



# NEWSLETTERS

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## THE PASCHOS LAW UPDATE NEWSLETTER

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### RECENT TRENDS CONCERNING RESERVATION OF RIGHTS IN PENNSYLVANIA

Insurance carriers and coverage professionals are often confronted with a myriad of issues related to the duty to defend and the duty to indemnify. The duty to defend is generally broader than the duty to indemnify. The duty to defend is based upon allegations and potential coverage. A suit that triggers the duty to defend does not necessarily mean there is coverage. A situation arises when the claims alleged include both covered and uncovered claims or where there appears to be a question as to whether the claims alleged fall within the scope of coverage. Under these circumstances, the insurer will often agree to defend its insured through a reservation of rights letter.

#### Reservation of Rights Requirements

In Pennsylvania, when an insurer believes a claim is not covered, it may protect itself by issuing a reservation of rights under the policy which fairly informs the insured of the insurer's position. The notice must be timely, although delay in giving notice will be excused where it is traceable to the insurer's lack of actual or constructive knowledge of the available defense.

#### Change in Position Based on Discovery

When defending a case under a reservation of rights keeping an eye on evidence and admissions developed through discovery is prudent. New information could resolve disputed facts and end the duty to defend. However, in *Scopel v. Donegal Mut. Ins. Co.*, 698 A.2d 602 (Pa. Super. 1997), the intermediate appellate court of Pennsylvania ruled that an insurer does not have a continuing obligation to monitor pre-trial discovery to determine if facts had emerged that would change its no coverage position. The Superior Court ruled that "the rightful denial of coverage based upon a filed complaint should relieve an insurer of the duty and burden of tracking the developments in a case in which the insurer has no legal interest."

#### Recent Trends Concerning Reservation of Rights

A reservation of rights letter creates difficult choices for both the insurance company and the policyholder. As such, this election by the insurance company can result in issues other than coverage or policy limits. Recent trends in Pennsylvania law deal with some of the issues that may arise.

##### 1. Reservation of Rights Triggers Right to Independent Counsel

The leading national case addressing the rights of policyholders with the respect to the right to independent counsel in "conflicts" cases is *San Diego Federal Credit Union v. Cumis Ins. Society*, 162 Cal. App.2d 358 (1984). Under the Cumis doctrine, when an insurer agrees to defend its insured under a reservation of rights, a conflict exists between the insurer and insured. In those instances, the insured has a right to retain independent counsel to be paid for by the insurer, commonly referred to as "cumis

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counsel.”

Some courts have held that the existence of a reservation of rights letter does not automatically give rise to a conflict of interest between the insurer and the insured with regard to the conduct of the insured's defense.

Pennsylvania law does not support that a conflict automatically arises when the insurer, under the policy of insurance issued to the Plaintiffs, invokes a reservation of rights clause. Pennsylvania courts have held that the insurer does not breach any duty to the insured by simply providing a defense to its insured under a reservation of rights where specific coverages are either unavailable and/or denied. Rather, whenever such a situation arises where the insurance company and its insured are represented by the same attorney, Pennsylvania jurisprudence appears to have consistently resolved any claims of conflict, other than those which are proven to actually exist, by holding that the lawyer involved is professionally and ethically bound to act exclusively on behalf of and in the best interests of the insured, to whom is owed first and foremost a duty of uncompromised loyalty. *Eckman v. Erie Ins. Exch.*, 15 Pa. D. & C.5th 55 (2010)

## 2. Insurer's Ability to Reserve Rights to Seek Reimbursement of Defense Costs

Some courts have held that the carrier is entitled to reimbursement of defense costs when it is later determined that there is no duty to indemnify. However, other courts have held that the carrier cannot obtain reimbursement of defense costs even if it is determined that there is no duty. In *American and Foreign Insurance Company v. Jerry's Sport Center, Inc.*, 606 Pa. 584, 2 A.3d 526 (2010) a unanimous Pennsylvania Supreme Court ruled that insurers that issue commercial general liability policies obligating them to defend any suit that seeks damages to which the insurance may apply, do not have the right to recover defense costs from the insured if a court later determines that the suit does not obligate the insurer to pay indemnity.

The Pennsylvania Supreme Court considered the two lines of cases that had developed on the issue. The majority view among the states is that an insurer's reservation of the right to recover defense costs creates a basis for such a recovery. The other states in the minority have held that there could be no right of reimbursement of defense costs absent a contractual provision to that effect, and the insurer could not unilaterally modify the contract through a reservation of rights letter. The Supreme Court concluded that the latter approach of which had also been followed by the Third Circuit in *Terra Nova Ins. Co. Lt. v. 900 Bar, Inc.*, 887 F.2d 1213 (3d Cir. 1989) was the correct one. The Court concluded that to find a right of reimbursement of defense costs would “amount to a reactive erosion of the broad duty to defend” and “would . . . narrow Pennsylvania's long-standing view that the duty to defend is broader than the duty to indemnify.”

## 3. Insurer's Control of Settlement Under Reservation of Rights

Issues can arise regarding an insured's ability to control litigation when represented by insurer appointed counsel. One such issue is the control of settlement. In *Babcock & Wilcox Co. v. American Nuclear Insurers*, 2013 Pa. Super. 174 (2013), the Superior Court addressed the issue of control of settlement where the insurer defends under a reservation of rights. The *Babcock* Court held that when an insurer tenders a defense subject to a reservation of rights, the insured may either (1) accept the defense, in which case the insured remains bound to the terms of the consent to settlement provision of the insurance policy and the insurer retains full control of the defense; or (2) the insured may reject the defense and furnish its own

defense through independent counsel retained at the insured's expense. Under the second option, the insured is not bound by the consent to settle provision of the policy. The insured retains full control of its defense, including the option of settling the underlying claim under terms it believes is best. So long as the settlement is fair, reasonable and non-collusive, the insurer will be obligated to reimburse its insured.

The holding in *Babcock* sheds some light on the issue of an insured's right to independent counsel ("cuims" counsel). The implied lesson from *Babcock* is that if an insured believes that a reservation of rights creates a conflict of interest with regard to insurer appointed counsel, appointment of independent counsel is not necessary to resolve the conflict. The insured could simply reject the defense and recover the cost of defense in addition to indemnify coverage.

***Copies of the full text of any of the cases discussed in this Newsletter may be obtained by calling our office. The articles contained in this Newsletter are for informational purposes only and do not constitute legal advice.***

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