"So, You Might Not Accept Defense Of Our Claim?" Using The Reservation Of Rights Letter To Your Advantage

A Reservation of Rights letter (ROR). As corporate counsel, if you have not seen this letter much before, you are certain to see it more in the future. An ROR is what you might receive from an insurance company after you have just tendered a claim for coverage. You should know how to respond to it.

Traditionally, when you tendered a claim against your company to your insurance company, your insurance company would accept the defense and appoint panel counsel to defend against it. In a perfect world, that would be the end of your involvement. You could trust panel counsel to manage the litigation and the insurance company to pay for it.

But times have changed. More and more, insurance companies are undertaking defense of tendered claims, but conditionally. They say, in effect, "We'll agree to defend your claim – for now – but we want you to know we reserve our right to abandon defense and force you to pay for the claim if we discover such-and-such down the road." Some add this chilling addendum (in states like California where they might get away with it): "By the way, if we find we are right on why we should not accept the defense, we will recoup all our expenses against you." This is the gist of the ROR.

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What is that "such-and-such down the road?" It is one or more – usually a lot more – provisions under the policy that the insurer presents as potential excuses to deny coverage obligations. As the current economic screw tightens, it is no surprise why insurance companies are undertaking this option with greater frequency. And the higher the stakes of the claim, the more likely the ROR.

On receiving such a letter, corporate counsel is tempted to whistle in the dark and hope "such-and-such" does not happen. Resist this temptation. Failure to take the right steps can allow your insurance company to avoid, and your company to absorb, substantial expense.

Immediately on receiving an ROR, write the insurance company and disagree with the analysis. You need not be specific in your response, but you need to be on record with your disagreement. That is because often, buried in the morass of indecipherable policy-rich language, is some paragraph that says, in effect, "Unless we hear otherwise from you, we'll assume you agree with our approach." You know what happens when you let this pass. Should you ever have to fight your insurance company over coverage, your insurance company will use your silence against you. Avoid this. Create your record of opposition.

What happens next is largely the insurance company's move. Often, the insurance company will ask you to provide all sorts of information, even while the defense is on-going. Be careful. The investigation is not being done to help you. But you cannot refuse to help back. All policies impose a duty to cooperate on the policyholder. However annoying these investigations are, you must do *something*. Ask the insurance company to explain the relevance of the information requested. That may allow you to bolster your claim. Produce paper, ask for clarification, invite on-site document review. As long as the insurance company is strutting down the runway in this staged beauty contest for subsequent judicial review, you must strut, too.

Having said that, avoid this trap: Do not turn over attorney-client privileged documents, in spite of any insurance company's demands. Provision of such documents may be discoverable by your litigation opponent and you may be deemed to have waived that privilege. Most states allow you to protect that privilege. If your insurance company persists, at least insist on a confidentiality agreement to preserve your rights in an eventual discovery feud with your opponent.

Pending RORs are fertile breeding grounds for conflicts of interest between you and the insurance company in the course of panel counsel's defense. Just what this conflict consists of has been the subject of much litigation, but with more or less predictable results. When a policyholder can show the existence of an actual conflict of interest between the policyholder and the insurer, the insurer will be *required* to appoint a second, independent counsel for the policyholder.

This is not a gratuity from the insurance company; it is a *right* of the policyholder. And the rationale tends to be both *ethical* and *contractual* – ethical, because panel counsel has an ethical duty to represent only one client (the policyholder); contractual, because the policyholder has bargained for unbiased representation and panel counsel's ability to steer coverage away from the insured vitiates that bargain.

Determining *what* constitutes a conflict of interest is something that, thankfully, can be in your control. At the same time, jurisdiction matters. Alaska and Mississippi make it easy for the policyholder to demand independent counsel by holding that a conflict of interest exists *merely* when an insurer undertakes a defense under a ROR. On the opposition end, a couple of jurisdictions (notably, Hawaii and Washington) decline independent counsel as a solution, but impose an exalted duty on panel counsel to represent the interests of the policyholder and give a special cause of action in the event of breach.

The vast majority of states, however, follow the rule that, when panel counsel is capable of steering litigation toward non-coverage, the policyholder has a right to independent counsel. Examples are myriad, but usually measured by asking this one question: "Based on the ROR, is panel counsel capable of harming the policyholder, even inadvertently?"

Your task as corporate counsel is to scrutinize allegations of the third-party complaint and determine whether panel counsel has any tangible way of defending the claim that puts your company at risk of non-coverage. If so, write the insurance company immediately, point out the risk, and demand independent counsel.

If the insurance company refuses, do not be too hasty in retaining separate counsel and sending the insurance company the bill. Some courts may require a greater showing than the *possibility* of a conflict (which causes courts to parse distinctions worthy of Aristotle). Seize upon panel counsel's *actual or threatened* position in litigation that raises the *likelihood* of non-coverage. The vast majority of states will then likely support your claim for independent counsel.

How do you assert that right? First, ask for it. If the insurance company denies your request, then separately retain counsel with instructions to work with panel counsel and ensure your coverage interests are protected. If the insurance company balks, you may have to involve a court in the matter – preferably under seal – to sort out proper roles of representation

States vary on certain details of retaining independent counsel, such as hourly rates, experience of counsel, and, less so, who has right to selection. But these are concerns you should more gladly embrace than finding yourself before trial, with big damages looming, and a insurance company sending you a letter withdrawing defense, saying, "See, we told you." That is what an ROR may do to you.

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