

**EFFECTIVE
RESERVATIONS OF RIGHTS**

Steven E. Leder, Esq.
Lord & Whip
Baltimore, Maryland

June, 1990

EFFECTIVE
RESERVATIONS OF RIGHTS

by: Steven E. Leder
Lord & Whip, P.A.

I.

INTRODUCTION

An Insurer has three choices when an insured submits a claim:

- (1) Accept liability,
- (2) Provide a defense under a reservation of rights, or,
- (3) Disclaim liability completely.

Cf. Glen Falls Insurance Co. v. American Oil Co., 254 Md. 120, 136 (1969) (disclaim, non-waiver, or declaratory judgment action).

If the claim is clearly covered the insurer accepts liability. Disclaiming liability results in loss of control of the litigation and selection of counsel. When there is any question, a reservation of rights should be sent. Liability policies impose two duties on the insurer: the duty to defend and the duty to indemnify. The duty to defend, is broader and separate, right of the insured from the duty to indemnify.

Brohawn v. Transamerica Ins. Co., 276 Md. 396 (1975). The duty

to reserve rights is a part of the duty to defend. The insured has a right to know which aspects of a claim will be covered and which may not be covered. He can then decide whether to engage his own attorney and whether to settle or whether to permit the insurer to continue to defend.

II

WAIVER & ESTOPPEL

A reservation of rights allows an insurer to preserve the right to assert coverage defenses while providing a defense. When the "questions are independent and separable from the claims asserted in" the underlying tort action, a pre-tort trial declaratory judgment action is permissible. See Allstate v. Atwood, 572 A2d 154, 156 (1990), citing Brohawn, Supra. at 405. Otherwise, an Atwood type or other declaratory judgment action may be filed at the conclusion of the underlying tort action.

In many states the rule is that absent an adequate reservation of rights letter, the insurer may be precluded from later denying coverage. See, e.g., Windt, Insurance Claims & Disputes, Section 2.06 (2d ed. 1988). Coverage may expand to include risks not contracted for, unless the insurer has specifically reserved as to those risks. The Courts justify this result by the doctrines of "waiver" and "estoppel".

Waiver and estoppel are often used interchangeably by the courts but their distinctions are important.

Waiver means a "voluntary and intentional relinquishment of a known right." Progressive Casualty Ins. Co. v. Ehrhardt, 69 Md. App. 431, 433 (1986); Rubenstein v. Jefferson Nat'l Life, 268 Md. 388, 392 (1973). In short, a knowing election. Waiver really should not apply to coverage situations because insurers do not really decide not to assert defenses or assume additional risks. Really waiver, in this sense, like failing to is a timely object at trial; it's not an election, it's a conclusion.

Estoppel means "to stop" in archaic french. "One asserting the benefit of an estoppel must have been misled to his injury and have changed his position for the worse, having believed and relied on the representations of the party sought to be estopped. Id. at 393. Estoppel precludes an insurer from asserting what may be an otherwise legitimate policy defense because it has conducted itself in such a manner that it would be contrary to equity and good conscience to let it assert the defense. Wright v. Wagner, 182 Md. 483, 492 (1943). The Estoppel generally results when an insurance company assumes defense of an action or claim with knowledge of a defense of non-liability under the policy without reserving

its rights. In that situation the insured may have been denied the right to hire its own counsel (at the insurer's expense conceivably), to control the defense, or to insist that the insurer provide independent counsel to control the defense. See, e.g., Diamond Serv. Co. v. Utica Mut. Inc. Co., 476 A.2d 648, 655 (D.D.C. 1984).

In Maryland neither waiver nor estoppel will expand the duty to indemnify. See St. Paul Fire & Mar. Ins. v. Molloy, 291 Md. 139, 146 n.4; Neuman v. Traveler's Indemnity Co., 271 Md. 636, 654, (1974); Insurance Co. of N. Amer. v. Coffman, 52 Md. App. 732, 742-43 (1982). In Coffman the court, citing Molloy, supra, and Neuman, supra said:

[T]he Court of Appeals sees a distinction between defenses founded upon lack of basic coverage and those arising from the failure of the Claimant to satisfy some "technical" condition subsequent. The former, it is apparent, may not be waived merely by the company's failure to specify them in its initial response to the claim, for the effect of that would be to expand the policy to create a risk not intended to be undertaken by the company.

Id. at 742-43. See, also, Travelers Insur. Co. v. Godsey, 260 Md. 669, 675.

In Neuman, supra, the court said:

For principles of estoppel to be applicable, the party claiming the benefit of the estoppel must have been misled to his injury and changed his position for the worse, having believed and relied upon the representations of the party sought to be estopped. Id. at 654

Even if the insurer refuses to defend it is not estopped from later denying coverage under its duty to indemnify. See Fireman's Fund Ins. Co. v. Rairigh, 59 Md. App. 305, 317-18 (1984); Oweiss v. Erie Ins. Exchange, 67 Md. App. 712, 720-21 (1986).

However insurers will be barred from asserting technical conditions subsequent such as late notice or failure to cooperate if they do not reserve their rights in a timely manner. See, e.g., Medical Mutual Liab. Ins. v. Miller, 52 Md. App. 602, 611-613 (1982).

III

EFFECTIVE RESERVATION OF RIGHTS LETTERS

There are three requirements for an effective reservation of rights notice:

- (1) It must be communicated to the insured;
- (2) It must be timely; and,
- (3) It must fairly inform the insured of the insurer's position.

A.

COMMUNICATION TO THE INSURED

Notice by letter is sufficient and the insured need not be served with the notice personally. See Cooper v. Employers Mut. Liab. Ins. Co., 199 Va. 908, 103 S.E.2d. 210 (1958).

There is no requirement that the reservation of rights notice go by certified mail, however, it is safer. Absent such a reservation of rights letter, equivalent oral advice or the prompt institution of a declaratory judgment action will have the same effect. Beckwith Machinery Co. v. Travelers Indem. Co., 638 F. Supp. 1179, 1187 (W.D. Pa. 1986); Basoco v. Just, 154, Pa. Super. 294, 35 A.2d. 564 (1944) (there the court held that the oral statement was ineffective to release the insurer from its liability, apparently based on the lateness of the notice rather than its oral character).

B.

TIMING

Once the insurer is put on notice of a claim, it should promptly respond. Prompt notice to the insured as soon as the insurer learns of a defense is safest. There is no bright line test in Maryland as to when the insured must be notified of the reservation of rights. However, keep in mind the reason that the reservation of rights prevents the insurer from forfeiting

its coverage defenses; that is, it gives the insured an opportunity to hire his own counsel to take over the defense if it so desires. Appleman, Insurance Law & Practice, (Berdal ed.), Section 4694. Reasonable notice to the insured, therefore means notice that will give the insured reasonable time to assume the defense. The closer to the trial date the more likely the court is to find prejudice to the insured. Neuman, Supra. 654; Medical Mut. Liab. Ins. v. Miller, 52 Md. App. 602, 611-12 (1982). If the basis of the reservation does not come to light until it is too late for the insurer to withdraw without prejudicing the rights of the insured, the insurer can continue the defense without losing any rights. Note that when there is a long period of time between notice of claim and the undertaking of defense the insurer should send a second reservation of rights letter. Another reservation of rights letter sent shortly before trial in protracted litigation will remind all parties of the coverage issues and prevent surprise after trial.

C.

CONTENTS OF THE NOTICE

Md. courts have not been too clear as to exactly what must be contained in a reservation of rights letter. See, e.g.

Casualty Co. v. Mitnick, 180 Md. 604, 606 (1942). Generally, it should:

1. Fully inform the insured of the nature of any conflict of interest relating to the insured's defense;
2. Set out the pertinent exclusions;
3. State that the application of the exclusions might result in a denial of coverage;
4. Suggest the insured retain his own legal counsel regarding the questions raised in the letter;
5. Be complete, but not too broad, and unambiguous.

The purpose of reservation of rights letters is to permit the insured to make a decision as to whether it should take over the defense, settle the case, or take some other action in order to protect its interests. An insurer, therefore, should set out in its letter every reason why the insured may not ultimately be entitled to coverage. See e.g., American & Foreign Ins. Co. v. Church Schools in the Diocese of Virginia, 645 F. Supp. 628 635 (E.D.Va. 1986); but see Norman v. INA, 218 Va. 718, 239 S.E.2d. 902, 906, 907 (1978).

The letter must specifically identify the grounds relied upon. Fortunately in Maryland, only technical conditions subsequent are forfeited. The scope of the coverage cannot be expanded by waiver or estoppel.

In many states the rule is that absent an adequate reservation of rights letter, the insurer may be precluded from later denying coverage. See, e.g., Windt, Insurance Claims & Disputes, Section 2.06 (1988 2d ed.). Coverage may expand to include risks not contracted for, unless the insurer has specifically reserved as to those risks.

VI.

CONCLUSION

The duty to disclaim coverage or to reserve rights is a part of the duty to defend. In most states, if a insurer has a duty to defend the insured, the insurer may be estopped from denying coverage if the insurer has conducted the defense with knowledge of any defense to coverage. This means that when the insured tenders the defense of the claim to the insurer, the insurer must either accept the defense and admit coverage, disclaim coverage, or conduct a defense subject to a reservation of rights.

2684I