

# New Jersey Law Journal

VOL. CXCI – NO.7 – INDEX 515

FEBRUARY 18, 2008

ESTABLISHED 1878

IN PRACTICE

## INSURANCE LAW

BY NICHOLAS KIERNIESKY

### Proper Notification To Disclaim Responsibility

Where the insured is an attorney, the reservation of rights letter need not be as explicit

The New Jersey Appellate Division's decision, *Kaplan v. Harleysville Insurance Company*, held that when the insured is an attorney, the language used in a reservation of rights letter need not literally tell the insured that he has the right to "accept or reject" if the meaning and legal effect of the language would be sufficiently clear to an attorney.

Although an unpublished opinion, *Kaplan* can be cited as persuasive authority in New Jersey pursuant to Rule of Court 1:36-3. This opinion is noteworthy in that it represents a victory for an insurance company, and the opinion is a helpful restatement of legal principles that enable an insurance carrier to effectively reserve its rights to later disclaim coverage while initially providing a defense to an insured.

*Kaplan* concerned legal malpractice insurance coverage. A law firm

allegedly mishandled a case and that resulted in its dismissal. The firm received a malpractice complaint. The firm's insurance carrier offered to defend the firm, subject to a reservation of rights, under a "claims made" insurance policy. An issue existed as to whether the alleged malpractice occurred within the period of coverage. About three years later, the carrier denied coverage entirely and withdrew from the case. That led to a declaratory judgment action, seeking a ruling that coverage existed. The trial judge found that the carrier was estopped from denying coverage.

The reservation of rights letter was dated February 23, 2001. After determining that the claim did not fall within the period of coverage, the carrier disclaimed coverage on June 25, 2004. The trial judge held that the reservation of rights letter was defective because it did not comport with the legal standard set forth in *Merchants Indemnity Corp. of N.Y. v. Eggleston*, 37 N.J. 114, 126 (1962). *Merchants* held that an insurance carrier may respond to a claim against its insured by advising the insured that the carrier is willing to

defend under a reservation of rights or a "non-waiver agreement." Accord, *Griggs v. Bertram*, 88 N.J. 347, 357 (1982). Such an agreement allows a carrier to disclaim responsibility for payments that may otherwise be required by the insurance policy. Such an agreement may be "inferred from the insured's failure to reject the carrier's offer to defend with a reservation of rights." In order to "spell out acquiescence by silence [of the policyholder]," the reservation of rights letter "must fairly inform the insured that the offer may be accepted or rejected."

The trial judge in *Kaplan* found the carrier's reservation of rights letter to be invalid because it did not literally tell the insureds that they may "accept or reject" the defense that was being offered. The Appellate Division disagreed with the trial judge. The appeals court held that the controlling law "does not stand for the proposition that [those] exact words have to be used." The appeals court observed that the reservation of rights letter did not in any way "reflect or even suggest a unilateral decision by Harleysville." Rather, the letter stated that the carrier was

prepared to provide [the principals of the firm] with a defense under a reservation of rights, which will be discussed more fully below. If you and [the other principal] accept this reservation, we will assign the defense of this matter to [a defense firm].

You may wish to retain personal counsel to protect your uninsured interests.

*Kierniesky is an associate with Marshall, Dennehey, Warner, Coleman & Goggin of Cherry Hill. A version of this article first appeared in September 2007 issue of Defense Digest, and is reprinted with permission. © Marshall, Dennehey, Warner, Coleman & Goggin of Cherry Hill. All rights reserved.*

The Appellate Division stated that the trial judge failed to address the "precise language" used in the reservation of rights letter and also "failed to consider that [the insureds] are attorneys, and thus sufficiently sophisticated to understand the meaning and legal effect of Harleysville's reservation of rights."

In other words, it appears that if the insured is an attorney, the language of the reservation of rights letter need not be as explicit as it might otherwise have to be for a layperson.

The Appellate Division cited an example of an improper, and unenforceable, unilateral decision to reserve rights by an insurance carrier in *Sneed v. Concord Insurance Company*, 98 N.J. Super. 306, 314 (App. Div. 1967). In that case, the carrier stated it "will continue to investigate this matter, but reserves any and all of its rights under the policy contract and may, at any time, disclaim liability thereunder." The Appellate Division contrasted that unilateral language with the language used by Harleysville and observed that the Harleysville language comported with the language that was found to be acceptable in *Neilson v. American Mutual Liability Insurance Company of Boston*, 111 N.J.L. 345, 349 (E. & A. 1933), i.e., "If this is not agreeable to you, we will return the summons and complaint for such action as you think advisable."

The Appellate Division found no

difference between the language that was acceptable in 1933 and the language used by Harleysville in 2001, that it was "prepared" to defend "if" the insureds were willing "to accept the reservation," particularly when the 2001 letter expressly declined coverage for only the period of time during which the alleged malpractice occurred and also suggested that the insureds might want to "retain personal counsel to protect their uninsured interests."

The Appellate Division concluded that the insureds were properly notified of the carrier's reservation of its rights to disclaim coverage and had not suffered any prejudice from the timing of the carrier's later withdrawal. Accordingly, the insured had no enforceable claim to any of the insurance policy benefits.

Finally, the Appellate Division rejected the claim that the insureds were entitled to coverage because Harleysville waited over three years to disclaim coverage, while the malpractice claim was still pending. The insureds relied upon *Merchants* and *Griggs*. The Appellate Division rejected those arguments and found those cases to be distinguishable. The Appellate Division found that both of those cases involved untimely reservation of rights letters. The Appellate Division found that such untimeliness did not exist in the present case. However, in dicta, the Appellate Division stated that those

cases would be "pertinent by inference" if the insured attorneys had suffered prejudice by the timing of the withdrawal of the defense. The Appellate Division found no such prejudice under the facts of this case.

In conclusion, for a reservation of rights letter to be enforceable, it must fairly inform the insured of the right to accept or reject the tender of the conditional defense. When the insureds are attorneys, the language that is used need not literally tell the insureds that they have the right to "accept or reject" if the meaning and legal effect of the language would be sufficiently clear to attorneys. Purely "unilateral" language, however, is still not acceptable. It would, of course, be most desirable for the insured to sign and return an endorsement that affirmatively consents to the carrier's tender of the conditional defense.

Parenthetically, the insured attorneys in *Kaplan* had settled with the claimants, the underlying plaintiffs. The settlement consisted of an assignment to the claimants of the insureds' rights under the policy. The Appellate Division rejected the claimants' request to vacate that settlement and allow them to prosecute their claims against the attorneys. There was no allegation of fraud, and such an assignment was found to be sufficient consideration to support enforcement of the settlement. ■