
## IS A RESERVATION OF RIGHTS LETTER SUFFICIENT TO RESERVE THE RIGHT TO CONTEST COVERAGE?

***Harleysville Group Insurance v. Heritage Communities, Inc. et al.*, 2017 WL 105021 (S.C. 2017)**

In *Harleysville Group Insurance v. Heritage Communities, Inc. et al.*, the South Carolina Supreme Court considered whether an insurer adequately reserved its right to contest coverage. 2017 WL 105021, at *1 (S.C. 2017).

The Riverwalk and Magnolia North condominium developments in Myrtle Beach, South Carolina were completed in 2000 and, after the sale of the units, the unit owners discovered defective conditions associated with the construction of their units including, structural deficiencies, water-intrusion and building code violations. *Id.* The unit owners filed lawsuits against the general contractor, Heritage, to recover damages. *Id.*

Heritage maintained multiple liability insurance policies, including Commercial General Liability policies, with Harleysville Group Insurance ("Harleysville") during the construction projects. Harleysville agreed to defend Heritage against the lawsuits under a written reservation of rights. *Id.* at *2. At each trial, Heritage's assigned defense conceded liability and the trial court directed a verdict in favor of the plaintiffs on the negligent construction cause of action. *Id.* The parties contested damages resulting from the admitted negligent construction. *Id.* The juries returned general jury verdicts awarding actual damages as well as punitive damages. *Id.*

After the general jury verdicts, Harleysville commenced declaratory judgment actions "to determine what portion of the judgments in the underlying construction-defect lawsuits would be covered under Heritage's CGL policies." *Id.* "Harleysville contended that, under the terms of the policies, it has no duty to indemnify Heritage for these judgments." *Id.* The declaratory judgment actions were referred to a Special Referee, who held an evidentiary hearing. *Id.* The Special Referee found that there was coverage under the policies for some of the damages and ordered payment of the full

amount of actual damages because "it would be improper and purely speculative to attempt to allocate the juries' general verdicts between the covered and non-covered damages." *Id.* at *3. The parties then filed cross-appeals based on the Special Referee's findings. *Id.*

On appeal, the Court considered whether Harleysville "failed to properly reserve the right to contest coverage as to the underlying damages that constitute faulty workmanship, which are not covered under South Carolina law." *Id*. The main "question in determining coverage under a CGL policy is whether the claim at issue is for 'property damage' caused by an 'occurrence' within the general grant of coverage in the CGL insuring agreement." *Id.* Although "the cost of repairing faulty workmanship is not covered under CGL policies[,]" the "resulting property damage beyond the defective work product itself is covered." *Id*.

Harleysville contended that "the Special Referee erred in finding it failed to properly reserve the right to contest coverage as to the underlying damages that constitute faulty workmanship." *Id*. "Where the insurer fails to adequately reserve the right to contest coverage, the insurer may be precluded from doing so." *Id*.

The Court stated that "an insured must be provided sufficient information to understand the reasons the insurer believes the policy may not provide coverage." *Id*. "[G]eneric denials of coverage coupled with furnishing the insured with a verbatim recitation of all or most of the policy provisions (through a cut-and-paste method) is not sufficient." *Id*. The Court elaborated further by stating that "'[a] reservation of rights letter must give fair notice to the insured that the insurer intends to assert defenses to coverage or to pursue a declaratory relief action at a later date.'" *Id*. (citations omitted). "'For a reservation of rights to be effective, the reservation must be unambiguous; if it is ambiguous, the purported reservation of rights must be construed strictly against the insurer and liberally in favor of the insured.'" *Id*. at *6 (citations omitted). Also, "because an insurer typically has the right to control the litigation and is in the best position to see to it that the damages are allocated, courts have found that where an insurer defends under a reservation of rights, an insurer has a duty to inform the insured of the need for an allocated verdict as to covered versus noncovered damages." *Id*. at *5. The Court went on to state that "'[t]he right to control the litigation carries with it certain duties,' including 'the duty not to prejudice the insured's rights by failing to request special interrogatories or a special verdict in order to clarify coverage of damages.'" *Id*. at *6 (citations omitted). "[B]y 'virtue of its duty to defend, an insurer gains the advantage of exclusive control over the litigation,' and 'it would be unreasonable to permit the insurer to not disclose potential bases for denying coverage.'" *Id*. (citations omitted). "'If the insured does not know the grounds on which the insurer may contest coverage, the insured is placed at a disadvantage because it loses the opportunity to investigate and prepare a defense on its own.'" *Id*. (citations omitted). "Without knowledge of the bases upon which the insurer might dispute

coverage, 'the insured has no reason to act to protect its rights because it is unaware that a conflict of interest exists between itself and the insurer.'" *Id*. (citations omitted).

The Court examined how Harleysville reserved its rights concerning the issue of actual damages and stated the following:

> These [reservation of rights] letters identify the particular insured entity and lawsuit at issue, summarize the allegations in the complaint, and identify the policy numbers and policy periods for policies that potentially provided coverage. Additionally, each of these letters (through a cut-and-paste approach) incorporated a nine- or ten-page excerpt of various policy terms, including the provisions relating to the insuring agreement, Harleysville's duty to defend, and numerous policy exclusions and definitions. Despite these policy references, the letters included no discussion of Harleysville's position as to the various provisions or explanation of its reasons for relying thereon. With the exception of the claim for punitive damages, the letters failed to specify the particular grounds upon which Harleysville did, or might thereafter, dispute coverage.

*Id*. The Court also noted that "none of the reservation letters advised Heritage of the need for allocation of damages between covered and non-covered losses or referenced a possible conflict of interest or Harleysville's intent to pursue a declaratory judgment action following any adverse jury verdicts in the underlying lawsuits." *Id*. at *7. The Court also agreed with the Special Referee that oral reservations of right "'fall short of the specificity [required] and are ambiguous at best . . ..'" *Id*. (citations omitted).

The Court held that Harleysville's reservation of rights letters "were insufficient to reserve its right to contest coverage of actual damages . . .." *Id*. "Harleysville's reservation letters gave no express reservation or other indication that it disputed coverage for any specific portion or type of damages. Nor did the letters . . . indicate that, in the event Heritage was found liable in the construction-defect suits, Harleysville intended to file the instant lawsuit to contest various coverage issues." *Id*. Further, "Harleysville did not expressly put its insureds on notice that it intended to litigate the issues of whether any damages resulted from acts meeting the definition of occurrence, whether any damages occurred during the applicable policy periods, what damages were attributable to non-covered faulty workmanship, and whether certain damages resulted from intentional acts by the insured and were thus excluded." *Id*. Moreover, the reservation of rights letter did not "inform the insureds that a conflict of interest may have existed or that they should protect their interests by requesting an appropriate verdict." *Id*.

With respect to the issue of punitive damages, the Court held that Harleysville sufficiently reserved its rights by providing "in detail the basis for the potential denial

of coverage . . .." *Id*. The letter explained the basis for the reservation of rights and "advised Heritage of the possibility it may face an uninsured exposure or interest to the extent that any damages ultimately awarded exceeded the policy limits." *Id*. Harleysville also "recommended that Heritage and its principals consider employing personal counsel to represent any uninsured exposure or interest . . .." *Id*.

## IS A SECOND RESERVATION OF RIGHTS LETTER NECESSARY?

***American Guarantee & Liability Insurance Company v. Lamond et. al.*,**
**2016 WL 1312008 (D. Mass. 2016).**

In *American Guarantee & Liability Insurance Company v. Lamond et. al.,* the United States District Court for the District Court of Massachusetts addressed whether the plaintiff, American Guarantee & Liability Insurance Company (hereinafter "AGLI"), was "estopped from denying professional liability insurance coverage to defendant John F. Lamond because it did not issue to Lamond a second reservation of rights letter . . .." 2016 WL 1312008, *1 (D. Mass. 2016). AGLI issued Lamond, who was an attorney at the time, a professional liability policy (the "Policy").

The underlying complaint alleged that Lamond failed to advise his clients of facts during their purchase of several lots of land for development. *Id*. Prior to the closing, Lamond learned that the land was a Native American burial ground site and subject to restrictions. *Id*. However, Lamond certified to his client's mortgage company that the titles to the land were free of encumbrances. After the sale, Lamond's client was unable to build on the land because of the restrictions and defaulted on the mortgage. *Id*. The mortgage company foreclosed on the lots, but was unable to develop or sell the land because of the burial ground. *Id*.

In 2009, the mortgage company commenced a lawsuit in state court against Lamond and his client. *Id*. Lamond's client filed a third-party complaint against Lamond asserting claims of professional negligence and violation of the Mass. Gen. Laws ch. 93A. *Id*.

In May 2009, after commencement of the lawsuit, AGLI sent a letter to Lamond stating that "'it was reserve[ing] all rights and defenses available under the Policy and at law to deny coverage on any of the bases' identified in the letter." *Id*. The letter stated the following:

> [the] Policy does not apply . . .'[t]o any intentional, criminal, fraudulent, malicious or dishonest act or omission by an Insured; except that this exclusion shall not apply in the absence of a final adjudication or admission by an Insured that the act or omission was intentional, criminal, fraudulent, malicious or dishonest.'

*Id.* The letter also noted the following:

> [T]he definition of covered damages under the policy excluded . . . 4. criminal or civil fines, penalties (statutory or otherwise), fees or sanctions; 5. punitive, exemplary or multiple damages; . . . [and] 7. legal fees, costs and expenses paid to or incurred or charged by the Insured.

*Id.* at *1 – *2. AGLI did not send a second reservation letter addressing the third-party complaint by Lamond's client. *Id.* at *2.

The Court stated that "the absence of a second reservation letter is not reasonably understood as a representation that AGLI did not intend to reserve its rights with respect to Murphy's third party claims against Lamond in light of the first letter." *Id.* Lamond argued that a second reservation of rights letter was required because the third-party complaint raised new issues. *Id.* Lamond argued that the mortgage company did not assert a claim pursuant to Mass. Gen. Laws ch. 93A and his client asserted a 93A claim. *Id.* In response, the Court stated the following:

> The reservation letter is clear that what was excluded under the policy was Lamond's conduct and certain categories of damages, and not a technical formulation of the legal claims. The policy excluded 'any intentional, criminal, fraudulent, and malicious or dishonest act or omission by an Insured.' The letter identified the allegations that Lamond's 'failure to advise of the [Native American] issue was deceitful and . . . [his] failure to advise . . . was done so fraudulently.' As Murphy's third-party claims were based on the same allegations of misconduct, no new issues were raised.

*Id*. at *3 (citations omitted). The Court also stated "[a]ssuming, *arguendo*, that the absence of a second letter implied a conflicting message from the first letter, Lamond's reliance, without any efforts to rectify the two positions, was not reasonable." *Id*. The Court noted that "[t]he record is devoid of any evidence that Lamond obtained assurance or clarification from AGLI on his interpretation of the absence of a second letter. As a matter of law, he cannot now 'rel[y] on one of a pair of contradictories simply because it facilitates the achievement of [his] goal.'" *Id*. at *4.

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