Writing a Reservation of Rights:

A North American Compendium

Alaska

By Kimberlee A. Colbo

What statutes or regulations, if any, govern the drafting of a reservation of rights letter?

No statute or regulation specifically governs the drafting of reservations of rights letters to an insured. Generally, Alaska's Unfair Claims Settlement Practices Act, codified at Alaska Statutes Section 21.36.125, includes the following requirements, all of which could apply to the drafting and timing of reservations of rights letters:

> (a) A person may not commit any of the following acts or practices:
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> (1) Misrepresent facts or policy provisions relating to coverage of an insurance policy;
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> (2) Fail to acknowledge and act promptly upon communications regarding a claim arising under an insurance policy;
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> (3) Fail to adopt and implement reasonable investigation of all of the available information and an explanation of the basis for denial of the claim or for an offer of compromise settlement;
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> (4) Refuse to pay a claim without a reasonable investigation of all of the available information and an explanation of the basis for denial of the claim or for an offer of compromise settlement;

> (5) Fail to affirm or deny coverage of claims within a reasonable time of the completion of proof-of-loss statements;
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> …
>
> (15) Fail to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement;
>
> …

Further requirements related to Alaska's Unfair Claims Settlement Practices are found in Alaska's regulations at 3 Alaska Administrative Code Sections 26.010 to 26.300. Finally, Alaska Statutes Section 21.96.100(f) does set forth the language that must be used in a written waiver when the insured agrees to waive its right to select independent counsel.

What events necessitate an insurer to issue a reservation of rights letter?

An insurer is required to issue a reservation of rights to its insured as soon as the insurer "has good reason to believe that a coverage dispute may exist." *Lloyd's & Inst. Of London Underwriting Cos. v. Fulton*, 2 P.3d 1199, 1204 (Alaska 2000). In addition, if an insurer believes that there is a potential "policy defense" to coverage, for instance based on an insured's failure to cooperate, the insurer must issue a reservation of rights to preserve those policy defenses. *CHI of Alaska, Inc. v. Emp'rs Reinsurance Corp.*, 844 P.2d 1113, 1115 (Alaska 1993). In short, the requirement to issue a reservation of rights is triggered anytime a potential conflict of interest arises between the insurer and the insured, with three limited exceptions as set forth in Alaska Statutes Section 21.96.100(b).

What are the timing requirements for issuing a reservation of rights letter?

In *Sauer v. Home Indemnity Co.*, 841 P.2d 176, 182 (Alaska 1992), the Alaska Supreme Court held that an insurer has a duty to give its insured prompt and full notice of its intention to deny coverage:

> An insurer is required to give the insured "such notice of its intention to deny liability and of its refusal to defend as will give the insured a reasonable time to protect himself." … Such notice must not only be prompt but it must "provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim." … Prompt notice of the basis for the denial of coverage or a defense is necessary to avoid prejudice to the insured which may result from delays in the insured undertaking its own defense or from

delays in gathering evidence essential to successfully challenge the denial of coverage or a defense.

Pursuant to 3 Alaska Administrative Code Section 26.070, "prompt" notice would require that it be made, at the latest, within 15 working days of when the insurer identifies the potential coverage issue:

> (a) Any person transacting a business of insurance who participates in the investigation, adjustment, negotiation, or settlement of a first-party claim:
>
> (1) *shall advise a first-party claimant in writing of the acceptance or denial of the* ***claim within 15 working days*** *after receipt of a properly executed statement of claim, proof of loss, or other acceptable evidence of loss* unless another time limit is specified in the insurance policy, insurance contract, or other coverage document; payment of the claim within this time limit constitutes written acceptance; ***a written denial of the claim must state the specific provisions, conditions, exclusions, and facts upon which the denial is based; if additional time is needed to determine whether the claim should be accepted or denied, written notification giving the reasons that more time is needed shall be given to the first-party claimant within the deadline***. While the investigation remains incomplete, ***additional written notification shall be provided 45 working days from the initial notification, and no more than every 45 working days thereafter giving the reasons that additional time is necessary to complete the investigation***; if there is a reasonable basis supported by specific information for suspecting that a first-party claimant has fraudulently caused or wrongfully contributed to the loss, and the basis is documented in the claim file, this reason need not be included in the written request for additional time to complete the investigation or the written denial; however, within a reasonable time for completion of the investigation and after receipt of a properly executed statement of claim, proof of loss, or other acceptable evidence of loss, the first-party claimant shall be advised in writing of the acceptance or denial of the claim[.]

(Emphasis added). While this regulation applies specifically to "first-party" claims, it would be advisable for an insurer to comply with the specified timing requirements in any claim where there is a question about coverage. Insurers should issue the reservations of rights letter within 15 working days of identifying the coverage issue. Thereafter, the insurer must advise the insured in writing every 45 working days of the status of the investigation until the coverage question is resolved. However, while an insurer may have 15 working days, insurers may wish to immediately notify the insured as soon as the coverage issue is identified and not wait the full 15 working days to send out a reservation of rights letter.

What information must be included in a reservation of rights letter?

While there is no specific statute outlining exactly what must be included in a reservation of rights letter, Alaska Statutes Section 21.36.125(a)(15) does require the insurer to "provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim." Based on Alaska Statutes Section 21.36.125(a)(15) and the various decisions of the Alaska Supreme Court addressing when reservations of rights letters are required, such letters must be specific and must identify the provisions of the policy that raise a possibility of either a policy defense or a coverage defense as those provisions relate to the alleged or known facts underlying the request for coverage. *See, e.g.*, *Jones v. Horace Mann Ins. Co.*, 937 P.2d 1360, 1365 (Alaska 1997) ("notice must also 'provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim.'") While there is no specific requirement to quote policy language or provide a summary of the underlying facts or pleadings in the reservation of rights, in order to comply with the notice requirements adopted by the Alaska Supreme Court that is what is required. If the matter involves a lawsuit against an insured, then the reservation of rights notice must notify the insured of its right to select independent counsel. Alaska Statutes Section 21.96.100.

What specific statutory or regulatory language must be included in a reservation of rights letter?

There is no specific statutory or regulatory language that must be included in a reservation of rights letter, although there is specific language that must be used if an insured agrees to waive its right to select independent counsel. Alaska Statutes Section 21.96.100(f).

May an insurer reserve the right to seek reimbursement of defense or indemnity payments?

The Alaska Supreme Court has held that an insurer may not seek reimbursement of defense or indemnity payments made pursuant to a reservation of rights. In *Attorneys Liability Protection Society, Inc. v. Ingaldson Fitzgerald, P.C.,* 370 P.3d 1101 (Alaska 2016), the Alaska Supreme Court interpreted Alaska Stat. § 21.96.100 as precluding any attempt

by the insurer to seek reimbursement of funds paid to independent counsel selected by an insured where the insurer has issued a reservation of rights, even where it is later established there was "no possibility of coverage." The court noted: "A review of the statutory text indicates that reimbursement is prohibited, and because there is no evidence of contrary legislative purpose or intent, we conclude that the statute prohibits reimbursement provisions." *Id.* at 1107. However, in *CHI of Alaska*, 844 P.2d 1113, the court noted: "The insurer is only required to pay the reasonable cost of the defense." 844 P.2d at 1121 (citing *Illinois Masonic Med. Ctr. v. Turegum Ins. Co.*, 522 N.E.2d 611, 613 (Ill. 1988) ("insurer must underwrite the reasonable costs incurred by the insured in defending the action…") and *Allstate Ins. Co. v. Noorhassan*, 551 N.Y.S.2d 942, 944 (N.Y. App. Div. 1990)). Once it is determined there is no coverage for a claim, the insurer's duty to defend ceases. Alaska Stat. § 21.96.100.

What are the consequences of not issuing a proper reservation of rights letter?

An insurer who fails to issue a proper reservation of rights letter, or who does so untimely, generally will be estopped from denying coverage. *Fulton*, 2 P.3d at 1209 ("an insurer's breach of the duty to defend must be considered a material breach that estops denial of coverage unless the breach clearly has no adverse impact on the relationship between the insurer and the insured"); *Continental Ins. Co. v. Bayless and Roberts, Inc.*, 608 P.2d 281, 292 (Alaska 1980) (doctrines of waiver and estoppel barred insurer from relying on insured's breach of cooperation clause as basis to deny coverage where its appointed counsel knew of potential basis to deny coverage, knowledge that was imputed to insurer, and insurer failed to inform insured of its intention to deny liability based on breach of cooperation clause until after trial began). The Alaska Supreme Court elaborated on the consequences to an insurer for failing to communicate the reasons for its denial of coverage to its insured:

> Where, as here, the insurer does not communicate its decision to withdraw or explain the basis for its decision but simply denies coverage, it should be precluded from later arguing that coverage under the policy did not exist. … As noted above, an insurance company is under a duty to notify its insured of its intention to deny liability and to state the grounds therefore. … Such notice is

> essential so that the insured may promptly undertake its own defense and evaluate whether to contest the insurance company's decision to deny coverage.

Sauer, 841 P.2d at 183.

Proving an "adverse impact" or "prejudice" from an insurer's breach of the duty to defend does not require the insured to show that "it changed the outcome of the case." Rather, the insured needs to show only that it "caused some actual harm" to the insureds. *Fulton*, 2 P.3d at 1207-08. However, coverage by estoppel does not apply if the breach of the insurer's duty to disclose a coverage defense is unrelated to the coverage defense under which it ultimately denies coverage.. *Progressive Cas. Ins. Co. v. Skin*, 211 P.3d 1093, 1103 (Alaska 2009). Insurers who breach a defense obligation are precluded from relying on the cooperation clause as a policy defense to liability for a subsequent settlement reached by an insured without the consent of the insurer. *Great Divide Ins. Co. v. Carpenter ex rel. Reed*, 79 P.3d 599, 608 (Alaska 2003).

Insurers may also be subject to claims for "bad faith" or breach of the covenant of good faith and fair dealing if they fail to issue a proper reservation of rights. The Alaska Supreme Court will impose liability on the insurer for any subsequent judgment against the insured if an insurer refuses to provide a defense where there is a possibility that coverage may exist based on the allegations of the complaint or extrinsic facts that are reasonably knowable to the insurer. *Afcan v. Mut. Fire, Marine & Inland Ins. Co.*, 595 P.2d 643, 646-47 (Alaska 1979) (if complaint contains allegations that may be within coverage, insurer has obligation to defend and burden of showing that claims are baseless); *Bayless & Roberts*, 608 P.2d at 288 (where insurer has "policy defense," i.e., where insurer admits that policy covers claim but argues that actions by insured breached contract, then insurer must either defend unconditionally or deny unconditionally and accept consequences if it is wrong; if insurer has "coverage defense," it may offer defense under reservation of rights to reserve its right to dispute coverage); *CHI of Alaska*, 844 P.2d at 1115 (insured has right to request separate counsel at insurer's expense where insurer reserves rights in coverage defense situation).

Alaska law applicable to the duty to defend is summarized as follows:

> An insurer's duty to defend and its obligation to indemnify are separate and distinct contractual elements. The insurer's duty to defend is broader than its duty to provide coverage. The insurer may therefore be obligated to defend even where it has no ultimate liability under the policy. "The duty to defend arises 'if the complaint on its face alleges facts which, standing alone, give rise to a possible finding of liability covered by the policy.'"

Fejes v. Alaska Ins. Co. Inc., 984 P.2d 519, 522 (Alaska 1999).

"[I]nsurers who misinterpret their policies or who refuse to defend their insureds in the face of a reasonable expectation of coverage do so at the risk of indemnifying any loss due to claims they should have defended." *Makarka ex rel. Makarka v. Great Am. Ins. Co.*, 14 P.3d 964, 970 n.29 (Alaska 2000). The Alaska Supreme Court will impose liability on an insurer that wrongfully fails to defend, even if the facts ultimately show that there was no basis for coverage under the applicable policy. *Sauer*, 841 P.2d at 184; *Makarka*, 14 P.3d at 969 ("failure to defend gives rise to an indemnity remedy, even if it could later be proved that no coverage was due.")

Under what circumstances does the issuance of a reservation of rights letter require independent counsel?

Any time an insurer issues a reservation of rights in the context of a third-party lawsuit against an insured where the insurer has a duty to defend, the insured must be advised of its right to select independent counsel to represent it in the lawsuit and the insurer must pay for independent counsel. Alaska Stat. § 21.96.100(c). In addition, insurers have an obligation to provide independent counsel when a "conflict of interest arises that imposes a duty on the insurer to provide independent counsel to the insured." Alaska Stat. § 21.96.100(a). While the wording of this statute is somewhat circular, if a "conflict of interest" potentially exists, an insurer has a duty to offer independent counsel regardless of whether it has issued an actual reservation of rights. As a general matter, if a conflict of interest has arisen, a reservation of rights should be promptly issued to the insured.

A conflict of interest exists anytime an insurer identifies a possible policy defense or a possible coverage defense:

> Sometimes, however, the insurer claims that the policy has been breached by the insured. These are so-called policy defenses of which the insured's failure to

> give notice or to cooperate are typical examples. The insurer may wish to preserve its policy defenses and still provide a defense to the insured. By doing so it may be able to avoid paying the underlying claim either by succeeding in its defense of the insured or, failing that, by successfully asserting its policy defense.
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> …
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> Similarly, the insurer may claim that although no condition of the policy has been breached by the insured, a particular claim made by the plaintiff does not come within the coverage of the policy. Such defenses are called coverage defenses. … In such cases the insurer's duty to defend may require it to defend even if the most likely theory of recovery is one for which there is no insurance coverage. The insurer can preserve its coverage defense and fulfill its duty to defend by defending under a reservation of rights to later disclaim coverage if liability is attributable to the excluded theory.

CHI of Alaska, Inc., 844 P.2d at 1115. The nature of the potential conflicts of interest have been categorized by the Alaska Supreme Court into three general types: "the insurer may offer mere token defense, the insurer may steer result to judgment under an uninsured theory of recovery, [or] the insurer may gain access to confidential or privileged information which it may later use to its advantage." *Id.* at 1118. A "conflict of interest" does not include: (a) a claim for punitive damages; (b) a claim for damages in excess of the available policy limits; or (c) "claims or facts in a civil action for which the insurer denies coverage." Alaska Stat. §21.96.100(b).

An insured may waive, in writing, its right to select independent counsel. Alaska Stat. §21.96.100(f). The insured must sign a statement that "reads substantially as follows:"

> I have been advised of my right to select independent counsel to represent me in this lawsuit and of my right under state law to have all reasonable expenses of an independent counsel paid by my insurer. I have also been advised that the Alaska Supreme Court has ruled that when an insurer defends an insured under a reservation of rights provision in an insurance policy, there are various conflicts of interest that arise between an insurer and an insured. I have considered this matter fully and at this time I am waiving my right to select independent counsel. I have authorized my insurer to select a defense counsel to represent me in this lawsuit.

Id.

To whom must the insurer send the reservation of rights letter and to whom must the insurer send a copy?

Alaska law does not specify exactly to whom the reservation of rights must be sent, but at a minimum, it would have to be sent to the insured seeking coverage under the policy and to the insured's attorney, if the insured is represented. Further, while the Alaska Supreme Court has not specifically addressed the issue, a reservation of rights letter is probably discoverable in litigation pursuant to Alaska Rules of Civil Procedure, Rule 26(a)(1)(F), which requires production of "each insurance agreement under which any person carrying on an insurance business may be liable…." To the extent that a reservation of rights letter would limit an insurer's potential liability, Alaska's trial courts might conclude such documents are discoverable if asked to address the issue.

Are there any situations where a disclaimer is required as opposed to a reservation of rights?

Alaska law does not contain any specific requirements as to when a disclaimer of coverage or a duty to defend should be issued as opposed to a reservation of rights. However, the three-year statute of limitations for an insured to sue an insurer for an improper disclaimer of coverage generally does not begin to run until the insurer has issued written notification of its intent to disclaim coverage to its insured. In *Christianson v. Conrad-Houston Ins.*, 318 P.3d 390 (Alaska 2014), the Alaska Supreme Court held that a letter issued by an insurer to its insured advising the insured that he should defend himself against a claim based on an exclusion in the policy at issue was sufficient to put the insured on inquiry notice that he might have a claim against his broker for malpractice. As such, when the insured failed to file a lawsuit against the broker within three years of the date when the insured received the letter advising that the insurer intended to disclaim a duty to defend a lawsuit, the statute of limitations precluded the insured from pursuing a malpractice claim against his broker. *Id.* at 396-97.

Are there any other notable cases or issues regarding reservation of rights letters that are important to the law of this state?

The leading case in Alaska establishing the right to independent counsel is *CHI of Alaska, Inc. v. Emp'rs Reinsurance Corp.*, 844 P.2d 1113 (Alaska 1993). Alaska Statutes

Section 21.96.100 was adopted following the Alaska Supreme Court's decision in *CHI of Alaska* and defines what limitations exist with respect to the qualifications of the counsel selected by an insured to serve as independent counsel, the hourly rates independent counsel can charge, what services for which independent counsel can be paid, and what the respective roles of independent counsel and counsel representing the insurer are.

Specifically, the insurer can require that independent counsel "have at least four years of experience in civil litigation, including defense experience in the general subject area at issue…" Alaska Stat. §21.96.100(d). In addition, the insurer is required to pay fees to the independent counsel that are equal to the "rate that is actually paid by the insurer to an attorney in the ordinary course of business in the defense of a similar civil action in the community in which the claim arose or is being defended." *Id.* The insurer is not responsible for fees attributable to defending claims for which there is no coverage or for which coverage has been denied. *Id.* Independent counsel is required to keep detailed records allocating fees and costs appropriately. *Id.* Any disputes over the reasonableness of fees are to be resolved via arbitration pursuant to the terms of Alaska's Revised Uniform Arbitration Act, codified at Alaska Stat. §09.43.300, et seq. *Id.* Further, the insured and independent counsel are required to "consult with the insurer on all matters relating to the civil action" and must disclose information to the insurer relevant to the action "except information that is privileged and relevant to disputed coverage." Alaska Stat. §21.96.100(e). An insurer may have appointed counsel participate in the litigation as counsel for the insurer. Alaska Stat. §21.96.100(g). Finally, an insurer can still elect to settle a claim where an insured is represented by independent counsel "if the settlement includes all claims based upon the allegations for which the insurer previously" reserved coverage or accepted coverage. Alaska Stat. §21.96.100(h).

Author

Kimberlee A. Colbo has been practicing law in Alaska since 1992 and became a member of Hughes White Colbo Wilcox & Tervooren LLC in 1998. Her practice focuses in the areas of insurance defense, insurance bad faith, insurance coverage, product liability, employment law (management), and general civil litigation. Ms. Colbo has been selected for Best Lawyers in America for Alaska in Insurance Law and Personal Injury Litigation-Defendants

since 2008 and has been named in Super Lawyers Alaska in Personal Injury Defense since 2009. Ms. Colbo is a member of DRI and is a past president of the Defense Counsel of Alaska. In March, 2020, Ms. Colbo was inducted as a Fellow of the American College of Trial Lawyers.

Hughes White Colbo Wilcox & Tervooren, LLC | 907.274.7522 | kcolbo@hugheswhite.com