

## **RESERVATION OF RIGHTS UNDER THE COMMERCIAL GENERAL LIABILITY INSURANCE POLICY**

There are two very important promises that are contained in the commercial general liability insurance policy (the “CGL policy”). These promises are referred to as the duty to pay and the duty to defend. The duty to pay originates under the CGL policy Insuring Agreement. Here it provides that the insurance carrier is obligated “to pay sums that the Insured becomes legally obligated to pay because of Bodily Injury or Property Damage.” The duty to defend also originates under the insuring agreement. It states that the insurance carrier will have the right and duty to defend all lawsuits that seek bodily injury or property damages.

In most lawsuits filed where CGL insurance exists to cover the lawsuit, there is not much debate over whether the insurance carrier has a duty to defend. For example, if a claim is filed over a visitor who slips and falls at a company facility or if a claim is filed for property damage caused by products of an insured, the insurance company will step in and undertake the defense of the claim. There are lawsuits however where determining if the duty to defend exists or not is more difficult to ascertain. Most construction defect litigation cases filed against subcontractors and suppliers would fall into this category. It is these types of cases where the existence of the duty to defend and the duty to pay is far more problematic.

If we assume it is debatable whether an insurance carrier has an obligation to defend a particular suit, one fact certainly works to the advantage of the insured. There is risk to the insurance carrier in refusing to defend complaints where the duty to defend arguably exists. First, the insurer waives certain of its other rights under the CGL policy such as notice and approval of any settlement. Thus, where the insurance company refuses to defend, personal counsel for the insured could possibly settle the case with the plaintiff. As part of this settlement the insured and the plaintiff could agree to a judgment amount and what is referred to as a covenant not to sue. The covenant not to sue would provide that even though the plaintiff has a judgment against the insured, he or she agrees to not seek attachment of the insured’s assets. Instead the insured may assign to the plaintiff its rights against the insurance company for failing to defend. The reason for this rule in many jurisdictions is that once an insurance carrier breaches its duty to defend, the insured is free to proceed as it chooses. This may in fact bind the insurance carrier to any settlement or judgment the insured agrees to. The only issue that will then be litigated as between the plaintiff (who now holds the rights of the insured against the insurance carrier) and the insurance carrier is whether the insurance carrier had a duty to defend or not. If the court finds a duty to defend exists, the insurance carrier is obligated to then pay the amount of the judgment that was agreed upon between the insured and the plaintiff.

To avoid this risk, many insurance carriers instead of refusing to defend lawsuits where it is not clear whether the duty to defend exists, will choose different options. The insurer may undertake the defense of the case but in turn reserve their right to withdraw from defense as facts are established. In this event they will most likely mail a “reservation of rights” letter to the insured. The letter will state the insurance carrier is preliminarily agreeing to defend the insured, but that certain rights are being reserved. The first right, which is fairly self explanatory, being reserved is the right to withdraw from the defense of the lawsuit as facts are established. The second right being reserved is the right to claim that all or a portion of the damages being claimed by the plaintiff in the complaint are not covered under the insurance policy. In other words, the insurance company would be saying with respect to this second reservation, we do not think that we ultimately will have any duty to pay in this case. This uncertainty as to what will happen in the future with respect to this case obviously places the insured in a very precarious position.

If the insurance carrier undertakes the defense of a lawsuit and does not mail a reservation of rights letter, most likely the insurance carrier will be deemed to have waived its rights to later either withdraw from the defense of the case or to refuse to pay the damages awarded in a judgment against the insured if the case is lost.

If an insurance company agrees to undertake a defense on behalf of an insured under a reservation of rights letter, the insured is generally not required to accept the defense. An insured, if it so elects, could reject the defense counsel selected by the insurance company and defend the lawsuit at its own expense and pursue one of two litigation alternatives. The first alternative would be to file a separate lawsuit against the insurer for any damages that might thereafter be assessed as a result of the complaint filed against the insured. The second alternative is to file what is referred to as a “declaratory judgment action” and ask a court to declare whether certain claims are covered under the policy.

Many states view the issuance of a reservation of rights letter by an insurance carrier as creating a possible conflict of interest. Here is the reason. The insurance company agrees to defend a lawsuit yet is reserving its rights to either withdraw from the defense of the case or refuse to pay damages awarded in a judgment. The defense attorneys retained by the insurance carrier are paid by the insurance carrier and are usually attorneys that the carrier uses on a regular basis. To have these same attorneys defend an insured, lose and then have the insurance company that pays their fees refuse to pay the damages in the judgment is viewed by many states as inherently creating a conflict of interest. If a conflict of interest results, the insurer may be required to appoint separate independent counsel to represent the insured.

Despite these options, in the great majority of cases, insureds accept an insurance carrier's reservation of rights letter. We would recommend however that any time an insured ever receives a reservation of rights letter from an insurer after notifying such insurer of receipt of a complaint, we would strongly recommend you to seek legal advice on your options.

Here is an example of an adverse outcome to an insured where it essentially ignored a reservation of rights letter.

#### CASE EXAMPLE

A lumberyard is served with a complaint filed by an individual homebuilder who alleges he was beaten up by a salesman of the lumberyard for failing to pay an outstanding balance due. The occurrence alleged in the complaint is the striking of the plaintiff homebuilder by the lumberyard salesman. The plaintiffs allege damages for medical care, pain and suffering and lost wages. The complaint asserts assault and battery alleging the salesman intentionally struck the plaintiff and because the action was intentional he seeks an additional recovery of punitive damages. Because intentional torts are excluded under the CGL policy, the plaintiff further alternatively alleges negligence stating the salesman accidentally struck the plaintiff. Because of the negligence cause of action and as an occurrence is alleged causing bodily injury, the lumberyard's CGL insurance carrier has a duty to defend. Because of the intentional tort that is also alleged whereby punitive damages are sought, the insurance carrier issues a reservation of rights letter to the lumberyard. Various offers to settle are made by the plaintiff to settle the case for less than the lumberyard's policy limits but the offers are refused by the insurance carrier.

The complaint goes to trial and the jury finds for the plaintiff but finds an intentional tort and not negligence. Because of the exclusion in the CGL policy for intentional torts, the insurance carrier refuses to pay the judgment. The lumberyard does not have the financial resources to pay the judgment and is forced into filing bankruptcy. Had the lumberyard treated the reservation of rights letter more seriously, they may have engaged personal counsel to monitor the insurance carrier's handling of the case and who most likely would have counseled the lumberyard on seeking to compel the insurance company to settle the case rather than to proceed to trial and thereby subject the lumberyard to a great deal of uninsured risk.