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INSURANCE COVERAGE: RESERVATION OF RIGHTS LETTERS

SELECTIVE WAY INS. CO. V. MAK SERVICES, INC.

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A new Pennsylvania Superior Court case requires greater specificity in reservation of rights letters based on a duty to investigate, meaning insurer's must compare the policy language to known factual allegations.

CASE BACKGROUND

On April 24, 2014, Pennsylvania's Superior Court issued a 2-1 decision in **Selective Way Insurance Co. v. MAK Services**. This is an important opinion to all those responsible for drafting reservation of rights letters directed at Pennsylvania insureds.

MAK was exclusively in the business of snow and ice removal. Selective issued a policy having an exclusion for snow and ice removal. MAK was sued for a slip and fall on an icy parking lot, and made demand on Selective for defense and indemnification.

Selective defended under a reservation of rights. Despite the clear snow and ice removal exclusion, Selective did not expressly reference the exclusion in its reservation of rights letter. Rather, it defended the case for 18 months before first raising the exclusion via a declaratory judgment complaint, seeking a declaration that it had no duty to defend or indemnify. MAK counterclaimed for defense and coverage, bad faith, fraud, and most significantly for present purposes, that Selective "should be estopped from ceasing its representation and indemnification…."

Selective's reservation of rights letter makes clear that a defense is being provided. Selective then attempts to preserve its right to disclaim defense and indemnification: "In the meantime, please be aware that Selective will be handling this matter under a reservation of rights. This means that Selective reserves all rights reserved to it under applicable law, insurance regulations and policy provisions that may become relevant as this matter continues to develop. Those rights include, but are not limited to, the rights to decline coverage for this claim and to withdraw assigned defense counsel."

As stated, the letter did not specifically reference the snow and ice exclusion.

The trial court found this broad reservation of rights language sufficient to preserve the insurer's right to assert the snow and ice exclusion 18 months later, and granted the insurer summary judgment on all counts. The Superior Court majority reversed.

STANDARDS GOVERNING RESERVATION OF RIGHTS LETTERS AND IMPORTANT PRACTICE POINTS

The majority opinion observed some general principles in reaching its decision:

1. "[I]nsurance companies can also choose to send multiple reservation of rights letters during the evolution of a case as a best practice."

2. "Pennsylvania law does not require an insurance company to list every potential defense to coverage in its reservation of rights letter. However, the small body of recent case law discussing this precise issue suggests that some level of specificity is necessary."

3. "Pennsylvania counterbalances the insurer's broad obligation to defend even claims as to which coverage may not apply by providing the insurer [with] the option of defending subject to a reservation of its rights later or simultaneously to contest coverage."

4. "Where the insurer assumes the duty to defend, the insurer can simultaneously challenge whether the claim is covered under the insurance policy, even if the underlying case settles. An insurer's defense of the insured, therefore, does not waive the insurer's claims that a policy exclusion applies."

5. An insurer is "required to provide timely and sufficient notice of any such reservation of rights to the insured…."

6. The reservation of right must "(1) be submitted in a timely fashion; and (2) 'fairly inform the insured of the insurer's position' in order to preserve an insurer's assertion of policy exclusions once a defense of the insured has been mounted."

7. "[A]n insurance company preserves defenses via a reservation of rights '[i]f its investigation is conducted with reasonable dispatch and its disclaimer is made with promptness upon the discovery of the facts…."

8. An insurer "cannot delay its decision and refrain from giving notice to the insured until such time has elapsed that his rights in relation to the accident are prejudiced or may become so…."

9. "'[W]here an insurer fails to **clearly communicate** a reservation of rights to an insured, prejudice may be fairly presumed.'" (Court's emphasis)

10. The majority quoted, and emphasized, a nearly 40-year old Superior Court opinion as guiding precedent:

"[A] liability insurer will not be estopped [from setting] up the defense that the insured's loss was not covered by the insurance policy, notwithstanding the insurer's participation in the defense of an action against the insured, **if the insurer gives timely notice to the insured that it has not waived the benefit of its defense under the policy**. However, a reservation of rights in this respect, to be effective, must be communicated to the insured. **It must fairly inform the insured of the insurer's position and must be timely, although delay in giving notice will be excused where it is traceable to the insurer's lack of actual or constructive knowledge of the available defense**." (Court's emphasis)

11. The majority cited 91-year old Supreme Court precedent for the proposition: "When an insurance company or its representatives is notified of loss occurring under an indemnity policy, it becomes its duty immediately to investigate all the facts in connection with the supposed loss as well as any possible defense on the policy. It cannot play fast and loose, taking a chance in the hope of winning, and, if the results are adverse, take advantage of a defect in the policy. The insured loses substantial rights when he surrenders, as he must, to the insurance carrier the conduct of the case."

12. "[I]nsurance carriers may be estopped from asserting a policy exclusion where it has 'lulled the insured into a sense of security to his detriment.'"

THE RESERVATION OF RIGHTS LETTER WAS TIMELY

In this case, Selective issued the reservation of rights letter within three weeks of the suit against the insured, and before any defense was undertaken. The majority generally observed "that a reservation of rights letter sent close-in-time to the institution of a potentially covered legal action is 'timely' under Pennsylvania law." The court found Selective's reservation of rights letter timely.

THE RESERVATION OF RIGHTS LETTER DID NOT "FAIRLY INFORM THE INSURED OF THE INSURER'S POSITION"

The majority observed that the reservation of rights letter stated the insured's defense was "potentially covered," and that defense counsel was being appointed. Although the letter stated MAK had "a right to obtain private counsel on its own initiative, it simultaneously instructed MAK to refrain from discussing the case with 'anyone other than your attorney or a properly identified representative of Selective.'"

As set out above, the letter only "generally reserved all of Selective's rights under 'applicable law, insurance regulations and policy provisions,' including the right to deny coverage. However, the letter failed to specifically identify any emergent coverage issues. Instead, it simply purported to include any and all issues that may become relevant as this matter continues to develop.'"

In this case, while the reservation of rights letter may have adequately apprised the insured that something might occur in the future affecting coverage, "it provided no notice whatsoever of the existing coverage issue appearing on the face of the Policy, i.e., the snow and ice removal exclusion." The majority found Selective failed in its duties to investigate before issuing the reservation of rights letter.

The majority stated, "[a]ny complete review of the Policy would have immediately revealed the existence of this exclusion." If the insurer had done so, it would have "vitiated any obligation … to defend or indemnify…." "Instead, the boilerplate language relied upon by Selective obfuscated this absolute defense to coverage, and caused MAK to reach the reasonable conclusion there was no pressing need to secure back-up counsel."

The Superior Court added that while insurers do not have to list every potential defense in a reservation of rights letter, the trend in the "small body of recent case law discussing this precise issue suggests that some level of specificity is necessary." The majority tied specificity to the insurer's duty to investigate before issuing a reservation of rights.

Thus, it was not the lack of specificity in itself that doomed the insurer here:

"The lack of specificity in Selective's reservation of rights letter is not determinative, in and of itself. We are not announcing some new paradigm by which Pennsylvania insurance companies must prophylactically raise all potential coverage defenses in order to preserve them. However, the lack of specificity in the letter bespeaks the **deficient investigation** carried out…." (Court's emphasis)

In this case, the insurer had both the policy language and actual knowledge of the nature of the claim, but waited 18 months before specifically raising the exclusion.

THERE WAS PRESUMPTIVE PREJUDICE SUFFICIENT TO ESTOP THE INSURER FROM DISCLAIMING COVERAGE

The majority then observed that an insurer's own conduct may lead to estoppel in belatedly asserting exclusions where, e.g., the insurer lulls the insured into a sense of security detrimental to the insured's interests, or only raised the exclusion 9 months accepting exclusive control of the defense. Here, where Selective failed to "'clearly communicate' its coverage position and the inherently speculative nature of determining how the case might have unfolded differently had the insurance company acted with appropriate diligence, prejudice can be fairly presumed in this instance." Thus, the majority held, "[a]s a consequence of [its] deficient investigation, [the insurer's] reservation of rights letter failed to 'clearly communicate' the extent of the rights being reserved, which resulted in presumptive prejudice…."

"As a result of this prejudice, Selective should have been estopped from asserting this policy exclusion for the first time eighteen months later without sufficient notice to MAK regarding Selective's coverage position."

Thus, the trial court's decision was reversed, and the case remanded.

If you have any questions concerning this opinion, you can contact S. David Fineman dfineman@finemanlawfirm.com or Lee Applebaum lapplebaum@finemanlawfirm.com