

Reservation of rights

Failing to reserve rights may cost insurers dearly.

“It seems very aggressive.” “The brokers don’t like it.” “It will upset the insured.” These remarks (and others on very similar lines) are often the initial response to the suggestion that an insurer client should issue a ‘reservation of rights’ letter before proceeding further with a claim or investigation. Of course, there may be good commercial reasons for not writing such a letter or, alternatively, an insurer simply may not wish to reserve its rights. However, before making any final decision on the point, the insurer should know what it is surrendering and the consequence of doing so.

There are two different situations where the issue is likely to arise:

- policy validity – where there is some doubt about the insured’s compliance with the duty of utmost good faith; and
- policy terms and conditions – where there is an apparent failure to comply with a term of the policy.

Issues concerning policy coverage are not included on the premise that one cannot waive or affirm into cover something which was never there. This is an area outside the scope of this article.

Policy validity

If an insurer has sufficient knowledge of a right available to it and then says or does something inconsistent with that right, it will be treated as having affirmed the contract or waived its entitlement to avoid it.

The difference between affirmation and waiver is a legal technicality that is not analysed here because the effect is identical: in either case, the right to avoid is lost.

To give a practical example: An insurer is faced with a claim and, at first sight, there is clear evidence of non-disclosure which would entitle avoidance.

However, the insurer fails to reserve its rights. It then appoints adjusters to investigate the claim's value with the insured. In these circumstances, the insurer will have lost any right to avoid: it has behaved like an insurer dealing with a claim in the ordinary way, as if it was insured by a valid policy. Put another way, the insurer had the choice of avoiding the policy or affirming it, and, by its conduct, chose to affirm it. The interposition of a suitable reservation would have saved the insurer's right at least for a time.

Of course, there are many types of conduct that could be regarded as inconsistent with a right to avoid: for example, the making of an interim payment, the acceptance of a premium, or reliance upon a policy term or condition. Each case will have its own particular facts.

Policy conditions

Until recently, it was not clear whether there was any real difference between how the law treated policy validity and policy conditions. A recent case (in which Kennedys acted for the claimant) suggests, however, that there is a difference.

In *Kosmar Villa Holidays plc v Trustees of Syndicate 1243*, a 17-year-old boy called James Evans dived into a swimming pool at the Marina Beach apartments in Corfu on 22 August 2002 and fractured his spine. Kosmar had exclusive use of the pool. As a result of the incident, Mr Evans became tetraplegic. Kosmar had a liability policy which required immediate notice of 'the occurrence of any injury' and similar notice of claims as conditions precedent to insurance cover. Notice of Mr Evans' injury – and of a claim by him – was given on 4 September 2003 (over a year later).

The insurer then notified Mr Evans' solicitors of its interest and asked for further and more up-to-date information. It wrote to Kosmar with 25 questions about Mr Evans and his claim and, shortly after that, wrote to Mr Evans' solicitors about facilities for inspection of the pool. All of the correspondence was without reservation of rights. On 30 September, the insurer wrote to Kosmar, asked for an explanation of the delay in notification and purported to reserve its rights.

The key question was whether the insurer could rely on the condition precedent and the late notice of the occurrence of injury. The answer was no, they couldn't, said Mr Justice Gross, giving judgment on 4 April this year. The law regarding election, he said, had been accurately summed up by Lord Goff in *The Kanchenjunga* (1996): "When a state of affairs comes into existence in which one party becomes entitled ... to exercise a right, he has to decide whether or not to do so. His decision, being a matter of choice for him, is called an election."

Mr Justice Gross went on to say that reliance by the other party is irrelevant. As at 4 September 2003, the insurer had sufficient knowledge of the facts to realise that there had been a failure to comply with the notice condition. It had, however, behaved in a manner that was inconsistent

with a rejection of the claim for indemnity under the policy. He discounted the argument that the insurer had not had 'a reasonable time' to make its decision.

Kosmar's claim for indemnity therefore succeeded but it is clear from the remarks of the judge that, had Euclidian reserved its position on or shortly after 4 September (and before it wrote its various letters), the court's view would have been different.

The reservation

What should an insurer do if it wants to reserve its position despite the commercial difficulties that may flow from that decision?

The reservation must be expressed in plain words. In *Hill v Citadel* (1996), a reinsurer made it plain, without using express words, that its position was reserved pending inquiries and the provision of information which had previously been promised. It was held that two particular sentences, written in these circumstances, could not be treated in isolation as amounting to affirmation. Merely expressing concerns about placing of the risk may not be enough to constitute reservation, either. The argument that, by taking particular steps, insurers were "*impliedly* reserving their rights [was] dismissed by the court, on the basis that every businessman knows how to reserve his rights".

Any letter recording a reservation of rights should reserve the position as regards all identifiable defences, as a failure to include potential defences may constitute a waiver of them. In *Vitol SA v Esso Australia Ltd* (1989), Lord Justice Mustill said that where rights are reserved in respect of one contention made by the claimant, but are not reserved in relation to another matter known to the insurer then this amounts to a tacit representation that the insurer will continue not to reserve its rights in relation to that second matter. Although initially a general reservation may be appropriate, specific issues should be highlighted by further reservations as soon as these can be identified. (for safety's sake, though, the general reservation should be maintained as well). When rights are reserved, the insurer must then take care to ensure that any subsequent conduct is not inconsistent with that reservation.

Consequently, if the insurer impliedly or expressly accepts the claim under the policy, the fact that it has also reserved its rights will not stop it from being treated as having waived its rights (see *Reid v Campbell Wallace Moule & Co Pty* (1990)). By contrast, a mere acceptance of the payment under the policy may not be inconsistent with the insured's reservation of rights (see *Barber v Imperio Reinsurance Co (UK) Ltd* (1996)).

Given this uncertainty, a prudent insurer should not accept payment of any premium under the policy if it has reserved its rights and, in most cases, the best course of action will be for the insurer to decide swiftly whether it wishes to remain on risk and act accordingly. If the insurer does decide to repudiate liability, the insurer should return the premiums (see *Simon Haynes Barlas and Island v Boubert* (1946)).

Where there has been an initial reservation (either generally or of particular rights) but things have to be dealt with pending a final conclusion, the wisest course is to repeat the reservation – with whatever variation is necessary – every time there is a need to do anything inconsistent with the rights reserved (see further *TSB Bank v Robert Irving & Burns* (1996)).

Naturally, an insured will want the insurer to waive as many of its rights as possible. However, if the insured attempts to manufacture a waiver, the court will react unfavourably. The best course that an insured can adopt is to pass on in writing all information relating to breaches of the policy, ensure that the information is communicated to the appropriate underwriter/claims manager and request the insurer to state its position in response. If the insurer fails to reserve its position or to repudiate liability within a reasonable time, the insured may then be able to argue that the insurer has waived its rights.

In the interests of both parties, the insurer should not wait until there is a claim before telling the insured that it thinks that there has been a breach of the insured's obligations. If at any time the insurer is uncertain of its position and decides to investigate, it should reserve its rights specifically if possible but otherwise it should reserve them generally. If the insurer is uncertain of its rights while investigating a claim, it can either reserve its rights or carry out any of the standard inquiries that are made in every case, whether or not the claim is actually met at the end of the day. There are three caveats to the above, though:

- The fact that the insurer has reserved its rights in one regard will not protect the insurer in relation to other rights, which may be treated as having been waived.
- Second, the courts have sometimes said that an insurer has waived its rights despite a prior reservation. Where an insurer acts wholly inconsistently with the reservation – for example, by calling for performance under their contract – the courts will be reluctant to allow the insurer the benefit of such inconsistency. They will be equally antipathetic towards an insurer that is trying to avoid the provisions of the contract in circumstances where it would be unmeritorious or impracticable for it to do so.
- On occasions, the courts have said that a waiver is a conclusion of law to be reached whenever the necessary facts are established. If this line is taken in a particular case, then, once the elements of a waiver are made out, the court will override an insurer's protestations to the contrary, as well as any purported reservation of rights.

All these approaches should be treated with caution. If an unequivocal representation is required to establish a waiver, the only way in which a reservation of rights will not protect the insurer is if the court concludes that, on the particular facts of the case, the reservation of rights is a sham, with the insurers intending it to have little or no effect. This will happen rarely. The third caveat is also limited in its practical impact because it is obviously correct that a waiver is a conclusion of law. As with all legal conclusions, it will necessarily be based on an individual set of facts.

Effects of silence

If an insurer has taken no action to affirm or repudiate the contract – and a reasonable time for a decision or a reservation of rights letter has elapsed – it risks being treated as having affirmed the contract.

Where an insurer delays its decision to such an extent that the rights of the insured are prejudiced, any entitlement to avoid or rely on a breach of condition is likely to be lost.

Consequently, an insurer facing circumstances that may entitle it to avoid or rely on a breach of condition should expressly reserve its rights, so that the insured cannot argue later that it was led to believe that there was cover.

Final advice

If an insurer can see a chink of weakness in the insured's case when staring down the barrel of a claim, then it should reserve its rights unless there is a compelling commercial reason not to do so. But if all it can see is the bullet, then it is better off resolving the claim as rapidly as possible.

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