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Reservation of rights letter... The insurer's prenup agreement

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In determining whether to head into a relationship with its insured once a claim has been filed, an insurer, like a couple heading into marriage who want a prenuptial agreement, sometimes reserves the right to later drop out of the relationship with its insured. The reservation of rights letter is the insurer's prenuptial agreement and, typically, it comes about roughly as described below.

You get sued for defective construction and resulting damages, you give notice to your insurer and your insurer responds with a letter of about ten or more pages, letting you know all the reasons that coverage under your policy may not apply, but appointing you with a lawyer for whom the insurer will pay. This sounds great; a defense being provided at no cost to you. The question though, is do you accept the insurer's lawyer? Should you...?

No. At least in Massachusetts, do not accept the insurer's appointed counsel because under these circumstances, you are entitled to have your own chosen attorney represent you with the insurer, not you, paying the cost or the vast majority thereof.

When an insurer responds to its insured concerning a claim, it can do one of three things.

It can agree to defend without reservation, accepting full responsibility up to the limits of coverage. It can reject the claim, setting you adrift either to deal with the claim yourself, or to fight with the insurer for coverage. Last, an insurer can seize the middle ground by issuing a reservation of rights. When an insurer issues a reservation of rights, the insurer is telling you two things, namely, 1) that it will pay for your defense and, maybe, any future damage assessment, while 2) also reserving the right to disclaim coverage later, leaving you without any coverage in the event of a future judgment against you.

In this reservation of rights circumstance, where the insurer has one foot in and one foot out of providing you coverage, the Mass. Supreme Judicial Court has found that the insured is entitled to have its own counsel represent it at the insurer's cost.

Part 2 will appear in
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