



# Case Alert

## South Carolina Supreme Court Requires Transparency by Rejecting an Insurer’s “Cut-and-Paste” Reservation of Rights

In a decision rendered on January 11, 2017, the Supreme Court of South Carolina reminded policyholders that they are entitled to an explanation of any and all grounds upon which their insurer may be contesting coverage in a reservation of rights letter. Specifically, in *Harleysville Group Insurance v. Heritage Communities, Inc. et al.*,<sup>1</sup> the court found that an insurer’s reservation of rights, which included a verbatim recitation of numerous policy provisions that the court identified as the “cut-and-paste” method, was insufficient to reserve its rights to contest coverage.

In 2003, Heritage Communities, Inc. (“Heritage”), a parent company of several corporate entities engaged in developing and constructing condominium complexes from 1997 to 2000, was sued by multiple property owners’ associations. The lawsuits sought actual and punitive damages against Heritage as a result of alleged construction defects, including building code violations, structural deficiencies, and significant water intrusion. During the period of construction, Heritage was insured by Harleysville Group Insurance (“Harleysville”) under several primary and excess general liability insurance policies.

Upon notice of these lawsuits, Harleysville agreed to provide Heritage with a defense under a reservation of rights. Significantly, as the court described, the reservation of rights letter merely included “generic statements of potential non-coverage coupled with furnishing most of the Heritage entities with copies (through a cut-and paste method) of the insurance policies.”<sup>2</sup> In relevant part, one of the disputed reservation of rights letters stated:

[Harleysville] continues to reserve its rights

as set forth in its prior reservation of rights, and as set forth herein, including but not limited to the following issues:

- 1) Whether property damage or bodily injury was caused by an occurrence ...;
- 2) Whether notice was provided to [Harleysville] in compliance with the notice provision of the policy or policies;
- 3) Whether the cooperation clause of any policy or policies has been complied with;
- 4) Whether the applicable limits of any and all applicable primary and excess policies of insurance have, in fact, been exhausted;
- 5) Whether or not any exclusion applies to preclude coverage under any policy or policies; and,
- 6) Any additional coverage defense which may arise during the investigation of the matter.

In addition to the foregoing language, the reservation incorporated a ten-page excerpt of various policy terms, including provisions relating to the insuring agreement, Harleysville’s duty to defend and numerous policy exclusions and definitions.

The underlying lawsuits against Heritage proceed to trial and, ultimately, the property owners’ associations were awarded actual damages of \$6.5 million and \$4.25 million. Following the general jury verdicts, Harleysville filed a declaratory judgment action against Heritage seeking a determination as to

what portion of the judgments were covered under the policies.

A majority of the South Carolina Supreme Court determined that Heritage was entitled to coverage for the damages because Harleysville did not sufficiently reserve its right to contest coverage. The majority opinion noted that a reservation of rights is intended to benefit the policyholder by alerting them of the potential defenses to coverage so that the policyholder may take steps to protect any uninsured interests. Accordingly, the court reasoned that in order for a reservation of rights to be effective, it must be unambiguous and must specify in detail all bases upon which the insurer might contest coverage in the future.

The court found that Harleysville's reservations of rights letters did not accomplish the foregoing objectives because they failed to: 1) adequately notify Heritage of the particular grounds upon which Harleysville might dispute coverage; 2) advise of the need to allocate damages between covered and non-covered losses; and 3) inform the insureds that Harleysville would seek a declaratory judgment if there were adverse jury verdicts. Accordingly, the reservation was insufficient to reserve Harleysville's right to contest coverage after damages were awarded against Heritage.

In a dissenting opinion, one Justice reached the opposite conclusion, finding that Harleysville's reservations of rights did adequately place the policyholder on notice. The opinion reasoned that the reservations of rights letters, and the ensuing conversations, took place between sophisticated commercial entities. As a result, the dissent argued that the specificity required by the majority opinion was unwarranted.

This decision is important because it critiques a common practice amongst insurers: copying and pasting large swaths of policy language into a reservation of rights letter with little-to-no analysis of how the quoted language might impact the insured's coverage. Curiously, the reservation of rights at issue in

this case did include some indication of how the language applies; nevertheless, the court found that the explanation was insufficient. In particular, the reservation of rights did not address the potential need to allocate damages between covered and non-covered losses, and, therefore, the court found that it would be unreasonable to do so after a general verdict had been awarded. Ultimately, the majority's opinion is a welcome reminder that both commercial and individual policyholders are entitled to transparency when dealing with their insurance carrier in the event of a loss.

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1. No. 2013-001281, 2017 WL 105021 (S.C. Jan. 11, 2017).
2. *Id.* at \*2.