolina also requires that a reservation of rights letter provide sufficient notice to the insured—notice specifically designed to make sure the insured understands that the insurer will not pay the costs of actions not covered by the policy and to which the insurer has no duty to defend. *N.C. Farm Bureau Mut. Ins. Co. v. Fowler*, 589 S.E.2d 911, 914 (N.C. Ct. App. 2004). While North Carolina does not have any case law that specifically explains the specificity required for notice, it must be sufficient to inform the insured of the risks of non-covered claims.

Where an insurer denies liability for a loss on one particular ground, it cannot thereafter insist on another ground if the insured has acted on its initial position and incurred prejudice or expense by bringing suit or otherwise. *Council v. Metro. Life Ins. Co.*, 256 S.E.2d 303, 306 (N.C. Ct. App. 1979). Similarly, if an insurer assumes the defense of the insured without a reservation of rights letter denying liability on certain grounds, the insurer is estopped from later denying coverage. *Early v. Farm Bureau Mut. Auto. Ins. Co.*, 29 S.E.2d 558-59 (1944).

Florida

While many requirements under Florida law overlap with those of other states, Florida has very specific requirements when it comes to time. Namely, an insurer is not permitted to deny coverage based on a particular defense unless "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 by registered or certified mail sent to the last known address of the insured or by hand delivery." F.S.A.§ 627.426(2)(a). Once the initial 30-day requirement has been satisfied, the insurer then has an additional 60 days to do one of three things: (1) deny coverage, (2) defend under a

nonwaiver agreement after the rights and responsibilities of both parties has been communicated, or (3) to retain mutually agreeable counsel to defend the insured. *Auto Owners Ins. v.* Salvia, 472 So. 2d 486 (Fla. 5th D.C.A. 1985). It is important that the insured be notified of their right to participate in the selection. *Am. Empire Surplus Lines Ins. Co. v. Gold Coast Elevator, Inc.*, 701 So.2d 904, 906 (Fla. 4th D.C.A. 1997). For instance, Florida courts do not allow the insurer to simply apply for the appointment of mutually agreeable counsel, but rather require strict compliance with one of the statutory choices within the 60-day window. *Auto Owners Ins. Co.*, 472 So.2d at 488. The only item that can be left open for resolution by the court is the reasonable attorneys' fees for the mutually agreeable counsel, and unlike many states, the statute does not require the parties get independent counsel—just mutually agreeable counsel.

Moreover, the notice requirement only applies where coverage exists under the policy but the insurer seeks to assert a coverage defense. "[F]ailure to comply with the requirements of the statute will not bar an insurer from disclaiming liability where a policy endorsement has expired or where the coverage sought is expressly excluded or otherwise unavailable under the policy or under existing law." *Hartford Ins. Co. of the Midwest v. BellSouth Telecommunications, Inc.*, 824 So.2d 234, 240 (Fla. Dist. Ct. App. 2002)(quoting *AIU Insurance Co. v. Block Marina Investment, Inc.*, 544 So.2d 998, 999-1000 (Fla. 1989)). An insurer may provide a defense to the insured while simultaneously reserving the right to challenge coverage if the notice given is timely. However, a delay in informing an insured as to a coverage dispute may result in estoppel if the insured can show he or she has been prejudiced. *Centennial Ins. Co. v. Tom Gustafson Indus., Inc.*, 401 So. 2d 1143, 1144 (Fla. Dist. Ct. App. 4th 1981).

As for content, the letter should state that the insurer is reserving its right to deny or limit coverage and specify the basis for which those assertions are made. *Aguero v. First Am. Ins. Co.*, 927 So. 2d 894, 896 (Fla. Dist. Ct. App. 1st 1978). If a failure to object is intended to constitute an acceptance of the terms, the insured must be given express notice of that as well. *Nationwide Mut. Fire Ins. Co. v. Royall*, 588 F.Supp.2d 1306, 1318 (2008).

Georgia

Generally, an insurer must make a reservation of rights prior to assuming and conducting a defense of an action against an insured party. *State Farm Mut. Auto. Ins. Co. v. Wheeler*, 160 Ga. App. 523, 526, 287 S.E.2d 281 (1981). That said, the Georgia Court of Appeals has approved a reservation of the rights notice to deny coverage given to the insured a few days after the action was filed—with the letter in that case being followed by an agreement whereby the insured expressly agreed upon the terms set forth. *Id.* If a delay in notice is due to the insurer's lack of knowledge of the available coverage defense, the delay will be permitted. *Id.* An insurer sending a reservation of rights letter as soon as it was notified of the Georgia suit has been found to be sufficient. *Jacore Systems, Inc. v. Central Mut. Ins. Co.*, 194 Ga. App. 512, 514 (1990). Moreover, while an "insurer is not required to list each and every basis for contesting coverage in its initial reservation of rights letter in order to preserve its right to later assert a particular ground for noncoverage, it must act reasonably promptly upon learning of a policy defense." *Builders Ins. v. Tenenbaum*, 327 Ga.App. 204, 210 (2014).

Georgia law, in some respects, differs from that of other jurisdictions. An insurer may be estopped from contesting coverage where it assumes the insured's defense without first reserving its rights properly. In some jurisdictions, like Florida, estoppel requires a showing of prejudice. *Prescott's Altama Datsun v. Monarch Ins. Co. of Ohio*, 319 S.E.2d 445, 446 (Ga. 1984). In Georgia, it does not. *World Harvest Church Inc. v. Guideone Mutual Ins. Co.*, 695 S.E.2d 6, 9-10 (Ga. 2010).

The *World Harvest Church* court stated that "the reservation of rights must fairly inform 'the insured that, notwithstanding [the insurer's] defense of the action, it disclaims liability and does not waive the defenses available to it against the insured.'" *Id.* at 10. The reservation of rights must provide

the insured party with the "specific 'basis for the [insurer's] reservations about coverage….'" *Id.* Further, the content of the reservation of rights is not limited to one specific form—it can be written or oral as long as it is adequate. *Id.* In one instance, an oral statement to the insured that the insurer "did not see coverage" but would have to see if there would be issues failed to "fairly inform" the insured of the insurer's position, and thus, was not an effective reservation of rights. *Id.* On the other hand, an oral reservation of rights was found to be sufficient where it referred to prior written reservation of rights letters given to the insured and stated that the issues addressed by the previous letters remained applicable. See *Wellons, Inc. v. Lexington Ins. Co*., 566 Fed. Appx. 813 (11th Cir. 2014).

Following *World Harvest Church*, Georgia, like South Carolina, clarified that "boilerplate" language is ineffective in general reservations. In *Hoover v. Maxim Indemnity Company*, the Court rejected an insurer's attempt to deny coverage under one exclusion while at the same time attempting to reserve their rights under other policy terms. *Hoover v. Maxim Indemnity Co.*, 291 Ga. 402, 404 (2012); See *Browder v. Aetna Life Ins. Co.*, 126 Ga.App. 140, 144 (1972 ("ultimate denial of liability on another ground constitutes a waiver of forfeiture based on the lack of timely notice"). An insured may, however, reserve the right to raise any other coverage defenses as they become apparent and as the insurer obtains additional information— an insurer just may not reserve the right to raise a wide array of other defenses at a later date as a means of preserving all plausible avenues to deny coverage. *Id.* at 406-07. That does not adequately put the insured on notice. *Id.* While an insurer does not have to list every basis for contesting coverage, boilerplate language does not fairly inform the insured of the insurer's stance on the claim. *Id.* at 405.

Tennessee

Pursuant to Tennessee law, "an insurer is estopped to deny coverage where it has 'taken charge of and conducted the defense of the clams asserted against the insured, without having reserved its rights by some form of agreement, stipulation, or notice.'" *Knox-Tenn Rental Co. v. Home Insurance Co.*, 2 F.3d 678, 681 (6th Cir. 1993) (quoting *American Home Assur. Co. v. Ozburn-Hessey Storage Co.*, 817 S.W.2d 672 (Tenn. 1991)). In *Knox-Tenn Rental Company*, the court held that the reservation of rights was not communicated effectively to the additional insured, where the insurer sent the letter to the named insured, the additional insured's employer, but not directly to the additional insured himself. *Id.* at 683. Thus, knowledge of a reservation of rights cannot be imputed to an additional insured when the letter was addressed to another party and made no mention of the additional insured. *Id.*

Turning to another requirement under Tennessee law, the documents must be prepared with a high level of clarity when giving the insured notice of an insurer's reservation of rights. *Richards Mfg. Co. v. Great American Ins. Co.*, 773 S.W.2d 916, 919 (Tenn.Ct.App. 1988). Notice must be "clearly and fairly communicated to the insured." *Id.* In order to preserve the right to litigate coverage at a later date, the insurer" must advise the insured that it will represent the insured, but that it intends to reserve the right to litigate the issue of policy coverage of the insured should there be an adverse judgment in tort action." *Id.* In the *Richard's Manufacturing Company* case, the court held that a reservation of rights letter was adequate even though the basis stated for the reservation they were attempting to invoke was erroneous— "it is the insurer's conclusion regarding the existence or nonexistence of certain coverage that must be clearly and fairly communicated to the insured, not its legal reasons therefor." *Richards Mfg. Co.*, 773 S.W.2d at 919.

What to Remember When Drafting Reservation of Rights Letters

Although the requirements for reservation of rights letters in the southeast vary from state to state, there are several important issues to remember when drafting these letters, no matter the venue. Although specific requirements vary from state-to-state, courts in most southeastern states require that reservation of rights letters be issued in a timely fashion. It is therefore imperative that when notice of a claim is received, the insurer investigate the facts known to date and determine whether a reservation of rights letter needs to be issued. The insurer should also be sure to review any specific requirements for the state where the claim is made in order to ensure that all deadlines for issuance are met.

Further, simply issuing the reservation of rights letter in a timely fashion may not be enough to protect the insurer's right to contest coverage. Instead, the letter must clearly articulate the reasons that coverage may be challenged and provide notice to the insured of the possible consequences of this reservation. Finally, insurers should be aware of any particular requirements for letters in the state where the claim is made in order to prevent a subsequent waiver of its right to contest coverage.

Courts in the southeast have continued to articulate increasingly specific prescriptions for reservation of rights letters issued by insurers. While reservation of rights letters are a valuable tool for insurers to protect their right to contest coverage, especially early in litigation when few facts are known, mere recitations of the policy provisions without additional explanation are no longer effective to protect insurers. Instead, the burden is on insurers to be particularly vigilant when new claims come in, and take the time to ensure not only that reservation of rights letters are being issued in a timely fashion, but that these letters are sufficiently detailed and written with enough clarity to protect the insurer's right to challenge coverage, if necessary, as litigation progresses.