

HOT TOPICS AFFECTING COOPERATIVES & CONDOMINIUMS: 2003

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Insurance Carriers' Reservations of Rights

- I. What is a reservation of rights?
 - A. An insurance carrier's undertaking the defense of an action, while reserving the right to disclaim liability at a later time with respect to the insurer's obligation either to defend or to indemnify.
 1. From insurer's point of view purpose is to allow it to fulfill contractual obligation to defend where obligation to indemnify is open to question, while protecting against any claim of waiver or estoppel.
 2. Waiver is a knowing relinquishment of rights; it cannot create coverage where it did not otherwise exist. Rather, waiver relates to defenses an insurer might have to coverage and are usually based on insured's failure to comply with condition precedent, such as late notice or non-cooperation. Estoppel occurs where equitable principles prevent a carrier from denying coverage, even if coverage did not otherwise exist, and even if insurer did not knowingly waive. [*Albert J. Schiff Associates, Inc. v. Flack*, 51 N.Y.2d 692, 435 N.Y.S.2d 972 \(1980\)](#).
 3. A carrier may be estopped from denying coverage or a duty to defend when it assumes a defense without reserving its rights to disclaim coverage. [*Indemnity Insurance Company of North America v. Charter Oak Insurance Company*, 235 A.D.2d 521, 653 N.Y.S.2d 135 \(2nd Dep't 1997\)](#). An estoppel is particularly warranted when an insured has suffered the loss of the right to control its own defense. [*General Accident Company v. United States Fidelity and Guarantee Insurance Company*, 193 A.D.2d 135, 602 N.Y.S.2d 948 \(3rd Dep't 1993\)](#).
 - B. A reservation of rights is not a disclaimer – [*Hartford Insurance Co. v. County of Nassau*, 46 N.Y. 2d 1028, 416 N.Y.S.2d 539 \(1979\)](#).

II. When are you likely to see a reservation of rights?

A. The duty to defend is broader than the duty to indemnify and includes defense of non-covered claims – [Seaboard Surety Co. v. Gillette Co., 64 N.Y.2d 304, 486 N.Y.S.2d 873 \(1984\).](#)

4. The obligation to defend rests *solely* on whether the complaint alleges any facts or grounds which bring the action within the protection purchased, regardless of how false or groundless the allegations may ultimately turn out to be. 79th [Realty Co. v. X.L.O. Concrete Corporation, 247 A.D.2d 256, 668 N.Y.S.2d 599 \(1st Dep't 1998\).](#)

5. Where there is a contention that the claims may fall within an exclusionary provision of the policy, the duty to defend nevertheless is clearly imposed where the claims “are not solely and entirely within the exclusionary provisions of the policy.” [Inqber v. Home Insurance Company, 140 A.D.2d 750, 751, 527 N.Y.S.2d 630, 631 \(3rd Dep't 1988\).](#)

6. The insurer has a duty to defend its insured in a pending lawsuit if the pleadings allege a covered occurrence, even though facts outside the four corners of those pleadings indicate that the claim may be meritless or not covered. [Incorporated Village of Cedarhurst v. Hanover Insurance Company, 89 N.Y.2d 293, 653 N.Y.S.2d 68 \(1996\).](#)

7. To be relieved of its duty to defend on the basis of a policy exclusion, the insurer bears the heavy burden of demonstrating that the allegations of the complaint cast the pleadings *wholly* within that exclusion, that the exclusion is subject to no other reasonable interpretation, and that there is no possible factual or legal basis upon which the insurer may eventually be held obligated to indemnify the insured under any policy provision. [Frontier Insulation Contractors, Inc. v. Merchants Mutual Insurance Company, 91 N.Y.2d 169, 667 N.Y.S.2d 982 \(1997\).](#) In interpreting the policy, any ambiguity is to be construed against insurer. [Kennedy v. Valley Forge Insurance Company, CNA, 203 A.D.2d 930, 612 N.Y.S.2d 712 \(4th Dep't\), *aff'd* 84 N.Y.2d 963, 621 N.Y.S.2d 512 \(1994\).](#)

B. Scope of insuring agreement

C. Policy exclusions

1. Intentional acts - (e.g., assault v. negligence).

2. Comparison of scope of coverage of general liability policy and directors and officers coverage.

D. Defenses to coverage

1. Late notice.
2. Failure to cooperate.

E. Public policy considerations

1. Statutory limitations on scope of indemnification of directors and officers by insurance – Business Corporation Law §726 – active and deliberate dishonesty; pecuniary gain.
2. Statutory distinctions between limitations on indemnification of officers and directors by corporation and by insurance – [*Biondi v. Beekman Hill House Apartment Corporation*, 94 N.Y.2d 659, 709 N.Y.S.2d 861 \(2000\)](#) (corporation may not indemnify if bad faith; no such express prohibition for insurance).
3. Punitive damages – [*Hartford Accident and Indemnity Co. v. Village of Hempstead*, 48 N.Y.2d 218, 422 N.Y.S.2d 47 \(1979\)](#) (indemnification for punitive damages "defeats the purpose of punitive damages, which is to punish and deter others from acting similarly").

III. Is the reservation of rights effective?

- A. Is the reservation of rights specific – does it fairly apprise the insured of the basis for the reservation of rights, both by citing the policy provision and explaining its applicability to the facts?
- B. Does the reservation of rights letter properly interpret the policy – [*Kennedy v. Valley Forge Insurance Company, CNA*, 203 A.D.2d 930, 612 N.Y.S.2d 712 \(4th Dep't\), *aff'd* 84 N.Y.2d 963, 621 N.Y.S.2d 512 \(1994\)](#) (any ambiguity is to be construed against insurer).
- C. Is the exclusion relied upon actually in the policy?
- D. Are the relevant terms upon which the reservation of rights is based clearly defined? [*Boggs v. Commercial Mutual Insurance Company*, 220 A.D. 2d 973, 632 N.Y.S.2d 870 \(3d Dep't 1995\)](#) (failure to define terms "design" or "use" gave rise to ambiguity to be construed in insured's favor).
- E. Is the right policy form being used?
- F. Is the reservation of rights timely – *cf.* [*Utica Mutual Insurance Company v. 215 West 91st Street Corp.*, 283 A.D.2d 421, 724 N.Y.S.2d 758 \(2d Dep't 2001\)](#) ("If an insurer assumes the defense of an action and controls its defense on behalf of an insured with knowledge of facts constituting a

defense to the coverage of the policy without reserving its right to deny coverage, the insurer is estopped from denying coverage at a later time, even if mistaken on the requirement of coverage").

- G. Notice to the injured party – Insurance Law §3420 (d); [Zappone v. Home Insurance Co., 55 N.Y.2d 131, 447 N.Y.S.2d 911 \(1982\).](#)

V. What is the effect of a reservation of rights?

A. Possibility of denying coverage

1. Decision on preliminary injunction is not basis for denial of coverage, since preliminary injunction is not an adjudication on the merits so as to preclude reconsideration of the issues ruling the latter phase of the litigation. [Peterson v. Corbin, 275 A.D.2d 35, 713 N.Y.S.2d 361 \(2nd Dep't\), app. dismiss'd, 95 N.Y.2d 919, 719 N.Y.S.2d 646 \(2000\).](#)

- B. Possibility that if coverage denied, carrier will attempt to recover its legal fees to that point.

C. Creates a conflict

1. Carrier invites insured to designate counsel to oversee.
2. Carrier required to allow insured to control defense by designating independent counsel at insurer's expense – [Public Service Mutual Insurance Co. v. Goldfarb, 53 N.Y.2d 392, 442 N.Y.S.2d 422 \(1981\).](#)

a) Carrier required to pay reasonable fee

b) What is reasonable

D. Consent and estoppel issues

VII. How do you protect your client?

A. Read and analyze the reservation of rights.

- B. Effect of silence – acquiescence . [Allstate Insurance Company v. Manger, 30 Misc. 2d 326, 213 N.Y.S.2d 901 \(Sup. Ct. Queens Co. 1961\).](#)

C. Declaratory judgment action

1. Timing of lawsuit – [Prashker v. U.S. Guarantee Co., 1 N.Y.2d 584, 154 N.Y.S.2d 910 \(1956\)](#) (if an issue of contract interpretation, may commence suit before final outcome of case in chief; if involves determination of a theory of liability, declaratory judgment is premature prior to outcome of case in chief).

2. Who pays the legal fees for lawsuit?

a) If carrier institutes action, and if insured is successful, insured's legal fees will be covered. [*Mighty Midgets, Inc. v. Centennial Insurance Company*, 47 N.Y.2d 12, 416 N.Y.S.2d 559 \(1979\).](#)

Note: insured must continue to defend until court determination that plaintiff's claim is excluded from coverage. [*United National Insurance Co. v. Waterfront N.Y. Realty Corp.*, 948 F. Supp. 263 \(S.D.N.Y. 1996\).](#)

b) If insured commences suit, even if it succeeds, its legal fees will not be covered. [*Mighty Midgets, Inc. v. Centennial Insurance Company*, 47 N.Y.2d 12, 416 N.Y.S.2d 559 \(1979\).](#)

D. Statute of limitations issues

1. Review policy to see if policy language limits the period within which to bring a claim under the policy.
2. Review policy to see if policy language requires final judgment before suit against insurer.
3. When does the statute of limitations commence to run?

E. Non-waiver agreement.

F. Monitor the litigation and be prepared to step in if necessary.

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