Reservation of rights

Depending on where you sit in the market, reservation of rights may be regarded as a matter of best practice or a source of frustration

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Reservations of rights are typically issued by insurers on notification of a claim (especially when the scope of the notification is unclear); when there is a specific concern about coverage or misrepresentation/ non-disclosure; or when a contractual right has to be exercised (such as inspection). The rationale for their issue under English law is there is virtually no legal downside for the insurer and they reduce the risk of loss of coverage or avoidance rights through waiver by election or estoppel (affirmation).

Frustration at their receipt stems from the fact, in legal terms, the insured can do little but continue pursuing their claim. They can also be viewed by brokers and the insured as an aggressive act.

If a communication from the insured is unclear or vague, this will typically affect what the insurer could, in reality, waive. In *HLB Kidsons v Lloyds* [2007] the Court of Appeal examined a series of extremely "coy" updates to insurers concerning an accounting firm's promotion of tax avoidance schemes. *Kidsons* demonstrates, however, as a general proposition an insurer should not just sit back and ignore such communications. If an insurer is unclear about what is being notified or even if it is being notified of a claim or circumstance at all, it ought to question what has been received. In such circumstances, the insurer is often well advised to make expressly clear they are seeking this clarity, rather than simply responding with an open-ended reservation.

The courts have been careful to discourage insurers from automatically issuing reservations as a "knee-jerk" reaction to every notification or claim development. *Kosmar v Syndicate 1243* [2008] demonstrates how far an insurer can go in asking questions without committing a waiver.

In *Kosmar* the insurer corresponded with its insured concerning a personal injury claim for a month before issuing a reservation. Despite the insurer being immediately aware of the insured's failure to give notice of the injury more than 12 months before submitting the claim, the Court of Appeal held the insurer had not waived its right to rely upon a notice clause. This case demonstrates the extent of the reluctance of the courts to allow an insured to claim waiver on the basis of routine communication by an insurer with its insured.

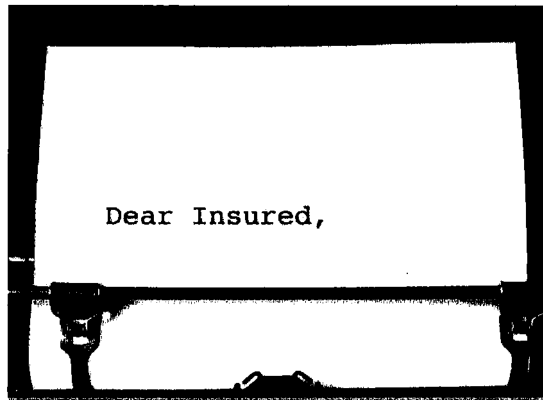
Where an insurer determines it does need to issue a reservation, there are a number of points that should be borne in mind. The first is reservation is definitely an area where there is absolutely no need to be expansive under English law. All the insurer really needs to say at the outset is it "reserves all its rights" and to refer back to that reservation in any subsequent communication.

There is no general requirement to give reasons and in many circumstances, where a reservation is required, the reason will be abundantly clear. To the extent an insurer wants expressly to give reasons, for the sake of good relations with the broker and insured, then again "less is more".

It is important if you go on in your reservation to make a specific reference to coverage that you also cover avoidance rights (which are strictly not matters of coverage). You should also not add a statement to your reservation that the insured should "act as a prudent uninsured".

Such a statement suggests for the future the insured does not need to comply with their obligations under the policy, which may include providing further information and documents helpful to the insurer.

Although extended delay on the part of an insurer could in theory give rise to a waiver, as a matter of practice there have been no recent cases where silence or inactivity has been held to amount to an affirmation. It is, obviously, however, not a matter of best practice for an insurer to extensively delay responding to the insured, to remain silent or to be inactive.



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When engaging in commutation discussions with their insured, insurers must be extremely careful to ensure a reservation is in place and being maintained with respect to any contentious claims issues of which the insurer has knowledge. A case such as *Barber v Imperio* [1993] demonstrates without such a reservation, any element of a global commutation payment that can be attributed to the claim in question will amount to the clearest possible affirmation of the policy.

In the subscription market, members of the following market may be dependent on the leader to issue a reservation on their behalf. By virtue of the Lloyd's Claims Scheme 2010, for risks incepting in the Lloyd's market after July 1, 2012, the managing agent of the lead and/or second syndicate is required to exercise a duty of reasonable care of a reasonably competent managing agent in performing such functions for the following market. This duty is backed by liability of the lead and/or second syndicate to the following market up to an annual limit of £2m ($3.2m) on any one claim and £10m in the annual aggregate.

In the company market, however, the existence of a duty of care by the leader toward the following market is more uncertain. The general underwriter agreement says nothing about a duty of care being owed. While there have been a number of cases in which the courts have suggested such a general duty of care may exist, there has not been any definitive determination of the issue.

Reservation of rights is a useful tool for the insurer to protect itself against the risk of loss of coverage or avoidance rights. It is not, however, a complete substitute for clear and effective communication with brokers and the insured.