CARLTON FIELDS

So, What Was Reserved? Potential Claims Handling Pitfalls Under a Reservation

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It is common claims handling practice to use reservations of rights. Whether during an initial investigation, providing the insured with a defense, or even in the context of a denial of coverage, claims handlers routinely rely on reservations of rights – whether general or specific – to place an insured on notice of the potential for noncoverage. Many in the industry view a broad, general reservation of rights (most commonly used at the conclusion of a communication regarding coverage) as a failsafe. They believe the practice acts as a defense against claims of waiver of coverage defenses that were not specifically identified in the coverage communication. In reality, however, states' laws regarding the use and effect of reservation of rights vary greatly. In some, a reservation of rights is no reservation at all under certain circumstances. This is particularly true in the context of a denial of coverage under some state laws.

The Different Approaches to Waiver of Coverage Defenses

Hoover v. Maxum Indemnity Co., 291 Ga. 402, 730 S.E.2d 413 (2012), provides a good example of the dangers of relying on a reservation of rights to preserve coverage defenses where coverage was denied. In Hoover, the insured did not provide notice of an employee's fall from a ladder. Two years later, after the employee filed suit, the insurer denied coverage and refused to defend the case based on an employer liability exclusion. The denial letter also reserved rights on all other defenses, including specifically the defense of late notice of the occurrence. The Georgia Court of Appeals affirmed the trial court's grant of summary judgment in favor of the insurer based on late notice, and also found no duty to defend.

The Georgia Supreme Court reversed, concluding that the insurer had waived its late notice defense despite its specific reservation of rights. The court stated that reservations of rights are appropriate only for advising the insured of other potential grounds when one is defending the case

under a reservation of rights and cannot be used to allow an insurer to deny coverage while continuing to investigate other potential grounds of denial. The court then held that the "boilerplate" reservation as to late notice was ambiguous and did not properly inform the insured that the insurer intended to pursue a late notice defense.

The majority holding in *Hoover* effectively finds waiver or estoppel whenever policy defenses are omitted as the grounds for the disclaimer, regardless of whether the insurer has expressly indicated its intent not to waive any additional defenses and regardless of whether additional defenses are specifically identified as reserved. However, numerous courts in other jurisdictions have refused to find implied waiver in Hoover-like situations, namely where the denial of coverage contained a reservation of rights.

For example, in *Gary G. Day Constr. Co., Inc. v. Clarendon Am. Ins. Co.*, 459 F. Supp. 2d 1039, 1049-50 (D. Nev. 2006), the court found that an insurer did not waive any rights "because its April 15, 2004 letter explicitly contained a reservation of rights" and "[t]he addition of this language in its denial letter expressly negate[d] any intentional relinquishment of rights by Defendants." And in *Nat'l Fire Ins. Co. v. Entertainment Specialty Ins. Services, Inc.*, 485 F. Supp. 2d 737, 742 (N.D. Tex. 2007), the court found defendants' claim of waiver lacked merit "for the additional reason that [plaintiff insurance company]'s August 28, 2003 letter did not purport to rely only on a particular defense against policy coverage." Instead, the insurance company's letter "included several paragraphs reserving other potential defenses" and the court found "such disclamatory language effectively reserved other defenses to coverage."

Further, in *Smith v. Shelby Ins. Co. of Shelby Ins. Group*, 936 S.W.2d 261, 263 (Tenn. App. 1996), a reservation of right to assert additional grounds not mentioned in the declination letter precluded waiver; and in *Lugo v. AIG Life Ins. Co.*, 852 F. Supp. 187, 192 (S.D. N.Y. 1994), the court noted, it seemed "obvious" that the insurer did not waive an unmentioned coverage defense, since its declination letter contained a general reservation as to any other defenses that might exist. And in *Progressive Ins. Co. v. Brown ex rel. Brown*, 966 A.2d 666, 668 (Vt. 2008), the court held an insurer that "initially denies coverage on a specified basis and does not reserve the right to later raise other grounds . . . waives any additional defenses."

Still other courts have occupied the middle ground. Given the general rule that coverage cannot be created or enlarged by waiver or estoppel, these courts have held that a disclaimer cannot constitute a waiver of any unmentioned defenses that are based on a policy exclusion or on the insuring agreement itself. By contrast, these courts will find waiver of any unasserted defenses based on an insured's breach of a policy condition, holding that an insurer's declination of coverage will give rise to a waiver of any such policy defenses.

For example, in *Martin v. Colonial Ins. Co. of California*, 644 F. Supp. 349, 352 (D. Del. 1986), the district court rejected an argument that the carrier had waived a "regular use" exception by failing to raise it in the denial letter. Distinguishing the Delaware authority cited by the insured, which involved a forfeiture of coverage provision, the court held that "[t]he doctrine of waiver cannot create coverage where none is contracted for by the parties. Waiver can only be used to continue coverage which would otherwise be lost by a technical non-compliance with a forfeiture clause." *See* also *Home Indem. Co. v. Reed Equipment Co., Inc.*, 381 So. 2d 45, 50 (Ala. 1980); *Insurance Co. of North America v. Coffman*, 52 Md. App. 732, 451 A.2d 952, 956–57 (1982). The rationale appears to turn on a perceived distinction between policy provisions that define, and then narrow, the scope of coverage (i.e., the insuring agreement and exclusions) and those that act as conditions precedent to coverage for which noncompliance may result in a forfeiture (e.g., a notice provision).

Under either the strict or intermediate approach, courts have implied waiver of a defense from the mere fact that it was not a defense on which the insurer specifically relied in denying coverage. As waiver traditionally requires the intentional relinquishment of a known right, the argument for these approaches is on shaky ground. Regardless, awareness of the nuances of each states' law regarding waiver and estoppel in the context of insurance coverage is critical before undertaking significant moves like providing a defense or disclaiming coverage.

What's the Solution?

For pending claims in which no position has been taken as to coverage, Hoover and cases like it offer an insurer little clear guidance. In practice, there are several approaches available to an insurer when faced with a claim. In theory, an insurer could disclaim coverage without citation to any policy provisions, requiring the insured to refer to the policy to determine the potential bases for the denial. In jurisdictions in which unasserted defenses are deemed waiver where other defenses are specifically relied on as the basis for the disclaimer, it would potentially eliminate the risk of implied waiver or estoppel, but is likely to lead to allegations of bad faith.

Alternatively, the insurer could disclaim coverage, including citation to any and all possible policy provisions that might apply under any set of yet-to-be-discovered facts, regardless of their relative merits or strengths. As the insurer would be asserting all potential bases for denying coverage in its initial disclaimer, there should be no risk of an implied waiver. Again, however, it is likely that some of the asserted bases for denial will be unsupportable after further investigation or discovery. As a result, an insured may still allege such a boilerplate disclaimer is made in bad faith.

Third, despite its reasonable belief of no coverage, an insurer can nevertheless tender a defense to its insured while reserving rights and/or seek alternative dispute resolution. This includes arbitration, if the policy provides for it. Or, the insurer could file a declaratory judgment action, a safe but perhaps unnecessarily expensive procedure.

Admittedly, none of these approaches are ideal, and each carries certain costs and risks. Given the multiple approaches courts may take to address waiver in the context of disclaimers of coverage, and whether additional defenses may be reserved at all, special attention should be paid to the law that will be applied to interpret the policy. The greater the understanding of the nuances of a particular state's law, the lesser the chance of a finding of implied waiver.

Authored By

Christopher B. Freeman

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