

INSURERS MAY BE PREVENTED FROM
RAISING COVERAGE DEFENSES

Under Indiana law an insurer may be estoppel from asserting coverage defenses where it fails to timely serve a notice of reservation of rights, misrepresents the extent of coverage, or fails to deal with the insured in good faith.

First, it is well established that, an insurer may be estopped from raising available coverage defenses where it defends without a reservation of rights and later denies coverage. In *Transcontinental Ins. Co. v. J.L. Manta, Inc.*, 714 N.E.2d 1277 (Ind. Ct. App. 1999), the insured was estopped from denying coverage where it defended its insured without a reservation of rights, discovered facts that would have allowed it to raise a policy defense, but failed to rely upon such facts to deny coverage for over a year, while controlling the defense the entire time.

Second, the *Transcontinental Court* further noted that the doctrines of estoppel and implied waiver may be invoked to extend the scope of an insurance contract, where an insurer misrepresents the extent of coverage to an insured, thereby inducing the insured to purchase coverage which does not in fact cover the disputed risk.

Third, in *Employers Ins. of Wausau v. Recticel Foam Corp.*, 716 N.E.2d 1015 (Ind. Ct. App. 1999), the court noted that an insurer must deal with its insured in good faith and may lose coverage defenses by failing to do so. *Recticel Foam* cited four criteria to consider when determining whether an insurer has acted in good faith as to its insured when defending subject to a reservation of rights:

First, the company must thoroughly investigate the cause of the insured's accident and the nature and severity of the plaintiff's injuries. Second, it must retain competent defense counsel for the insured. Both retained counsel and the insurer must understand that only the insured is the client. Third, the company has the responsibility for fully informing the insured not only of the reservation-of-rights defense itself, but of all developments relevant to his policy coverage and the progress of the lawsuit....Finally, an insurance company must refrain from engaging in any action which would demonstrate a greater concern for the insurer's monetary interest than for the insured's financial risk.

Id. at 1029, n. 17 (citing *Tank v. State Farm Fire & Cas. Co.*, 715 P.2d 1133, 1137 (1986)).

Furthermore, in *American Fire & Cas. Co. v. Roller*, 2007 WL 1139422 (Ind. Ct. App. 2007), the court relying upon the four criteria cited by *Recticel Foam*, determined that an insurer could be estopped from asserting a policy defense to coverage where it defended its insured but did not act in good faith in handling the defense of the injured party's claim.

Roller was a construction defect case where a builder was sued by a home buyer for construction defects. The builder's insurer defended subject to a reservation of rights and sought a declaration in federal court that certain damages were not covered by the builder's CGL policy. The plaintiff consolidated the federal court declaratory judgment action with the state court liability lawsuit and the two were prosecuted as one suit in state court. The insured and the tort plaintiff both asserted that the insurer should be estopped from relying upon coverage defenses to deny full indemnification based on the following conduct by the insurer: 1) the insurer delayed in notifying the insured of possible coverage defenses; 2) the insurer failed to notify other potentially liable non-parties of the lawsuit against its insured; 3) the insurer conducted the defense of the insured "on the cheap", postponing necessary but expensive steps in the defense; 4) the insurer refused to hire a necessary construction expert; and 5) the insurer provided an inadequate defense by employing an attorney operating under a "crushing conflict of interest."

Roller set forth the Indiana standard pertaining to an insurer's duty of good faith in dealing with its insured while defending pursuant to a reservation of rights, and succinctly stated the standard:

Indiana law has long recognized that there is a legal duty implied in all insurance contracts that the insurer deal in good faith with its insured." *Erie Ins. Co. v. Hickman by Smith*, 622 N.E.2d 515, 518 (Ind.1993). Thus, when an insurer undertakes to defend its insured under a reservation of rights, it must proceed in good faith. *See Recticel Foam*, 716 N.E.2d at 1029 (citing *Tank v. State Farm Fire & Cas. Co.*, 105 Wash.2d 381, 715 P.2d 1133, 1137 (1986)). "A reservation of rights agreement is not a license for an insurer to conduct the defense of an action in a manner other than the manner in which it would normally be required to defend. The basic obligations of the insurer to the insured remain in effect." *Tank*, 715 P.2d at 1137.

Id. at *5. The court noted that the counsel retained by the insurer to defend the insured was in a conflict of interest due to the fact that the coverage action was consolidated with the liability action against the insured and the defense counsel could not realistically, and did not actually, represent the insured against the insurer with respect to coverage issues. *Id.* at *9. *Id.* at *2. The insured and the third party argued that the insurer's bad faith conduct towards its insured required that the court recognize a third exception to the general rule against estoppel creating coverage. The court determined that, due to the alleged conduct by the insurer, a question of fact existed as to whether the insurer should be estopped from denying coverage, thus potentially recognizing the third exception to the general rule against expansion of coverage.

Thus, pursuant to the guidelines articulated in *Transcontinental* and *Roller*, it is imperative for insurers to promptly provide the insured with a detailed and meaningful reservation of rights, retain competent defense counsel, afford defense counsel with the

freedom to aggressively defend the tort case, file a declaratory judgment action to ascertain the extent of coverage, and, lastly, keep the tort action separate from the coverage action.