Understanding the Reservation of Rights Letter

You receive your mail and discover a letter from your professional liability insurance company. As you are about to file away the letter, you notice that the insurance company is advising you that there are allegations regarding a recently submitted claim that may potentially cause coverage problems. Your immediate concern is does this means you have no coverage for the claim.

The utmost thing to do at this time is to remain calm. Odds are the correspondence you’ve received is a Reservation of Rights letter. Periodically insurance companies communicate confusion relative to insurance issues. And one area where there seems to be a good deal of confusion has to do with the Reservation of Rights letters.

It is important to understand that each and every state insurance regulatory department has regulations requiring insurance companies to prepare and issue Reservation of Rights letter whenever there is an allegation or facts that arise in a claim matter which could possibly create a gap in coverage. As such, the insurance company is compelled by regulation to provide this information or it risks losing certain rights and defenses.

The purpose of the Reservation of Rights letter is to describe the legal rights of both the insured and the insurance carrier in a claim situation where a coverage problem may potentially be present. This is the case whether the issue is a claim or a lawsuit. The letter serves the purpose of detailing the issues in dispute, coverage of the policy that may or may not apply, and reciting what will be required from the parties until the claim is settled.

The letter protects the insurer, as well as the insured, as it allows both parties to deal with the area of dispute separately, while still allowing them to jointly defend the claim from a third party. It provides the design professional the opportunity to provide additional pertinent information that could clarify facts that may be the source of the Reservation of Rights. Furthermore, it provides the design professional sufficient opportunity to take actions to protect themselves from the effect of any potential coverage gap.

The part of the Reservation of Rights letter that seems to be the root cause of causing so much concern for design professionals is when the insurance carrier reserves its rights when the allegations of wrong doing are clearly groundless. A Reservation of Rights Letter is required regardless of the validity of the allegations in the claim or lawsuit. In other words, even if the allegations made against the design professional are completely unfounded, a Reservation of Rights Letter is still required.

The design professional who receives a Reservation of Rights letter must take into account that the carrier is required by State insurance regulations to take the allegations contained
in the claim or lawsuit at face value for the purpose of determining the applicability of coverage, even if the claims manager knows or suspects the allegations are unfounded. Therefore, the positions taken in the Reservation of Rights letter should not be construed as the insurance company's support or denial of the allegations. The carrier is simply doing what is necessitated by State insurance regulations.

After the Reservation of Rights Letter addresses the issues that are relative to coverage, it will indicate that the insurance company will continue to provide a defense for the claim or lawsuit. In most states, the design professional will have the right to hire separate counsel to defend it relative to the issues that are addressed in the Reservation of Rights letter.

Several states decree that separate counsel must be paid for by the insurance company. Note however, that serious consideration and thought must take place prior to taking this type of action due to the fact that your professional liability practice policy has an eroding limits element and the expenses of this separate legal representation will be applied against the policy limit. Factors affecting the choice for separate counsel should take into account policy limits, value of the claim deductible, potential validity of the allegations, and the effect of the coverage issues on the overall handling of the claim.

It is important to point out that even if a defense attorney has been assigned by the insurance company, that attorney represents the interests of the design professional, not the insurance carrier.

Generally, insurance companies will look for coverage until they cannot find it in a given claims scenario. This means that if there is any iota of facts in the claim that could be covered, they will defend the entire claim. Therefore, if you should receive a Reservation of Rights letter, the very first rule is to not panic! More often than not, the insurance company claims representative will call the design professional and discuss the issues prior to the actual Reservation of Rights letter being issued. The insured is then given the opportunity to provide additional information and documents to clarify the issues, and to discuss the way the claim is to be handled. A Reservation of Rights letter is only an insurance document used by the insurance carrier to ensure that there are no surprises to the design professional when faced with potential uninsured exposures.

Ashley Hurd is Executive Vice President of Hall & Company. He has specialized in A/E professional liability since 1994 and worked in the insurance industry for more than 20 years. He has a bachelor’s degree in business administration and has earned designations of Certified Risk Manager and Certified Insurance Counselor. Ashley has served as president, executive officer and board member for the Professional Insurance Agents of Washington/Alaska.

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