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Reservation of Rights Letters: Lack of Specificity Proves Fatal To CGL Insurer In South Carolina

Law360.com recently featured the South Carolina Supreme Court ruling in *Harleysville Group Insurance v. Heritage Communities, Inc.,* No. 2013-001291 (South Carolina 2017), as one of the five most important but potentially overlooked insurance rulings in the first quarter of this year. The *Harleysville* case points out the peril insurers face for issuing general, non-specific reservations of rights letter.

In *Harleysville,* the South Carolina Supreme Court held that a reservation of rights letter which did not clearly state why a carrier believed a commercial general liability ("CGL") policy may not provide coverage for a loss could bind the insurer to cover the loss. The Court affirmed a special referee's decision that Harleysville was obligated to insure a prorated share of large verdicts entered against developers of two Myrtle Beach condominium complexes for a series of construction defect cases.

Harleysville agreed to defend the developer, Heritage Communities, Inc., and related companies in the underlying litigation under the CGL policies but issued several reservation of rights letters during the defense which were used later to question the insurer's coverage obligations. A special referee ruled that the insurer had failed to properly reserve its right to dispute coverage for the actual damages verdicts against Heritage because the letters included only “generic denials of coverage” accompanied by verbatim copies of policy provisions.

The South Carolina high court agreed that the reservations of rights letters were insufficient, as they did not adequately place the insureds on notice of the insurer's specific concerns and arguments against coverage. Writing for the Court, Justice John W. Kittredge held:

> It is axiomatic that an insured must be provided sufficient information to understand the reasons the insurer believes the policy may not provide coverage.
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> At the hearing before the Special Referee, Harleysville produced letters it sent to former Heritage principals and counsel between December 2003 and February 2004. These letters explained that Harleysville would provide a defense in the underlying suits and listed the name and contact information for the defense attorney Harleysville had selected to represent Heritage in each matter. These 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** (emphasis added).

. . . .

> Here, except as to punitive damages, Harleysville's reservation letters gave no express reservation or other indication that it disputed coverage for any specific portion or type of damages.

Justice Kittredge went on to point out, for example, that Harleysville did not identify the basis on which it intended to contest that no "occurrence" took place, as defined in the policy. On that basis, the Court affirmed the referee's finding that Harleysville could not contest coverage under the CGL policies based on the reservation of rights letters it issued.

Editor's Note:
The obvious takeaway here is that insurers should make every effort to be thorough when it comes to the drafting of reservation of rights letters. The better practice is to have inside or outside counsel prepare claim specific reservation letters as part of the coverage analysis or coverage opinion, if and when reservation letters are indicated.

This ruling cautions against any conventional view that reservation of rights letters are merely "cookie cutter" documents that can be generated primarily by word processors. Reservation of rights form letters may be used as a starting point, but never an ending point — the letters must ultimately contain specific grounds supporting any reserved claim, and wherever possible include citation to facts and information tending to suggest a reasonable dispute as to the terms of the policy on which reservation is being made.

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