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LIABILITY INSURANCE:
RESERVATION OF RIGHTS, INTERVENTION, AND DECLARATORY JUDGMENTS

Liability insurance policies describe two duties on the part of a liability insurer: the duty to defend a suit against an insured and the duty to indemnify an insured when there is an obligation to pay damages. These duties are spelled out in the liability policy in language similar to the following: "we will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. We will have the right and duty to defend the insured against any "suit"seeking those damages."[1]

When notified of a suit against its insured, the insurance company must decide whether to defend the insured or not. In Alabama, as in most states, the duty to defend is broader than the duty to indemnify. Ladner & Co. v. Southern Guaranty Ins. Co., 347 So.2d 100, 102 (Ala. 1977). In other words, a complaint could contain sufficient allegations to trigger a duty to defend when the same complaint, with the

same allegations, would not trigger a duty to indemnify upon entry of a judgment against the insured in the same case. An insurer's duty to defend is broader than its duty to indemnify because the decision as whether to provide a defense must be made at a preliminary stage in proceedings. Burnham Shoes v. W. Am. Ins., 504 So.2d 238 (Ala. 1987).

Alabama law provides that an insurer is to determine whether there is a duty to defend its insured by comparing the policy language to the allegations of the complaint. USF&G v. Armstrong, 479 So.2d 1164 (Ala. 1985); Universal Underwriters v. Stokes Chevrolet, Inc., 990 F.2d 598 (11th Cir., 1993). "Whether an insurance company owes a duty to provide an insured with a defense to proceedings instituted against him must be determined primarily from the allegations of the complaint." Armstrong, 479 So.2d at 1167 (citing Ladner, 347 So.2d at 102 (Ala.1977)). If the injured party's complaint alleges an accident or occurrence which comes within the coverage of the policy, the insurer is obligated to defend, regardless of the ultimate liability of the insured. Ladner, 347 So.2d at 102. If the complaint suggests that the injury alleged may not be within the coverage of the policy, then other facts outside the complaint may be taken into consideration. Ladner, 347 So.2d at 103.

It occasionally happens that a complaint clearly and completely describes allegations which trigger a duty to defend and a duty to indemnify the insured. It also happens that a complaint contains allegations which do not create any duty to

defend or indemnify an insured. More often, a complaint contains some counts or allegations which could trigger coverage and others counts or allegations which do not. The issue can be further complicated by vague and ambiguous statements in the complaint which cannot clearly be said to allege coverage or fail to allege coverage. It is these complaints which present difficult questions for an insurance company. Alabama law provides a mechanism by which these complaints can be handled: a reservation of rights defense combined with (1) intervention in the liability case for the purpose of proposing special verdict forms and (2) the filing of a declaratory judgment suit.

A reservation of rights defense allows the insurer to comply with its obligation to defend, but not waive its right to withdraw that defense at a later date, nor waive its ability to deny a duty to indemnify any judgment against the insured. It is typically employed where some, but not all, of the allegations create a duty to defend or when the complaint is so vague and ambiguous that one cannot tell if there is a duty to defend or not.

To defend under a reservation of rights, an insurer sends the insured a "Reservation of Rights" letter which sets out those coverage issues known to the insurer which might preclude coverage for the claim. The timing of the letter can be important. Usually, the best practice is to send this letter before the defense is undertaken. Under certain circumstances, undertaking to defend the insured without a reservation of rights can preclude the insurer from later withdrawing the defense or

denying the duty to indemnify. See, Moordian v. Canal Ins. Co., 272 Ala. 373 (Ala. 1993); Liberty Mutual Fire Ins. Co. v. Parish, 630 So.2d 437 (Ala. 1993); Home Ins. Co. v. Rice, 585 So.2d 859 (Ala. 1991); Shelby Steel Fabricators, Inc. v. U.S.F.&G., 569 So.2d 309 (Ala. 1990); Burnham Shoes, Inc. v. West Alabama Ins. Co., 504 So.2d 238 (Ala. 1989); Campbell Piping Contractors, Inc. v. Hess Pipeline Co., 342 So.2d 766 (Ala. 1977); Integrity Ins. v. King Kutter, Inc., 866 F.2d 408 (11th Cir. 1989) certified and withdrawn, 596 So.2d 55 (Ala. 1990).

Once a reservation of rights letter is issued and the case is being defended, the insurer has two additional steps which it should consider filing a motion to intervene under A.R.C.P. 24(b) and, if needed, a declaratory judgment action. Alabama law permits an insurer to "permissively" intervene in an action against its insured where there are coverage issues related to that liability case. Universal Underwriters v. East Central Alabama Ford- Mercury, 574 So.2d 716 (Ala. 1991).

There are several variations which this intervention can take. The process outlined in the majority opinion of Universal Underwriters envisions the insurer intervening, participating in discovery, there being a trial of the liability issues without the participation of the insurer, and then a trial of the coverage issues before the same jury. Universal Underwriters, 574 So.2d at 723-724. This is not the exclusive, nor usually the fairest, method of obtaining a decision on the coverage issues. The problem with the Universal Underwriters format is that it requires the insurer to try the coverage issues to the same jury that has just rendered a verdict

against the insured. Under Universal Underwriters, the jury which has just decided that the plaintiff should recover money damages against the insured is then asked to decide whether an insurance policy should fund that judgement. The outcome under such circumstances is often a foregone conclusion.

A second variation of the intervention procedure is to intervene solely for the purpose of requesting a special verdict form or interrogatories to the jury under A.R.C.P. 49. This option was endorsed by Justice Jones in his dissent to Universal Underwriters. The use of a special verdict form or interrogatories allows an insurer to unobtrusively obtain relevant coverage information from the liability jury. These are fact finding tools. Most commonly, their use allows the insurer to determine upon which count(s) a verdict is rendered against the insured, when the complaint contains multiple counts. The special verdict form and interrogatories are also effectively used when the complaint alleges many different types of damages, only some of which are covered under the policy. The verdict form or interrogatories allow the insurer to determine whether and to what extent it has a duty to indemnify the insured for the damages awarded by the judgment.

It is often assumed that the verdict forms or interrogatories benefit only the insurer. That is not the case as was noted by Justice Jones in his Universal Underwriters dissent. Both the insured and the insurer have an interest in obtaining this information. Under Alabama law, an insured has the burden of proving a verdict against him falls within the insuring provisions of a policy. Alabama Hospital

Association Trust v. Mutual Assurance Society of Alabama, 538 So. 1209 (Ala. 1989); Bankers Fire & Marine Ins. Co. v. Contractors Equipment Rental Co., 276 Ala. 80 (1963). If only a general verdict form is used, one cannot determine whether the verdict was based on a covered count or a non- covered count and one cannot determine if the damages awarded were for insured damages, such as bodily injury, or for damages which are not insured. Under such a circumstance, the insured cannot carry its burden to prove coverage.

The insurer has a similar burden with respect to proving the application of an exclusion (once the insured has established that the claim falls within the insuring provisions of the policy). An insurer has the burden of proving the application of an exclusion to a verdict. Fleming v. Alabama Farm Bureau Mut. Cas. Ins. Co., 293 Ala. 719, 722 (Ala. 1975). If the insurer is unable to do so, as would occur with a general verdict, the insurer has a duty to indemnify the insured. It is rare that a case does not involve issues related to both the insuring provisions and the exclusionary provisions. Thus, all interested parties benefit from this process, including the plaintiff in the underlying case who wants to collect his judgment from insurance policy proceeds, rather than from execution on property or garnishing wages.

Once the insurer has the information needed from the jury regarding the verdict against its insured, it must decide whether there is a duty to indemnify. Under certain circumstances, this decision can be made by comparing the policy provisions to the verdict form or interrogatory answers. For example, where there is an

allegations of negligence causing bodily injury, among other non-covered counts and other non-covered damages, a general liability insurer can determine that its occurrence-based policy applies to the verdict to the extent of the award for bodily injury resulting from negligence.

Under other circumstances, having the information from the liability jury as to the basis for its award provides only half of the equation because there are also coverage questions as to the counts alleged. Where that is the case, the insurer can seek a judicial determination of the coverage issues. This can be done in the Universal Underwriters fashion, though the insurer should seek separate juries, or it can be done by way of a separate declaratory judgment action. A separate declaratory judgment action can be filed in state or federal court (assuming there is federal jurisdiction). Alabama's statutory provisions for filing a declaratory judgment are found at Ala. Code §6-6-220 through §6-6- 232 with a complementary procedural rule found at A.R.C.P. 57. The relevant federal provisions for declaratory judgments are 28 U.S.C.A. 2201 and 2202, F.R.C.P. 57, and 28 U.S.C.A. 1322.

One benefit to the separate declaratory judgment action is that it allows the insurer to obtain a decision as to the duty to defend while that defense is being provided. Under the Universal Underwriters scenario, the coverage decision as to the duty to defend would be moot because the defense had already been provided. It is occasionally argued that an insurer who intervenes for special verdict forms or interrogatories and also files a declaratory judgment action is pursuing the same

course of action in two different courts. That is not the case. Rather, the intervention serves to obtain factual information from the liability jury which information can then be used to determine the rights and duties under the policy as declared by the court hearing the declaratory judgment action. When viewed in this fashion, the intervention/declaratory judgment course of action provides to all interested parties an efficient, non-prejudicial, mechanism for determining the rights and obligations under the insurance contract with respect to a specific suit against the insured.

QUESTIONS?
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