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Reservation of rights letter: The insurer's prenuptial agreement with its insured - by Cole and Sams

April 28, 2023 - Spotlights

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Did you know that when your insurer agrees to defend you in litigation, but reserves the right to disclaim coverage, you have the right to hire your own attorney – and your insurer pays those legal bills?

You get sued for defective construction and resulting damages, you give notice to your insurer, and your insurer responds with a “reservation of rights” letter, with its reasons that coverage under your policy may not apply, while assigning you a lawyer it selects and pays for. While this sounds great, must (or should) you accept the insurer’s chosen attorney?

No. In Massachusetts, you are entitled to select your attorney, and your insurer, not you, must pay most costs.

When an insurer responds to a claim, it can: (1) agree to defend you, accepting full responsibility up to the limits of coverage; (2) reject the claim and require you find your own counsel; or (3) hedge by issuing a “reservation of rights” letter. When an insurer “reserves its rights,” it is saying it will pay for your defense, while also reserving its right to later disclaim coverage, potentially leaving you without any coverage in the event of a future judgment.

However, in the 1964 case Magoun v. Liberty Mut. Ins. Co., the Massachusetts Supreme Judicial Court held that the insured is entitled to hire its own attorney to defend it, at the insurer's cost. The SJC reasoned that because counsel appointed by your insurer has no interest in doing more than defending you (and is ethically prohibited from fighting with the insurer over coverage issues), there can be a conflict of interest. Your own counsel, however, has only one client—you—and should work to find you coverage if possible while defending the case against you. Further, as your counsel works to defend you from the claim asserted against you, your insurer is responsible for paying those legal bills.

While your insurer will try to force its counsel upon you when it issues a reservation of rights, that counsel cannot help you with insurance coverage disputes, perhaps the most critical issue with which you are faced. Where Massachusetts courts have held that the insurer must pay the reasonable cost of your chosen lawyer when it issues a reservation of rights, you should reject that counsel and hire the lawyer you want to work with – at your insurer's cost. Protect yourself.

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