Insurance Law – Lawsuits and Reservation of Rights Letters

by Ken White

A prior article discussed coverage triggers under commercial general liability policies and how insurers may be required to at least provide a defense to claims not otherwise subject to indemnity coverage under such policies. These types of scenarios often prompt a "reservation of rights" (ROR) letter from the insurer. At first blush, and thankful for any indication of coverage, these letters appear somewhat innocuous and the insured relaxes thinking the insurer is going to take care of the suit giving little thought to what these letters ultimately may mean. The insured puts the letter away confident that the matter is handled and that all is well. The reality is that an ROR letter can be a trap for the unaware.

Generally speaking, a ROR letter starts out acknowledging the claim, citing to the applicable policy at issue and reciting the allegations of the complaint as the "facts" giving rise as to why any coverage is presently being extended. The letter goes on to recite that a defense to the lawsuit is being provided, but under a "reservations of rights" which roughly translates to "Coverage is being provided at present, but it may be withdrawn at any time." The letter typically continues for several pages setting forth any number of policy defenses or specific policy exclusions stating why coverage may be withdrawn depending on how the facts of the lawsuit are developed relevant to policy defenses or exclusions. The letter usually ends with a "catch all" reservation saving to the insurer any and all other rights under the policy which the insurer may later divine.

What follows are four possible consequences of a ROR letter, mandating an insured's diligence which could include immediate retention of independent counsel to review the letter and monitor the progress of the underlying litigation.

1. It is generally considered that a ROR letter creates an immediate conflict of interest between the insurer and the insured. Theoretically, the insurer would prefer that the facts of the case be developed to support a policy defense or exclusion so the defense of the lawsuit may be withdrawn and liability coverage ultimately never triggered. The insured, however, desires exactly the opposite. Accordingly, the insured should consider retaining independent counsel to at least monitor the lawsuit, if not also to become actively involved in the insured's defense as the facts are developed.

2. Some insurers will insert one or two sentences in a five or six page ROR letter to the effect that if it turns out through the development of the facts of the case or later in coverage litigation that the insurer did not have to provide a defense, the insurer reserves the right to recoup or charge back and recover from the insured all defense costs incurred by the insurer. The insurer may attempt to reserve this recoupment even though the policy does not provide for any such charge back. To date, there is no Ohio Supreme Court decision on point, but there is some Ohio case law suggesting such a recoupment is allowable based on very specific facts. A reason cited in one of those cases was that the insured never objected to this part of the ROR letter. Accordingly, ROR letters should be reviewed for this type of reservation and written objection made, especially if such a charge back is not addressed in the policy.

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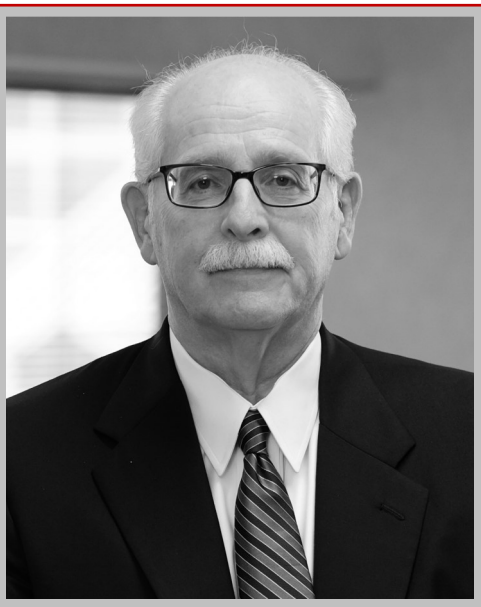
3. On the other hand, as the facts of the lawsuit are developed, additional coverage under the policy could be triggered or the efficacy of an ROR letter diminished. This is particularly true if an amended complaint is filed clarifying existing claims or adding new ones. Any clarified or additional claims should be analyzed for potential or strengthened coverage arguments and brought to the insurer's attention as may be warranted. These types of changes may require an insurer to respond to a lawsuit and defend even though the original compliant did not trigger coverage. Insureds should continue to monitor a reservation of rights situation, and also cases in which there was an initial legitimate outright denial of coverage, in the event new coverage opportunities are presented.



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4. Although there appears to be a paucity of Ohio case law on this issue, the majority rule country-wide is that the burden of proof is on the insured to allocate damages between covered and non-covered claims. Taken to its extreme, the majority rule might require that if there is an adverse general verdict against the insured which encompasses covered and non-covered claims without such an allocation, the insured pays all of the damages--a pretty harsh result. Situations which prompt ROR letters frequently involve covered and non-covered claims, and thus, the insured needs to be proactive to ensure that a proper allocation is established.

Further Reading :

Insurance Law-Coverage/Website Article

Insurance Law-Claims Submission/Excess Policies/Website Article