The Devil Is in the Details:  
A Practical Overview of Notice, Tender, and Reservation-of-Rights Letters

Alison R. Christian, Esq.  
Harper Christian Dichter Sluga  
Phoenix, AZ

Doressia L. Hutton, Esq.  
Winston & Strawn LLP  
Chicago, IL

Katherine E. Mast, Esq.  
Sedgwick, Detert, Moran & Arnold LLP  
Los Angeles, CA

Andrew W. Miller, Esq.  
Thacker Martinsek LPA  
Perrysburg, OH
Introduction

Insurance carriers, policyholders, and coverage professionals are confronted with claims-related correspondence on an almost daily basis. While, to the seasoned professional, the task becomes routine—and almost mundane—there are countless small issues that must be kept in mind. This paper addresses some of the most common issues that must be taken into consideration, beginning with a policyholder’s notice and tender of a claim, to the carrier's initial response, and ending with the policyholder’s next steps. Of course, the topics covered in this paper are not intended to be comprehensive, nor replace the need to read the policies in question.

Discussion

I. Notice and Tender

A. Notice

After a claim, a policyholder’s first contact with its insurance carrier will likely be notice in some form. In some instances, particularly when a policyholder faces a suit brought by a third party, it makes sense to combine notice with a tender of the claim for defense and indemnity—though the two are distinct concepts. Notice is, quite simply, giving notice to a carrier, or the carrier’s representative, of a claim or potential claim. While simple in concept, there are several important factors that a policyholder’s representative should keep in mind when preparing to give notice. As with many facets of insurance law, the sufficiency of notice is driven by the language of the policies and the legal precedent of the jurisdiction. For this reason, it is not only imperative for the policyholder to review all relevant policies to determine the notice obligations created by each, but also to understand how courts in the relevant jurisdiction will interpret such obligations.

1. When to Provide Notice

A frequently litigated issue pertaining to notice is the timeliness upon which a policyholder notifies its carriers of a claim or suit. Typically, a primary insurance policy will require a policyholder to notify the carrier of a suit or claim “as soon as practicable,” that “prompt notice” is required, or that “immediate notice” is required. Generally speaking, courts will interpret these provisions to mean the same thing: notice is required within a reasonable time, taking into consideration the facts and circumstances of the case. See e.g. RTE Corp. v. Maryland Casualty Co., 247 N.W.2d 171, 178 (Wis. 1976)(“There seems to be little difference in the meaning of the terms variously used to define the time for giving notice. The words ‘immediately,’ ‘forthwith,’ ‘promptly,’ ‘as soon as practicable’ all require notice in ‘a reasonable time.’”) (internal citations omitted); Clark v. Chubb Group of Ins. Cos., 337 F.3d 687, 693 (6th Cir. 2003).

The standard for a policyholder providing notice under an umbrella or excess insurance policy is slightly different than under a primary policy. While primary insurance policies often contain language requiring notice “as soon as practicable,” umbrella and excess policies typically require notice only when it is “reasonably likely” that a claim or occurrence will exhaust the underlying limits of liability. See, e.g., Hatco Corp. v. W.R. Grace & Co., 801 F. Supp. 1334, 1371 (D.N.J. 1992). Thus, providing notice to an umbrella or excess carrier is generally not

1 Although typical excess policies contain the “reasonably likely” language, it is important to be aware of any other provisions which may increase a policyholder’s duty for providing notice, and how different jurisdictions will handle them. For example, in Briggs & Stratton Corp. v. Royal Globe Ins. Co., 64 F. Supp. 2d 1346 (M.D. Ga. 1999), an excess policy contained the standard “reasonably likely” language, but also had a requirement for immediate written notice in the event of a claim or suit. Relying on the second provision, the district court for the middle district of Georgia held that the insured’s failure to notify for a thirteen month period was unreasonable as a matter of law. Id; see also Household Int’l Inc. v. Liberty Mut. Ins. Co., 321 Ill. App. 3d 859, 749 N.E.2d 1 (1
required until the policyholder has reason to believe that coverage will reach the excess policy. *Id.* at 1369-71; see also *Lumbermans Mut. Cas. Co. v. RGIS Inventory Specialists, LLC*, No. 09-0753-cv, 2010 U.S. App. LEXIS 25194 (2d Cir. Dec. 9, 2010) (“The difference between the policies' respective notice provisions reflects the general distinction between primary and excess insurance policies. ‘Since excess coverage is contingent on exhaustion of primary or underlying policies, excess insurers generally do not require notification of occurrences until the excess policy is reasonably likely to be implicated. Consequently, insurance policies for excess coverage grant the insured some discretion in evaluating the case.’”)(quoting *Santos v. Farmers Ins. Exch.*, No. 07-11229, 2008 U.S. Dist. LEXIS 13238 at *11-12 (E.D. Mich. Feb. 22, 2008))(applying Michigan law).

But even if a policyholder fails to provide timely notice, all is not lost. In fact, the vast majority of jurisdictions only penalize the policyholder if the carrier can demonstrate that it was prejudiced as a result. See e.g. *Managed Health Care Sys. v. St. Paul Fire & Marine Ins. Co.*, NO. 98-CV-10831-GAO, 2001 U.S. Dist. LEXIS 18302 (D. Mass. Sept. 28, 2001) (“An insured's failure to give its liability insurance company timely notice of a claim against it does not automatically excuse the insurance company from its contractual obligations. Instead, in order for the insurance company to be relieved of its obligations under the policy, it must ‘prove both that the notice provision was in fact breached and that the breach resulted in prejudice to its position.’”) (quoting *Johnson Controls, Inc. v. Bowes*, 409 N.E.2d 185 (Mass. 1980)). However, a small minority of courts continue to adhere to a per se rule that permits a carrier to avoid coverage when notice was improperly provided. See, e.g., *Metro Wastewater Reclamation Dist. v. Fireman’s Fund Ins. Co.*, 35 Fed. Appx. 839, 842 (10th Cir. 2002) (“Late notice, absent a justifiable excuse, results in the forfeiture of coverage and, in this case, would relieve [the insurer] of any defense or indemnity obligations under the policy.”) (citation omitted). And under a third line of reasoning, the policyholder’s failure to provide timely notice creates a rebuttable presumption of prejudice to the carrier. See e.g. *Montgomery v. State Auto. Mut. Ins. Co.*, 2000 Ohio 2010 (Ohio Ct. App. 2000) (“there is a rebuttable presumption that an unreasonable delay in giving notice is prejudicial to the insurer. The burden is on the insured to establish that the insurance company was not prejudiced by the delay.”) (internal citation omitted).

Even though the majority of jurisdictions require a showing of prejudice, it should be noted that certain types of policies, typically directors’ and officers’ or professional liability policies, require that the claim be made against the insured during the term of the policy and that the insured report it to the carrier during that period. Under these policies, the carrier is not typically required to suffer “prejudice” from the insured’s late notice to defeat coverage. There is simply no coverage if notice is delayed beyond the policy period. *Pacific Employers Ins. Co. v. Sup. Ct.*, 221 Cal. App. 3d 1348, 1359 (1990); *KPFF, Inc. v. California Union Ins. Co.*, 56 Cal. App. 4th 963, 972 (1997). This underscores the need to carefully review the specific terms and conditions of any policy when analyzing this issue.

2. **What to Include in the Notice**

Specific requirements for notice letters as to content, procedure and thoroughness will vary with the types and specific language of the policies as well as the nature of the claims. This is an area, therefore, where it is best to

---

2 A few jurisdictions have gone as far as passing legislation which requires a finding of prejudice before an insured’s claims are barred for untimely notice. See e.g. Md. Insurance Code Ann. § 19-110 (“An insurer may disclaim coverage on a liability insurance policy on the ground that the insured or a person claiming the benefits of the policy through the insured has breached the policy by failing to cooperate with the insurer or by not giving the insurer required notice only if the insurer establishes by a preponderance of the evidence that the lack of cooperation or notice has resulted in actual prejudice to the insurer.”).
consult the policy first, and err on the side of giving too much information.\(^3\) For example, courts will construe notice requirements in claims-made policies more strictly than those in occurrence-based policies. See FDIC v. Continental Casualty Co., 796 F. Supp. 1344, 1351 (D. Or. 1991) (“Courts typically enforce the notice requirements in claims-made policies strictly because the notice provision serves a materially different purpose from one in an occurrence policy. The notice provision of a claims-made policy is just as important as the requirement that the claim be asserted during the policy period. If the insured does not give notice within the contractually required time period . . . there is simply no coverage under the policy.”)(citing City of Harrisburg v. International Surplus Lines Ins. Co., 596 F. Supp. 954, 961 (M.D. PA 1984), aff'd, 770 F.2d 1067 (3d Cir. 1985)).

Other principles that a policyholder should keep in mind:

- where a policy requires notice in writing, oral notice is generally deemed insufficient. See National Surety Corp. v. Dotson, 270 F.2d 460, 464 (6th Cir. 1959) (“courts have recognized the right of the insurer to provide in its policy for written notice of an accident instead of oral notice and to insist upon the performance of this condition”); Continental Ins. Co. v. Stanley, 569 S.W.2d 653, 657 (Ark. 1978)(“In the absence of waiver, verbal notice is not sufficient when the terms of the policy require written notice.”);

- separate notification is required for each claim under a policy. See Federal Sav. & Loan Ins. Corp. v. Burdette, 718 F. Supp. 649, 654 (E.D. Tenn. 1989) (“Notification as to one loss or claim does not constitute notification as to another.”) (internal citation omitted); and

- providing notice under one policy does not relieve an ensured of its duty as to another. U.S. Underwriters Ins. Co. v. Landau, 05-CV-2049, 2010 U.S. Dist. LEXIS 57462, 10-18 (E.D.N.Y. June 8, 2010) (notice under property policy did not constitute notice under separate liability policy). This is true even if both are written by the same carrier. Sorbara Construction Corp. v. AIU Ins. So., 897 N.E.2d 1054 (N.Y. Ct. App. 2008) (notice under workers’ compensation policy was not considered sufficient notice under liability policy issued by same carrier).

Finally, if the party seeking coverage is not a “policyholder” under the carrier’s policy, a statement of why the policy applies to a given claim should be considered. For instance, many policies provide coverage for both the entity named on the declarations page, as well as all subsidiaries of that entity. While the link between a subsidiary and the parent corporation may be obvious to the entities and their counsel, it might not be so clear to the carrier. Another scenario is an entity that has undergone a name change, either directly or as a result of a merger,\(^4\) and is no longer readily identifiable as the entity listed in the declarations. This is a frequent occurrence in cases where coverage is sought under historic CGL policies for long-tail claims. In these situations the party seeking coverage should give serious consideration to including documents along with its notice letter—such as

\(^3\) Some courts have held that a policyholder need only provide enough detail so that the carrier can determine the likeliness of an asserted claim. See Charleston Laundry Co. v. Ohio Farmers Indem. Co., 89 F. Supp. 649 (S.D. W. Va.), aff’d, 183 F.2d 682 (4th Cir. 1950); see generally Campbell v. Allstate Ins. Co., 60 Cal. 2d 303, 384 P.2d 155, 32 Cal. Rptr. 827 (1963).

\(^4\) The situation is more complex when the corporate transactions at issue are more than simple mergers and name changes. For example, there is a split of authority regarding the insurance coverage implications after a transfer of assets/assumption of liabilities when an insurance policy contains a consent to assignment clause. Compare Pilkington N.A., Inc. v. Travelers Casualty & Surety Co., 861 N.E.2d 121 (Ohio 2006) (assignment of assets does not violate the consent to assignment provision), Henkel Corp. v. Hartford Accident & Indemnity Co., 62 P.3d 69 (Cal. 2003) (pre-loss assignment of policy rights invalid without consent of carrier), and Travelers Casualty & Surety Co. v. United States Filter Corp., 895 N.E.2d 1172 (Ind. 2005).
SEC filings, merger, or corporate documents—linking that party to the entity listed on the declarations page of the policy in question.

3. Where to Provide Notice

The “where” that a policyholder should direct its notice can vary by policy language, circumstances, and prevailing law of the applicable jurisdiction. For instance, some policies contain very specific notice requirements, specifying to whom notice must be supplied, and failure to comply may negate coverage. See, e.g. M.Z. Discount Clothing Corp. v. Meyninger, 23 F. Supp. 2d 270, 272 (E.D.N.Y. 1998) (insured, who sent notice only to the broker, had no excuse for failing to send notice directly to the insurer, as explicitly required by the policy); Grinnell Mutual Reins. Co. v. Jungling, 654 N.W. 2d 531, 541-42 (Iowa 2002) (the insured breached his obligations by sending notice to the broker rather than directly to the excess insurer, as required by the policy, but was legally excused because of the broker’s actions). In general, however, a policyholder may direct written notice to the carrier or an authorized agent of the carrier.5

If notice is not provided directly to the carrier, the next logical question becomes, who is an authorized agent for notice purposes? Usually, the broker is considered an agent of the policyholder, not an agent of the carrier. Van G. Miller & Assoc. v. Gulf Ins. Co., No. C00-2051 MJM, 2001 U.S. Dist. LEXIS 11522 (N.D. Iowa, Aug. 8, 2001); Mate v. Wolverine Mut. Ins. Co., 592 N.W.2d 379, 382 (Mich. Ct. App. 1998); Steelcase, Inc. v. American Motorists Ins. Co., No. 89-1344, 1990 U.S. App. LEXIS 11310 (6th Cir. 1991). Thus, notice provided to the broker will not automatically impute to the carrier. Gershow Recycling Corp. v. Transcontinental Ins. Co., 801 N.Y.S.2d 832, 833 (N.Y. Sup. Ct. App. Div. 2005) (Notice was not sufficient where the broker initially sent notice to the wrong insurer and did not correct his mistake until 5 months later).6 By contrast, an insurance agent is often considered to be an agent of the carrier, so notice provided to the agent is more likely to be imputed to the carrier. See e.g., D.C.G. Trucking Corp. v. Zurich Ins. Co., 440 N.Y.S.2d 74, 76 (N.Y. Sup. Ct. App. Div. 1981)(holding that insurance agent was an authorized agent of carrier, thus the initial notice provided to the agent constituted notice to the excess insurer).

B. Tender To Carrier

If the policyholder provides notice to the carrier, does it also have to tender the defense to the carrier?

Some courts do not require the policyholder/insured to tender the defense of the action to the carrier in addition to providing notice. See, e.g., 14 Couch on Insurance §199:98. The Illinois Supreme Court, for example, has held that tender is not required because actual notice is sufficient. Cincinnati Companies v. West American Insurance Company, 183 Ill.2d 317 (Ill. 1998). The court stated its holding as “where the [policyholder] has not knowingly decided against a [carrier’s] involvement, the [carrier’s] duty to defend is triggered by actual notice of the underlying suit.” Id. at 329. The court held actual notice is “notice sufficient to permit the [carrier] to locate and defend the lawsuit.” Id. The court further explained that notice sufficient to permit the carrier to locate and defend the lawsuit means the carrier “must know both that a cause of action has been filed and that the complaint falls within or potentially within the scope of coverage of one of its policies.” Id.

The Illinois Supreme Court also held that the policyholder’s ability to forgo assistance by the carrier should be protected. Id. at 326. Therefore, after receiving actual notice, the carrier can contact the policyholder to

---

5 Notice to an entity which is “intimately connected” to a carrier has also been held to be sufficient. Keepers v. Powell, 131 III. App. 2d 423 (1971) (holding that the carrier had received actual notice because the insurance agency and insurer were “intimately connected”) and Illinois Founders Ins. Co., 304 III. App. 3d at 608.

determine if its assistance is required. *Id.* If the policyholder indicates it does not want a defense or is unresponsive or uncooperative, the carrier is relieved of the duty to defend despite actual notice. *Id.*

Other courts hold that the policyholder must tender the defense to the carrier in addition to the carrier having notice. “An insurer cannot be expected to anticipate when or if an insured will make a claim for coverage; the insured must affirmatively inform the insurer that its participation is desired.” *Goodstein v. Continental Casualty Company*, 509 F.3d 1042, 1056 (9th Cir. 2007) (quoting *Unigard Ins. Co. v. Leven*, 983 P.2d 1155, 1160 (Wash. App. Ct. 1999).

As always, the policyholder should determine the rules for the applicable jurisdiction(s). Although not always required, to be safe, if the policyholder wants the carrier to defend, it should specifically state that it is tendering the defense to the carrier.

II. Carrier Response to Tender

A. Overview

Upon receipt of tender of the defense or indemnification of an insured, a carrier typically begins to process the claim to determine if there is coverage. The exact process followed by a carrier will vary, depending on the applicable state’s laws, the insurer’s internal processing procedures, and the type of policy at issue.

1. Acknowledgement

Carriers frequently make initial contact with the insured or the party tendering on the insured’s behalf, either verbally or in writing, to acknowledge receipt of the claim, request or obtain additional relevant information, inform the insured of the status of its investigation and of any coverage issues of which it is specifically aware, and to preliminarily reserve the insurer’s rights to deny coverage.

2. Investigate and Evaluate Claim

In the context of a liability policy, carriers take steps to determine whether the allegations against the insured in the suit or other covered proceeding or demand are within the scope of coverage provided by the policy or policies.

Frequent initial steps include locating potentially applicable policies and coverage forms, obtaining relevant pleadings, motions and discovery in the underlying litigation, requesting and reviewing relevant contracts or agreements, as well as prior related correspondence between the claimant and insured and any documents previously provided by the claimant in support of its position. Carriers may handle this process internally, or retain a third-party administrator or outside counsel. During the evaluation process, communications with the insured or its counsel may be ongoing, as the information requested by the carrier is provided and as the insured continues to keep the carrier informed of developments in the underlying action.

3. Inform Insured of Coverage Determination

Once the carrier has been able to determine its position as to coverage for the tendered claim, it will want to communicate that position to the insured and proceed with any other necessary steps to formalize that position.

   a. Decline Coverage

Where a carrier’s preliminary investigation shows that the tendered claim is plainly outside of the scope of coverage, for example the claim is not against an insured or falls outside of the policy period, the carrier may cease its investigation and inform the insured, generally in writing, of its position that there is no coverage under
the policy. However, as noted below, some states (or circumstances) may require a carrier to file a declaratory relief action that there is no coverage prior to declining coverage.

b. Agree to Defend Without Reservation

Alternatively, where the initial investigation shows that the tendered claim is clearly within the scope of coverage, the carrier may cease its investigation and inform the insured of its position that there is coverage under the policy, and that it will therefore be providing defense and indemnity without a reservation of rights. This position may be more unusual, in that providing a defense without any reservation, in many states, waives any coverage defenses of which the carrier was aware, or should have been aware. E.g. Miller v. Elite Ins. Co., 100 Cal. App. 3d 739, 755 (1980) ("If a liability insurer, with knowledge of a ground of forfeiture or noncoverage under the policy, assumes and conducts the defense of an action brought against the insured, without disclaiming liability and giving notice of its reservation of rights, it is thereafter precluded in an action upon the policy from setting up such ground of forfeiture or noncoverage.").

c. Defend Under Reservation of Rights

The trickier situation is where the claims asserted include both uncovered and potentially covered claims, or where there appears to be a question of law or fact as to whether any of the claims alleged fall within the scope of coverage. Because carriers are generally obligated to defend claims that are only potentially covered, insurers in these circumstances will frequently want to reserve their rights to deny coverage and withdraw from the defense, as well as reserve their rights to seek reimbursement of defense expenses paid toward non-covered claims, where permitted by the applicable laws. E.g., Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 275 (1966) (insurance carrier "must defend a suit which potentially seeks damages within the coverage of the policy") (emphasis in original); Buss v. Superior Court, 16 Cal. 4th 35, 61 (1997) (to obtain reimbursement of defense costs for non-covered claims, an insurance carrier must have properly reserved its rights); Nobel Ins. Co. v. Austin Powder Co., 256 F.Supp. 2d 937, 940 (W.D. Ark. 2003) ("absent an express agreement by the insured, an insurer who defends a claim for which coverage did not exist is entitled to reimbursement costs for both the settlement amount and litigation expenses only if the insurer: 1) timely and explicitly reserved its right to recoup the costs; and 2) provided specific and adequate notice of the possibility of reimbursement.").

Potential issues raised by providing a defense under a reservation of rights are discussed in greater detail below in the sections below.

d. Declaratory Relief

An insurer may also have the option of seeking declaratory relief that it owes no duty to defend its insured under an insurance policy. Some states require a carrier to seek declaratory relief after a claim is submitted for coverage but before a formal declination of coverage is issued. See, e.g. Atlanta Casualty Co. v. Fountain, 262 Ga. 16, 17 (1992). Other states require the carrier to defend the action and later seek declaratory relief after its conclusion. Hecla Mining Co. v. New Hampshire Ins. Co., 811 P.2d 1083, 1089 (Colo. 1991) (If an insurance carrier “believes that it is under no obligation to defend, [it should]…provide a defense to the insured under a reservation of rights to seek reimbursement should the facts at trial prove that the incident resulting in liability was not covered by the policy, or file a declaratory judgment action after the underlying case has been adjudicated.”). Other states permit the filing of a declaratory relief action while the carrier is defending, although such an action may be stayed pending resolution of the underlying litigation. E.g., Great American Ins. Co. v. Superior Court, 178 Cal. App. 4th 221, 225 (2009) (carrier that believes there is no longer any potential for coverage for underlying action may seek declaratory relief that it no longer needs to provide a defense).

B. Reservation of Rights

A key focus of this article is on the potential impact and issues to consider when a carrier agrees to defend its insured subject to its coverage defenses under the policy and at law through a reservation of rights letter.
Typically, a reservation is issued where the claims asserted include both uncovered and potentially covered claims, or where there appears to be a question of law or fact as to whether any of the claims alleged fall within the scope of coverage.

1. **Effect of General Reservation**

A typical “reservation of rights” letter serves to notify the insured that the carrier will defend it against the underlying action, but, at the same time, that the carrier reserves the right to refuse to indemnify the insured against any settlement or judgment on the basis that all or part of the claim is not covered, as well as the right to withdraw from the defense for the same reasons.

The carrier’s reservation of rights serves mainly to prevent waiver of its coverage defenses, and may also serve other purposes, such as to preserve its right to control the defense and/or settlement and to intervene in the underlying action to protect its own interests, to reserve the carrier’s right to reimbursement of defense costs incurred in relation to non-covered claims or settlement payments toward the same, or to avoid being bound by adverse findings in the underlying action. *E.g., Blue Ridge Ins. Co. v. Jacobsen*, 25 Cal. 4th 489 (2001); *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263 (1966); *Gray v. Begley*, 182 Cal. App. 4th 1509 (2010).

2. **Reservation as trigger to Independent Counsel?**

Because one of the main purposes of a reservation of rights letter is to prevent waiver of the carrier’s coverage defenses, a tendency is to draft the reservation to cover all potential coverage defenses, including citing each provision and law that potentially serves to bar coverage for one or more claims. In certain states, where any reservation triggers the insured’s right to independent counsel, this all inclusive approach is a no brainer. However, in other states, such as California, a reservation of rights in general does not trigger the right to independent counsel, as long as it involves coverage issues, the outcome of which cannot be controlled by defense counsel. *Cal. Civ. Code § 2860(b); James 3 Corp. v. Truck Ins. Exch.*, 91 Cal. App. 4th 1093, 1108–09 (2001); *Long v. Century Indem. Co.*, 163 Cal. App. 4th 1460, 1470 (2008).

Accordingly, in states such as California, if the carrier wishes to retain control of the defense, it may want to be careful to refrain from reserving its rights in relation to coverage defenses that could be predetermined by the manner in which the liability action is defended. A key example of a reservation triggering the right to independent counsel is where the insured's conduct at issue in the underlying litigation could be found to have been intentional, and the carrier reserved its rights to deny coverage based on the policy’s exclusion for intentional acts. *E.g., Golden Eagle Ins. Co. v. Foremost Ins. Co.*, 20 Cal. App. 4th 1372, 1395 (1993). Carriers may, therefore, wish to balance the potential pros and cons of asserting such a reservation on a claim by claim basis.

3. **Defenses Waived if Not Raised?**

A carrier that chooses not to reserve on grounds that may trigger the insured’s right to independent counsel, may risk waiving, or more likely, being estopped from later asserting, those defenses. In states such as California, an insurer’s denial of coverage on grounds that turned out to be unsupportable does not necessarily waive other valid defenses that the carrier failed to state in the original denial. *Waller v. Truck Ins. Exch., Inc.*, 11 Cal. 4th 1, 31 (1995) (rejecting “automatic waiver rule” recognized in some earlier cases); *Century Sur. Co. v. Polisso*, 139 Cal. App. 4th 922, 953 (2006). A carrier’s failure to mention a particular coverage defense does not demonstrate intentional relinquishment of a known contractual right required to constitute waiver. *Waller*, 11 Cal. 4th at 33. However, the carrier may be estopped from asserting a coverage defense where the insured can show it reasonably relied on the insurer’s representations and was prejudiced by the carrier’s later assertion of coverage defenses not previously waived. *See id.* at 35. Such prejudice may be potentially demonstrated where an insured does not assert its right to independent counsel based on the carriers limitation of coverage defenses asserted in its reservation of rights.
C. Excess Insurer Issues

1. Excess Insurance Generally

Much of what was discussed above applies to the duties placed upon primary insurers. Primary insurance is coverage where “under the terms of the policy, liability attaches immediately upon the happening of the occurrence that gives rise to liability.” Archer-Daniels-Midland Co. v. Phoenix Assur. Co. of N.Y., 975 F. Supp. 1129, 1134 (S.D. Ill. 1997), cited in American Family Mut. Ins. Co. v. Continental Casualty Co., 200 Ariz. 119, 121, 23 P.3d 664, 666 (App. 2001). A primary policy provides “first dollar” liability coverage up to the limits of the policy and, in some instances, up to the deductible. Id. An “excess” or secondary insurance policy provides coverage where “under the terms of the policy, liability attaches only after a predetermined amount of primary coverage has been exhausted.” Id. Excess insurance is the next “layer” of coverage above the primary policy. Id.

Courts recognize two types of excess insurance. The first is “true excess” coverage, which is also called “umbrella coverage,” and it exists when the same insured has purchased an underlying primary coverage for the same risk. See St. Paul Fire & Marine Ins. Co. v. Gilmore, 168 Ariz. 159, 162, 812 P.2d 977, 980 (1991). This type of policy is typically purchased for a modest premium and provides coverage against catastrophic losses that exceed the limits of the underlying coverage. Id. (citing 8C J. APPLEMAN, INSURANCE LAW & PRACTICE § 5071.65, at 107 (1981)). This excess type of excess insurance comes into play only after the limits of the same insured’s primary coverage have been exhausted. Id. (citing 16 COUCH ON INSURANCE § 62.48, at 484 (2d ed. 1983)). The limits of the underlying policy operate as a kind of deductible, and “an insured pays a reduced premium to the excess carrier expressly because that carrier will be obligated to pay a claim only after a certain amount has been paid” by the insured’s primary insurer. Id. (citing Maricopa County v. Federal Ins. Co., 157 Ariz. 308, 310, 757 P.2d 112, 114 (Ct.App.1988)); Allstate Ins. Co. v. Employers Liab. Assur. Corp., 445 F.2d 1278, 1280 (5th Cir.1971) (umbrella policy at issue expressly required same insured to maintain certain other policies of primary insurance); see also Ryder Truck Lines, Inc. v. Carolina Cas. Ins., 372 N.E.2d 504, 511 (Ind.App.1978) (comparing true excess coverage to deductible where amount of deductible is taken into account in reducing premium), rev’d on other grounds, 270 Ind. 315, 385 N.E.2d 449 (Ind.1979). The second type of excess insurance exists when other insureds have purchased insurance that fortuitously may be applicable to a given loss. Id., quoted in American Family Mut. Ins. Co., 200 Ariz. at 121.

2. Excess Insurer Duties

The majority rule is that “[w]here the insured maintains both primary and excess policies…the excess liability insurer is not obligated to participate in the defense until the primary policy limits are exhausted.” Keck, Mahin & Cate v. Nat’l Union Fire Ins. Co. of Pittsburgh, Pa., 20 S.W.3d 692, 700-01 (Tex. 2000) (citing Texas Employers Ins. Ass’n v. Underwriting Members of Lloyds, 836 F.Supp. 398, 404 (S.D.Tex.1993) (quoting 14 Couch on Insurance 2d § 51:36, at 446 and citing numerous cases)); see also 14 Russ & Segala, Couch on Insurance 3d §§ 200:44-200:45 (1999); Ostrager & Newman, supra § 6.03[b], at 294. The majority rule is supported by the reasonable expectations of the insured and its insurance carriers. Id.

Excess insurers are able to provide relatively inexpensive insurance with high policy limits because they require the insured to contract for underlying primary insurance with another carrier. Id. The primary carrier generally provides a much lower amount of coverage, but must insure against what is likely to be a greater number of claims and must provide a defense. Id. (citing Harville v. Twin City Fire Ins. Co., 885 F.2d 276, 279 (5th Cir. 1989); Hartford Accident & Indem. Co. v. Continental Nat’l Am. Ins. Cos., 861 F.2d 1184, 1187 (9th Cir. 1989). The premiums charged are thus a reflection of the risks undertaken. Id. Because the primary insurer’s duty to defend extends to covered claims without regard to their amount, an excess insurer’s duty to defend is not typically invoked merely because a claim has been asserted against the insured in excess of primary limits. Id. (citing 1 Windt, Insurance Claims & Disputes § 4.11 (3d ed. 1995)).
When an excess insurer is put on notice of a claim, it is not automatically obligated to take any action if it has no duty to provide a defense. See, e.g., 1 Insurance Claims and Disputes 5th § 2:1 (citing Century Indemnity Co. v. London Underwriters, 16 Cal. Rptr. 2d 393, 396-97 (Cal. Ct. App. 1993)). The general duty of good faith and fair dealing obligates the excess insurer to reasonably respond to reasonable questions from its insured about coverage. Id. (citing Schwartz v. State Farm Fire and Cas. Co., 106 Cal. Rptr. 2d 523, 526, 528, (Cal. Ct. App. 2001)). But the excess insurer is not obligated to do anything unless, and until, the amount of the primary limits are made available to settle the claim against the insured.7

Only once the primary policy limits have been exhausted might the excess insurer have a duty to provide any policy benefits; accordingly, it is only at that point that the excess insurer must come to a conclusion as to the settlement value of the covered claims. Id. An excess insurer might have previously monitored the litigation and conducted an investigation, but if it did so, it would not have done so out of any legal obligation to take such actions at that time. Id. It would have done so because, as a practical matter, it might not later have had adequate time to evaluate the claims made against the insured if and when the primary limits were tendered and the excess insurer was called upon to make a contribution to a settlement.

---

7 Id. (citing Keck, Mahin & Cate v. National Union Fire Ins. Co. of Pittsburgh, Pa., 20 S.W.3d 692, 701 (Tex. 2000))(excess insurer had no duty to act—to “explore coverage issues more diligently, reserve its rights against the insured, investigate the merits of the third-party claim more thoroughly, hire independent counsel to monitor the third-party claim,... or make a demand to settle”—until the primary insurer “tendered its limits”); see also Clegg v. Butler, 676 N.E.2d 1134, 1140 (Mass. 1997) (until primary made its policy limits available, “excess insurer had no reason to know that it would be required to provide compensation from its policy, ... and thus no reason to examine or determine the extent of its liability”); Kubrick ex rel. Estate of Kubrick v. Allstate Ins. Co., 121 Fed. Appx. 447 (3d Cir. 2005) (Pennsylvania law) (Insurer was not guilty of bad faith because it failed to conduct any investigation between 1989 and 1997 relating to whether it afforded any coverage. Although incorrect, Allstate could reasonably have believed in 1989 that the (UIM) coverage claim against it had not been ripe in light of the existence of underlying insurance under non-Allstate policies); Twin City Fire Ins. Co. v. Burke, 63 P.3d 282, 287 (Ariz. 2003) (“until a primary insurer offers its policy limit, the excess insurer does not have a duty to evaluate a settlement offer, to participate in the defense, or to act at all”); see generally Associated Wholesale Grocers, Inc. v. Americold Corp., 934 P.2d 65 (Kan. 1997) (“Before [the primary insurer] tendered its policy limits, [the excess insurer] was not obligated to defend Americold or to take charge of settlement efforts on behalf of Americold. However, an excess insurer owes an implied good faith obligation regarding settlement negotiations. Even when it has not assumed the defense or control of settlement negotiations, an excess insurer has the right under the policy to consent to any settlement reaching it coverage level. The excess insurer has an implied obligation to exercise that right in good faith. In the excess insurance context, the primary carrier (depending on the policy language) will not tender the defense to the excess carrier until exhaustion of coverage. Often the claim has reached the resolution stage, either through settlement discussions or entry of judgment. If the excess carrier claims it has no duty to investigate or make a coverage determination until tendered the defense, the excess carrier may have to decide coverage instantaneously when a settlement is demanded. The non-investigating carrier may be unprepared. If the size of the claim is not likely to reach the excess coverage layer, then the excess carrier may not need to disclose coverage. Also, if the insured failed to maintain the primary coverage or the primary insurer defaults, the excess carrier's obligations may never be triggered, and a coverage disclosure could be unnecessary. However, if the size of the claim exceeds both the primary and excess coverage, the facts for a coverage determination are readily available, the primary insurer has assumed the defense, and settlement discussions reaching the excess policy limits are in progress, prompt investigation and disclosure of the excess carrier's coverage position seem advisable. As an excess insurer, NPIC did not have the same duty to make a prompt investigation and disclosure of its coverage position that a primary insurer would have, at least until it was either called upon to make a settlement decision or the primary coverage was exhausted”); Atlanta Intern. Ins. Co. v. Checker Taxi Co., Inc., 574 N.E.2d 22, 25 (Ill. Ct. App. 1991) (“In contrast to primary insurance, excess coverage is contingent on the exhaustion of the underlying policy or policies of insurance. The primary insurer, not the excess carrier, normally investigates the facts of the occurrence and undertakes the defense of the personal injury lawsuit”).
Arizona courts have clearly and repeatedly held that an excess insurer has no duty to make any payment or otherwise recognize coverage until underlying insurance limits are exhausted. As the Arizona Supreme Court has stated, “[u]ntil a primary insurer offers its policy limit, the excess insurer does not have a duty to evaluate a settlement offer, to participate in the defense, or to act at all.” Twin City Fire Insurance Co. v. Burke, 63 P.3d 282, 287 (Ariz. 2003). Similarly, in St. Paul Fire and Marine Ins. Co. v. Gilmore, 812 P.2d 977 (Ariz. 1991), the Court described the obligations created by a “true excess [umbrella] policy” as follows:

This excess insurance comes into play only after the limits of the same insured’s primary coverage have been exhausted. With this type of coverage, the limits of the underlying policy operate as a kind of deductible, and ‘an insured pays a reduced premium to the excess carrier expressly because that carrier will be obligated to pay a claim only after a certain amount has been paid’ by the insured’s primary insurer’…


Consistent with the foregoing principles, the Ninth Circuit Court of Appeals has also concluded that a true excess insurer has no obligations with respect to an insurance claim until all primary policies have been exhausted. E.g. AMHS Insurance Co. v. Mutual Insurance Co. of Arizona, 258 F.3d 1090, 1096 (9th Cir. 2001)(applying Arizona law and recognizing that an insured pays a reduced premium to an excess carrier expressly because that carrier will be obligated to pay a claim only after a certain amount has been paid by the insured’s primary carrier); Guaranty National Insurance Co. v. American Motorists Insurance Co., 981 F.2d 1108, 1108 (9th Cir. 1992); Hartford Accident & Indemnity Co. v. Continental National American Insurance Companies, 861 F.2d 1184, 1187 (9th Cir. 1988). As the Ninth Circuit held in Guaranty National Insurance Company:

...[A] true excess policy is one which is specifically intended to only come into play when the limits of the underlying coverage are exhausted. It is issued in anticipation of the existence of the underlying policy and it is priced in the belief that the excess carrier will not have to provide a defense. Guaranty National, 981 F.2d at 1108.

3. Reservation of Rights

The general rule is that an excess insurer should not be required to issue a reservation of rights prior to the time that its policy limit is reached and it begins affording insurance coverage. 1 Insurance Claims and Disputes 5th § 2:1 (citing U.S. Fire Ins. Co. v. Vanderbilt University, 82 F. Supp. 2d 788, 794 (M.D. Tenn. 2000), aff’d, 267 F.3d 465 (6th Cir. 2001)); see also Old Republic Ins. Co. v. Ness, Motley, Loadholt, Richardson & Poole, P.A., 03 V 5238, 2006 WL 88666 (N.D. Ill. Jan. 11, 2006) (holding that excess insurer did not have a duty to issue a reservation of rights letter, if at all, until after excess judgment had been entered) (citing Montgomery Ward and Co. Inc. v. Home Ins. Co., 753 N.E.2d 999, 1006-07 (Ill. Ct. App. 2001 ) (rejecting estoppel and waiver arguments by the insured and stating that an excess insurer who has no duty to investigate or defend because excess coverage has not yet been triggered cannot be estopped from or has not waived asserting coverage defenses based on a failure to issue a reservation of rights letter)).

---

8 Under Arizona law, a true excess policy exists when, as here, the same insured has purchased underlying coverage for the same risk. AMHS Ins. Co. v. Mutual Ins. Co. of Arizona, 258 F.3d 1090, 1093 (9th Cir. 2001).
In analyzing the issue of whether an excess carrier is obligated to issue a reservation of rights letter when the insured is controlling its own defense, the court in *K. Bell & Associates, Inc. v. Lloyd's Underwriters* observed that it had been unable to locate any authority regarding the existence of such a duty. 1997 WL 96551 (S.D.N.Y. March 5, 1997). The Court relied on Allan Windt’s treatise, which also recognized that “there is little case law directly on point,” and which determined:

> [T]he following rules can be formulated with regard to evaluating an insured’s reliance on the absence of a reservation of rights letter. If the insurance company has assumed the insured’s defense, the insured can, absent actual knowledge as to the absence of coverage and, therefore, knowledge of the insurer’s error, reasonably expect that the company would have issued a reservation of rights letter if it had reason to believe that, following the completion of the lawsuit, it might deny coverage. In that event, because the company has already begun to provide substantial benefits under the policy, an insured could reasonably believe, absent a reservation of rights letter, that such benefits would continue.

If, on the other hand, the insurer does not begin to provide the insured benefits under the Policy, there is not sufficient reason for the insured to assume that the absence of a reservation of rights letter is indicative of the existence of coverage. When an insurance company takes no action under the policy beyond, perhaps, approving the insured’s choice of counsel or considering a settlement offer made by the plaintiffs and relayed to it by the insured, the insured cannot justifiably assume that because the insurer has not notified him or her of potential policy defenses, the company does not believe that there are any.

Nevertheless, in light of the current state of the law, good business practice warrants the issuance of a reservation of rights letter within a reasonable time after the insurance company receives notice of a claim under any third-party policy. Moreover, if the insurer is called on to take some action with regard to the policy, such as giving its consent to the insured’s choice of counsel, it should issue a reservation of rights letter prior to or contemporaneously with taking such action.

*Id.* (quoting 1 Allan Windt, *Insurance Claims & Disputes* § 2.20 at pp. 72-74 (3d ed.1995)).

Case law suggests that an excess insurer who decides to issue a reservation of rights letter, however, should avoid taking a premature coverage position and should instead adopt a “wait and see” approach. An example of this can be seen in the U.S. District Court for the Eastern District of Michigan case, *Comerica Inc. v. Zurich American Ins. Co.*, 498 F.Supp.2d 1019, 1025 (E.D. Mich. 2007). In *Comerica Inc.*, the insureds, who were accused of securities fraud, tendered their defense to an excess insurer before the limits of their primary coverage were exhausted. The primary insurer had denied their tender, and the insureds had entered a settlement with the plaintiff shareholders. *Id.* In response to the premature tender from the insureds, the excess insurer concurred with the position of the primary insurer, and stated that it did not believe that the claim was covered. Specifically, the excess insurer stated that the settlement did not appear to be a loss within the meaning of the policy, because the loss was restitutional in nature; the excess insurer, however, went on to state that it did not yet owe any duties because primary coverage had not been exhausted, and that it would review the matter once its duties were triggered by a payment of the primary policy limits. *Id.*

Once they settled their coverage dispute with the primary insurer, the insureds brought suit against the excess insurer based upon a purported anticipatory breach of the excess insurer’s obligations under the policy. *Id.* at 1028. More specifically, the insureds took the position that it was “justified in settling the underlying securities
suits as it saw fit once Zurich repudiated by unequivocally declaring its intent not to perform, and therefore it was excused from meeting the exhaustion requirement.”  Id.  The Court rejected the insureds’ position, stating:

[I]t is not entirely clear that Zurich’s position amounted to a repudiation, that is, an “absolute” and “unequivocal” declaration of an intention not to perform.  Rather, Zurich’s stance more accurately is characterized as a belief that [the insureds] had not yet fulfilled the condition precedent on the excess policy, so the time for Zurich’s performance had not yet arrived.

Id. at 1029.

4. Non-True Excess Insurer Duties When The Primary Carrier Refuses To Defend

Most courts have held that an excess carrier that has a duty to defend is not obligated to provide a defense if the primary carrier is so obligated.  1 Insurance Claims and Disputes 5th § 4:11 (internal citations omitted).  Since the primary carrier’s duty, once activated, encompasses the claims that have been made against the insured regardless of whether they exceed the primary insurer’s policy limits, the excess insurer’s duty to defend does not come into existence.  Id. (citing General Motors Acceptance Corp. v. Nationwide Ins. Co., 4 N.Y.3d 451, 796 N.Y.S.2d 2, 828 N.E.2d 959, 961 (2005) (“a primary insurer has a duty to defend without any entitlement to contribution from an excess insurer.”)).  However, in those jurisdictions in which an insurer is relieved of its duty to defend after it has paid its policy limits, the excess insurer should assume the defense after the primary insurer as fulfilled its contractual obligation.  Id. (citing Interstate Fire & Cas. Co. v. Stuntman, Inc., 853 F.2d 751, 755 (9th Cir. 1988)).

The foregoing rule with respect to the excess insurer’s responsibilities assumes that the primary insurer has, in fact, assumed the defense.  Id.  If it has not, the courts will apply a different rule.  Id.  With the insured’s equitable interests in mind, courts have held that when the primary insurer refuses to defend, an excess insurer that is not a “true” excess insurer (i.e. an insurer that is deemed excess by competing “other insurance” provisions) and that has a duty to defend provision in its policy must defend, assuming, of course, that the claim against the insured exceeds the policy limits of the underlying insurance.  Id.

The burden then shifts to the non-true excess insurer, rather than the insured, to obtain reimbursement from the primary insurer.  Id.  Most courts have held that an excess insurer that provides the insured a defense is entitled to reimbursement from a primary insurer that also has a duty to defend.  2 Insurance Claims and Disputes 5th § 10:14 (internal citations omitted).  The reasoning beyond this rule is that an insured who has obtained the protection provided by a non-true excess policy should be entitled to rely on that insurer.  1 Insurance Claims and Disputes 5th § 4:11 (internal citations omitted).

III. Policyholder Responses to Reservation of Rights

The policyholder should be aware that when a carrier reserves its rights it is doing so in order that it may not later be estopped from asserting defenses to coverage and withdrawing from the defense.  Some courts hold that to avoid being estopped from later raising defenses to coverage, a carrier who takes the position that coverage is questionable must defend under a reservation of rights or seek a declaratory judgment that there is no coverage.  General Agents Insurance Company of America v. Midwest Sporting Goods Company, 828 N.E.2d 1092, 1098 (Ill. 2005).  Therefore, the policyholder should view the reservation of rights as a means by which the carrier seeks to suspend the operation of the estoppel doctrine.  Royal Ins. Co. v. Process Design Associates, Inc., 582 N.E.2d 1234, 1239 (Ill. App. Ct. 1st Dist. 1991).  Of course, if the policy does not provide coverage, a carrier usually does not have to defend under a reservation of rights or seek a declaratory judgment that there is no coverage.
A. Sufficiency of Reservation of Rights

If the carrier agrees to defend and purports to reserve its rights, the policyholder should be aware that in order to be an effective reservation of rights the reservation must be communicated to it; must be timely; and must fairly inform the policyholder of the carrier’s position regarding coverage. See, e.g., *World Harvest Church, Inc. v. Guideone Mutual Insurance Company*, 695 S.E.2d 6, 9-10 (Ga. 2010). If the reservation of rights does not meet these requirements, it is insufficient and the carrier may be estopped from asserting coverage defenses. *Id.* Some jurisdictions require prejudice before the carrier may be estopped. *Id.* at 12 (“where, as here, an insurer assumes and conducts an initial defense without effectively notifying the insured that it is doing so with a reservation of rights, the insurer is deemed estopped from asserting the defense of noncoverage regardless of whether the insured can show prejudice”).

1. The Reservation of Rights Must Fairly Inform the Policyholder of the Carrier’s Position.

The reservation of rights “must make specific reference to the policy defense which ultimately may be asserted and to the potential conflict of interest.” *Royal Ins. Co. v. Process Design Associates, Inc.*, 582 N.E.2d 1234, 1239 (Ill. App. Ct. 1st Dist. 1991). “For it is only when the insured is adequately informed of the potential policy defense that he can intelligently choose between retaining his own counsel or accepting the tender of defense counsel from the insurer.” *Id.* The reservation of rights is not sufficient if it advises of the particular exclusion, but does not “unequivocally and clearly” inform the policyholder of the carrier’s intention of reserving that defense under all circumstances. *Id.* In *Process Design Associates*, the reservation was insufficient where the carrier indicated it may invoke the professional negligence exclusion if an amended complaint or cross-claim alleging professional negligence was filed. *Id.*

A reservation of rights letter was insufficient where the carrier stated it “is reserving all its rights under the insurance contract” and “will conduct an investigation of the claim but this investigation will not be a waiver of its rights to deny coverage because of the breaches that have occurred or that might occur in the future.” *Fellows v. Mauser*, 302 F.Supp. 929, 936 (D. Ver. 1969)

2. The Reservation of Rights Must Be Timely

Most courts hold that the carrier must timely reserve its rights, so that the policyholder will know whether the carrier will be defending it and if a conflict of interest is present. A timely reservation of rights is necessary so that the policyholder may protect its interests. Whether the reservation of rights is timely depends upon the particular facts of each situation.

When a carrier provides a defense pursuant to a reservation of rights, it must promptly communicate the reservation of rights to the policyholder. *Penn-America Ins. Co. v. Sanchez*, 202 P.3d 472, 476-477 (Az. Ct. App. 2009). Its failure to do so will result in waiver of its right to deny coverage or estoppel to assert an exclusion. *Id.*

“When a carrier undertakes the defense of its insured, it has a duty to give reasonable notice to the [policyholder] that it is proceeding under a reservation of rights or it will be estopped from denying liability.” *Amerisure Mutual Insurance Company v. Carey Transportation, Inc.*, 578 F.Supp.2d 888, 903 (W.D. Mich. 2008).

By way of example, a reservation of rights was not timely where over 22 months elapsed between the filing of the underlying complaint and the purported reservation of rights, and the reservation of rights did not occur until the very end of pre-trial proceedings. Cozzens, 456 F.Supp. at 201. Conversely, it has been held that a reservation of rights letter sent three months into the underlying litigation and just over a month after service was effected was timely. Amerisure Mutual Insurance Company v. Carey Transportation, Inc., 578 F.Supp.2d 888, 903-904 (W.D. Mich. 2008).

3. The Reservation of Rights Must Be Communicated to the Policyholder

Some cases hold that the reservation of rights letter has to be provided directly to each insured. See, e.g., Knox-Tenn Rental Company, 2 F.3d 678 (6th Cir. 1993). There, the court held that the reservation of rights was not communicated to the additional insured, where the carrier sent the reservation of rights letter to the named insured, which was the additional insured’s employer, but not to the additional insured. Id. at 682. The court also held that knowledge of the reservation of rights could not be imputed to the additional insured where the attorney hired by the carrier to defend the named insured and additional was sent a copy of the letter. Id. at 683. The court reasoned that the letter was addressed to the named insured and made no mention of the additional insured. Id.


B. When a Reservation of Rights Triggers Right to Independent Counsel

Policyholders should carefully review the reservation of rights to determine if there is a potential conflict of interest which could require the selection of independent counsel.

Where the carrier’s interest in defending the action is in conflict with the policyholder’s interests because the carrier would only be liable to indemnify upon some grounds, but not on others, the policyholder is entitled to select defense counsel, whose fee is to be paid by the carrier. Public Service Mutual Insurance v. Goldfarb, 425 N.E.2d 810, 815 (Ct. App. N.Y. 1981). The court further explained that “independent counsel is only necessary in cases where the defense attorney’s duty to the insured would require that he defeat liability on any ground and his duty to the insurer would require that he defeat liability only upon grounds which would render the insurer liable.” Id. at fn. 1. See also Morrone v. Harleysville Mutual Insurance Co., 662 A.2d 562, 567 (N.J. Sup. Ct. App. Div. 1995) (holding “where the pleadings set forth mutually-exclusive covered and non-covered claims, and without a reservation of rights to which the insured expressly agrees, the insurer cannot be permitted to control the defense.”).

Some courts hold that the policyholder’s right to select independent defense counsel is limited. For example, in Central Michigan Board of Trustees v. Employers Reinsurance Corp., 117 F.Supp2d 627, 635 (E.D. Mich. 2000), it was held “the insured has no absolute right to select the attorney himself, as long as the insurer exercises good faith in its selection and the attorney selected is truly independent.”

C. Whether Carrier Can Reserve Rights to Seek Reimbursement of Defense Costs

Carriers typically insert language in reservation of rights letters purporting to reserve the right to receive reimbursement of defense costs in the event it is determined that it has no duty to defend. Some courts have held that the carrier is entitled to reimbursement of defense costs when it is later determined that there is no duty to defend. However, other courts have held that the carrier cannot obtain reimbursement of defense costs even if it is determined that there is no duty to defend.

Some courts have held that the policyholder’s acceptance of the defense when the carrier reserved its right to seek reimbursement of defense costs constitutes an implied agreement to the reservation of rights. For example, in
Knapp v. Commonwealth Land Title Insurance Company, 932 F.Supp. 1169, 1170 (D. Minn. 1996), the carrier in its reservation of rights letter accepted the tender of defense, but also specifically reserved the carrier’s right to later seek attorney’s fees and costs if coverage was later denied. The court held the policyholder’s silence and acceptance of the defense constituted an implied agreement to the reservation of rights to seek reimbursement of the defense costs. Id. at 1172.

Other courts have held that a carrier cannot reserve a right to seek reimbursement of defense costs absent a specific provision in the policy allowing it to recover defense costs. General Agents Insurance Company of America, Inc. v. Midwest Sporting Goods Company, 828 N.E.2d 1092 (Ill. 2005). The reservation of rights letter stated:

Without waiving any of its rights and defenses, including the right to recoup any defense costs paid in the event that it is determined that the Company does not owe the Insured a defense in this matter, the Company agrees to provide the Insured a defense.

Id. at 1094. The policyholder accepted the carrier’s payment of defense costs. Id. After it was determined that the carrier did not owe a duty to defend, the carrier sought reimbursement of its defense costs. Id. at 1095. The Illinois Supreme Court examined cases holding that carriers have a right to reimbursement implied in law such as Buss v. Superior Court, 939 P.2d 766 (Cal. 1997). The court also examined cases holding that carriers cannot seek reimbursement for defense costs such as Shoshone First Bank v. Pacific Employers Insurance Co., P.3d 501 (Wy. 2000) and First Insurance Co. of Hawaii, Inc. v. State, by Minami, 665 P.2d 648 (Hawaii 1983). The court refused to allow the carrier to recover defense costs pursuant to a reservation of rights when the policy does not contain an express provision allowing the recoupment of defense costs. Midwest Sporting Goods Company, 828 N.E.2d at 1104.

When the reservation of rights letter is silent as to reimbursement of defense costs, at least one court has held that the carrier is not entitled to reimbursement. Matagorda County v. Texas Association of Counties County Government Risk Management Pool, 975 S.W.2d 782, 785 (Tex. Ct. App. 1998) (holding “[a]bsent specific notice to the insured that he may later be charged for these costs, the insurer has no right to reimbursement”).

If the policyholder receives a letter purporting to reserve the carrier’s right to reimbursement of defense costs, it should check the law of the appropriate jurisdiction. It should also consider sending a letter advising that it does not agree that the carrier has the right to reimbursement of the defense costs.

Conclusion

The issues raised above provide a basic backdrop for both policyholders and carriers handling routine claims—coupled, of course, with familiarity with specific policy language, and the law of the relevant jurisdiction. In sum, with so many issues involved, it is important for both the policyholder and the insurance carrier to pay careful attention to all claim related correspondence.