Waving Goodbye to Coverage Defenses: Litigating the Effect of Denial Letters

Seth M. Friedman¹
Weissman, Nowack, Curry & Wilco
Atlanta, Georgia

Christopher C. Meeks
Weissman, Nowack, Curry & Wilco
Atlanta, Georgia

¹ Seth M. Friedman is partner and Christopher C. Meeks is an associate at the law firm of Weissman, Nowack, Curry and Wilco, P.C., located at 3500 Lenox Road, Atlanta, GA 30326. Email: sethf@wncwlaw.com; chrism@wncwlaw.com
I. Introduction

When presented with a pre-suit claim or request for defense coverage, an insurer generally has three options: defend, deny coverage and refuse to defend, or defend under a reservation of rights and seek a declaratory judgment, if necessary. Each option has its own set of consequences for the insured and the insurer, and a decision as to which option to pursue should be thoroughly considered prior to taking any action. Unfortunately, though, information at the outset of a claim is often limited, making the decision of whether to reserve rights and defend or deny all the more perilous. An overly conservative approach favoring a defense under a reservation of rights will ultimately lead to defending uncovered or excluded claims at a much higher rate and, thus, expending defense dollars and company resources unnecessarily. Conversely, an overly-cavalier approach favoring the denial of questionable claims could also lead to additional litigation against the insurer and, in some states, extra-contractual liability, if the insurer is found to have wrongfully denied coverage. See Flannery v. Allstate Ins. Co., 49 F. Supp. 2d 1223, 1227 (D. Colo. 1999) (citing cases setting forth differing treatments for insurers that wrongfully deny coverage).

While risks exist with either course of action, sometimes a denial is appropriate. In many instances, an insurer’s decision to deny must be made quickly so that it can advise an insured to seek their own counsel to respond to or answer a claim or suit. Accordingly, an insurer intent on denying coverage for a particular claim can only include in its declination letter those grounds that it is aware of or that it believes are applicable at the time the decision to decline is made. However, additional grounds supporting a denial are often discovered after sending the declination letter, including new grounds based on the insuring agreement, exclusions, or conditions that may not have been apparent originally. Therefore, because new defenses can frequently come to an insurer’s attention post-denial, insurers often reserve their rights to raise new or additional grounds for a denial along with the stated grounds for the denial.
Generally, such reservation of rights are the accepted method for an insurer to decline coverage while avoiding any subsequent argument that the insurer waived any grounds for denial not stated in the declination letter. Allan D. Windt, 1 Ins. Claims & Disputes § 2:25 n.2 (6th ed.) However, a recent decision from the Supreme Court of Georgia specifically disapproved of this practice. The following explores the state of the law concerning denials of coverage and the recent expansion of waiver in Georgia and highlights the issues posed by such broad rules concerning waiver.

II. Waiver and Denials.

“A waiver is the intentional relinquishment of a known right.” 1 Ins. Claims & Disputes § 2:25. Waiver becomes an issue with regard to denial letters when an insurer refuses to defend a claim on certain grounds but does not assert other potentially applicable grounds until a later date. Id. How those unasserted grounds are treated can vary from by state, depending on how strictly an insured is required to show an insurer’s intent to waive, with most states requiring insureds to show evidence of some express or implied intent to waive. Additionally, most states recognize a difference between grounds based on the terms of the insuring agreement and exclusions (“coverage” grounds) and a policy’s warranties and conditions (“technical” or “forfeiture” grounds). See Enoka v. AIG Haw. Ins. Co., 128 P.3d 850, 867-68 (Haw. 2006); Potesta v. U.S. Fid. & Guar. Co., 504 S.E.2d 135, 147, 149-50 (W.Va. 1998). In the vast majority of states, insurers cannot waive “coverage” grounds in a denial letter; however, some states allow insurers to waive “technical” or “forfeiture” grounds under various circumstances.

One of the seminal cases in this area of law is Waller v. Truck Insurance Exchange, Inc., 900 P.2d 619, 636 (Cal. 1995), where the California Supreme Court held that, in order for a party to show that an insurer waived grounds not asserted in a denial letter, the party must show by clear and convincing evidence that the insurer evidenced an express or implied intent, either through words or actions, to relinquish its rights under the policy. In other words, intent to waive is not evidenced by the insurer’s failure to raise a policy defense in a declination letter. Id.

Although the Waller court did not engage in a thorough survey of each state’s jurisprudence on waiver, the court noted that, of the thirty-three (33) states which had considered the issue at the

The Waller court did not discuss if there was any distinction between policy defenses based on “coverage” grounds versus “technical” or “forfeiture” grounds. Id. However, other cases have made the distinction in a manner consistent with “the California rule,” holding that an insurer can waive “technical” or “forfeiture” grounds, but not “coverage” grounds, by implied waiver through conduct that warrants an inference of intent to relinquish a known right. See Enoka, 128 P.3d at 868 (citing Creveling v. Gov’t Employees Ins. Co., 828 A.2d 229 (Md. Ct. App. 2003); Utica Mut. Ins. Co. v. Klein & Son, Inc., 460 N.W.2d 763, 767 (Wis. Ct. App. 2006); Potesta, 504 S.E.2d at 147, 149-50 (citing Best Place v. Penn Am. Ins. Co., 920 P.2d 334 (Haw. 1996); U.S. Fire Ins. Co. v. Fleekop, 682 So. 2d 620 (Fla. Dist. Ct. App. 1996); Albert J. Schiff Assocs., Inc., 417 N.E.2d 84).

Under this rule, an insurer does not automatically waive a defense simply because it does not mention it in a declination letter, and an insurer can protect itself from waiver by specifically disclaiming any intent to waive and reserving the right to assert additional defenses at a later date. 1 Ins. Claims & Disputes § 2:25 n.2 (citing Universal Fire & Cas. Ins. Co. v. Jabin, 16 F.3d 1465, 1470 (7th Cir. 1994); Nat’l Tea Co. v. Commerce & Indus. Ins. Co., 456 N.E.2d 206, 213–14 (Ill. App. 1st Dist. 1983); Allied Steel Const. Co. v. Employers Cas. Co., 422 F.2d 1369, 1371 (10th Cir. 1970); Stargatt v. Avenell, 434 F. Supp. 234, 245-46 (D. Del. 1977); Tibbs v. Great Cent. Ins. Co., 373 N.E.2d 492, 493 (Ill. App. 5th Dist. 1978); Roberts v. Jersey Ins. Co. of N.Y., 457 S.W.2d 244, 248 (Mo. Ct. App. 1970); Havas v. Atlantic Ins. Co., 614 P.2d 1, 2 (Nev. 1980)). This rule represents the majority position. Enoka, 128 P.3d at 868; Creveling, 828 A.2d 229, 243-44 (citing cases); Potesta, 504 S.E.2d at 146-47 (citing cases); W.C. Crais, III, Annotation, Comment Note: Doctrine Of Estoppel Or Waiver As Available To Bring Within

Several other states, including Michigan and Alabama, have adopted a narrower rule that protects “coverage” grounds from waiver but automatically finds waiver of any “technical” of “forfeiture” grounds that are not set forth in a denial letter. See Lee v. Evergreen Regency Co-op. & Mgmt. Sys., Inc., 390 N.W.2d 183, 185 (Mich. Ct. App. 1986) (“once an insurance company has denied coverage to an insured and stated its defenses, the company has waived or is estopped from raising new defenses.” (citing Smith v. Grange Mut. Fire Ins. Co. of Mich., 208 N.W. 145 (Mich. 1926); Castner v. The Farmers Mut. Fire Ins. Co. of Van Buren County, 15 N.W. 452 (Mich. 1883); 1 A.L.R.3d 1139)); Home Indem. Co. v. Reed Equip. Co., Inc., 381 So. 2d 45, 50 (Ala. 1980) (“Where an insurer specifically disclaims liability because of one ground of forfeiture, it waives all other grounds of forfeiture which might have been stated but were not. [Cit.] Similarly, an insurer who disclaims liability solely on a theory of noncoverage thereby waives his defenses with respect to any grounds of forfeiture which might have been raised.” (citing St. Paul Fire & Marine Ins. Co. v. Smith, 194 So.2d 830 (Ala. 1967); Auto-Owners Ins. Co. v. English, 94 So.2d 397 (Ala. 1957))).

However, other states also permit the waiver of “coverage” grounds. See also Tate v. Charles Aguillard Ins. & Real Estate, Inc., 508 So. 2d 1371, 1375 (La. 1987) (requiring intent to waive but holding “that waiver may apply to any provision of an insurance contract . . . even though the effect may bring within coverage risks originally exclude or not covered.”); Armstrong v. Hanover Ins. Co., 289 A.2d 669 (Vt. 1972) (insurer waived right to assert any policy defenses when it raised a single defense in its denial letter but did not reserve its right to raise new defenses). For example, New York has enacted a statutory scheme for the issuance of denial letters that applies where a policy was issued or delivered in New York, the accident took place in New York, and the claim involves bodily injury or wrongful death. N.Y. Ins. Law § 3420(d)(2). This statute requires insurers to issue a disclaimer letter “as soon as reasonably possible,” and an insurer’s failure to raise a condition or exclusion as a ground for disclaimer waives the insurer’s

A related issue concerns when an insurer’s decision to decline defense coverage is incorrect. Consistent with the majority rule and the minority rule discussed supra, most states have found that an insurer that breaches the duty to defend retains the right to contest indemnity coverage. Flannery, 49 F. Supp. 2d at 1227-28 (citing cases and identifying Georgia, Wisconsin, Florida, Texas, New Mexico, Kansas, Hawaii, Massachusetts, Indiana, North Dakota, Minnesota, Alabama, Kentucky, California, New York, Idaho, and Maryland as allowing insurers to contest indemnity coverage even after an incorrect denial of defense coverage). However, a minority of states, including Washington, North Carolina, Mississippi, Illinois, Alaska, Connecticut, and Rhode Island, hold that insurers which breach the duty to defend are precluded from raising coverage defenses for the duty to indemnify. Id. (citing cases).

Therefore, the decision to deny should be guided by considerations of whether the insurer will be allowed to subsequently raise additional grounds for the denial, if the grounds are incorrect, whether the insurer will be able to assert defenses as to the duty to indemnify.

III. The Expansion of Waiver for Denials under Georgia Law.

In Hoover v. Maxum Indemnity Co., 730 S.E.2d 413 (Ga. 2012), the Georgia Supreme Court reached a landmark decision that significantly rewrote Georgia law concerning waiver of policy defenses in denial letters and created new risks for insurers that decide to deny claims. At issue in Hoover were the claims of an employee (Hoover) of Maxum’s insured (EWES) who was injured while assisting an independent contractor at a job site. Id. at 415. Following the accident, Hoover’s stepfather asserted that he notified Maxum of the accident within a week; however, Maxum claimed that its first notice of the accident did not come until it received a copy of Hoover’s personal injury lawsuit against EWES two years later. Id. If Maxum’s claim was true, the two year delay in receiving notice of the accident would have constituted late notice as a matter of law. See Bituminous Cas. Corp. v. J.B. Forrest & Sons, Inc., 209 S.E.2d 6 (Ga. Ct. App. 1974) (four month delay unreasonable as a matter of law). However, when Maxum disclaimed
coverage under the policy four days later, the only ground asserted for the denial was the policy’s Employers’ Liability Exclusion. 730 S.E.2d at 415-16.

Consistent with the safeguards discussed under the majority rule supra, the denial letter also contained a section reserving Maxum’s right to assert other defenses, including late notice, and advising that:

Maxum’s specific enumeration of the above policy defense is not intended as a waiver of any other policy defenses that Maxum may have or that may arise from facts discovered in the future nor should Maxum be estopped from raising additional coverage defenses. Maxum also continues to reserve the right to raise any other coverage defenses, including the right to disclaim coverage on any other basis that may become apparent as this matter progresses and as Maxum obtains additional information.

Id. at 416.

Subsequently, three lawsuits developed from Maxum’s denial: a declaratory judgment action filed by Maxum, which was later dismissed; a third-party suit by EWES in Hoover’s personal injury lawsuit; and a suit by Hoover to collect his judgment against EWES from Maxum. Id. As with the denial letter, Maxum’s complaint in the declaratory judgment action only raised the Employers Liability Exclusion as a ground for denying coverage; however, Maxum’s answers in the other two suits both asserted late notice as a defense. Id. In the suit filed by Hoover, Maxum and Hoover filed cross motions for summary judgment. Hoover v. Maxum Indem. Co., 712 S.E.2d 661, 663 (Ga. Ct. App. 2011). The trial court granted both motions, finding that Maxum breached its duty to defend EWES but did not breach the duty to indemnify because notice was untimely as a matter of law. Id. Both Hoover and Maxum appealed the trial court’s ruling.

The Georgia Court of Appeals affirmed the grant of summary judgment to Maxum and reversed the grant of summary judgment to Hoover, finding that the breach of the policy’s notice condition relieved Maxum of any obligation it may have had to defend or indemnify EWES in the underlying lawsuit. Id. at 664-66. Hoover argued that Maxum waived the late notice defense by failing to include it in the denial letter; however, the Court of Appeals rejected this argument, holding that there was no evidence to establish a waiver under Georgia law, which, at the time,

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required a showing that an insurer “expressly or impliedly took a position indicative of its intent
not to enforce satisfaction of the timely notice requirement.” Id. at 666 (citing Brazil v. Gov’t
Employees Ins. Co., 404 S.E.2d 807 (Ga. Ct. App. 1991)). The Court of Appeals credited the
reservation of rights language in the denial letter, including the mention of the late notice defense,
as “establish[ing] that Maxum did not expressly or impliedly waive the notice defense.” Id.
(citing Kay-Lex Co. v. Essex Ins. Co., 649 S.E.2d 602 (Ga. Ct. App. 2007); Brazil, 404 S.E.2d
807). At the time, the Court of Appeals’ decision in Hoover was consistent with the majority rule.
Compare id. with Waller, 900 P.2d at 636.

The Georgia Supreme Court’s decision in Hoover removed Georgia from the states that adhere to
the majority position in favor of a rule that strictly construes denial letters against insurers,
regardless of any actual or implied intent. 730 S.E.2d at 416-18. Key to the Supreme Court’s
decision is its drawing of a strict dichotomy between “denials” and “reservation of rights.” Id. at
416. Relying on an insurer’s three options in responding to a claim discussed supra, the Supreme
Court found that Maxum’s reservation of rights to raise new grounds, such as late notice, was
ineffective because “an insurer cannot both deny a claim outright and attempt to reserve the right
to assert a different defense in the future.” Id. (citing Browder v. Aetna Life Ins. Co., 190 S.E.2d
110 (Ga. Ct. App. 1972); Morgan v. Guar. Nat’l Ins. Co., 489 S.E.2d 803) In other words, the
Supreme Court’s decision in Hoover specifically limited “reservation of rights” to situations
where an insurer undertakes a defense. Id. (“a reservation of rights is only available to an insurer
who undertakes a defense while questions remain about the validity of the coverage.”).

In the Supreme Court’s view, the “proper and safe course of action” is for an insurer to address
questionable claims by entering into a defense under a reservation of rights and then seek a
declaratory judgment. Id. at 417 (quoting Richmond v. Ga. Farm Bureau Mut. Ins. Co., 231
S.E.2d 245 (1976)). That way, the insured will receive a defense while the insurer retains the right
to deny coverage pending its investigation. Id. Under a denial, however, the Court held that
“[o]nce the claim has been denied, the matter would not progress and Maxum would have no
need to obtain additional information unless it was later served with a third-party complaint with
regard to coverage.” Id. Thus, once an insurer makes the decision to deny, that decision forever
fixes the grounds for the denial, regardless of what new or additional information may become available to the insured. Id.

*Hoover* places Georgia closer in line with states such as Michigan and Alabama that automatically waive “technical” or “forfeiture” grounds that are not raised in an insured’s denial letter. Compare *id. with Lee*, 390 N.W.2d at 185; *Home Indem. Co.*, 381 So. 2d at 50. *Hoover* recognized that “technical” and “forfeiture” grounds are not favored under Georgia law and that “courts infer waiver of non-essential parts of an insurance contract that are penal in nature.” 730 S.E.2d at 418 (citing *James v. Pa. Gen. Ins. Co.*, 306 S.E.2d 422 (Ga. Ct. App. 1983); *N.Y. Underwriters Ins. Co. v. Noles*, 115 S.E.2d 474 (Ga. Ct. App. 1960)). As with most other states, such “non-essential parts” do not include items such as the insuring agreement or exclusions, but the Georgia Supreme Court has not completely ruled out the possibility that certain “coverage” grounds could be waived. *Prescott’s Altama Datsun, Inc. v. Monarch Ins. Co. of Ohio*, 319 S.E.2d 445, 446-47 (Ga. 1984).

Further, it appears that *Hoover* is limited to questions of waiver relating to the duty to defend. *Bank of Camilla v. St. Paul Mercury Ins. Co.*, 939 F. Supp. 2d 1299, 1305 (N.D. Ga. 2013) (*Hoover* did not apply to policy which only provides a duty to pay costs, i.e., indemnify). However, at least one federal court has held that *Hoover* applies to both the duty to defend and the duty to indemnify, magnifying the potential effect a waiver may have on an insurer’s liability, even if limited to “technical” or “forfeiture” grounds. *Latex Const. Co. v. Everest Nat’l Ins. Co.*, 11 F. Supp. 3d 1193, 1204-05 (N.D. Ga. 2014).

The dissenting justices rejected the majority’s conclusion that Georgia law does not permit insurers to “both deny a claim outright and reserve the right to assert a different defense in the future,” finding it inconsistent with then-existing Georgia law and the majority of other states that have adopted the majority rule. 730 S.E.2d at 419-20 (citing *Sahan v. Sahan*, 988 S.W.2d 529, 534 (Mo. 1999); *Waller*, 900 P.2d at 636; *Guberman v. William Penn Life Ins. Co. of N.Y.*, 538 N.Y.S.2d 571 (N.Y. App. Div. 2d Dept. 1989); *Ladd Const. Co. v. Ins. Co. of N. Am.*, 391 N.E.2d 568 (Ill. App. 3d Dist. 1979); *Consol. Rail Corp. v. Hartford Acc. & Indem. Co.*, 676 F. Supp. 82 (E.D. Pa. 1987); *Miss. v. Richardson*, 634 F. Supp. 133, 136 (S.D. Miss. 1986); *City of Pigeon*
Forge, Tenn. v. Midland Ins. Co., 788 F.2d 368, 371 (6th Cir. 1986)). The dissent argued that the Georgia decisions relied upon by the majority were actually consistent with the majority rule in that those decisions recognized that “[t]he mere assertion of one defense cannot be considered the waiver of other defenses, absent some statement or conduct showing an intent to waive.” Id. at 419-21 (citing Browder, 190 S.E.2d 110). Under this precedent, the dissent asserted that Maxum’s reservation of rights was sufficient to preserve its right to assert late notice in the subsequent coverage litigation. Id. at 421. Nonetheless, it now appears that Georgia has joined the minority of states which automatically waive any “technical” or “forfeiture” grounds that are not specifically raised in a denial letter. Id. at 416-18.

IV. The Practical Effect of Limiting Insurers to the Defenses in the First Denial Letter.

An insurer that denies coverage always does so “at its own peril” because, by denying coverage, the insurer loses the ability to control the defense of the claim and, in many circumstances, litigate the underlying facts pertaining to the claim. See Dowse, 605 S.E.2d at 29 (“An insurer that refuses to indemnify or defend based upon a belief that a claim against its insured is excluded from a policy's scope of coverage does so at its peril, and if the insurer guesses wrong, it must bear the consequences, legal or otherwise, of its breach of contract.”); Ladner Co., Inc. v. Guar. Ins. Co., 347 So. 2d 100, 104 (Ala. 1977) (citing Bandy v. Avondale Shipyards, Inc., 458 F.2d 900 (5th Cir. 1972); Cadwallader v. New Amsterdam Cas. Co., 152 A.2d 484, 488 (Pa. 1959)). Decisions such as Hoover dramatically increase those perils. 730 S.E.2d at 421. The most extreme of those perils is the extra-contractual penalties insurers may face in certain states for the wrongful denial of claims. Flannery, 49 F. Supp. at 1227. However, the practical effects of cases such as Hoover create even more immediate perils for insurers that deny coverage. Chief among these are the pressures placed on an insurer’s investigation from the outset of receiving notice of a claim. See Hoover, 730 S.E.2d at 421. As recognized by the dissent in Hoover, insurers who wish to deny a claim will essentially be required to do so blindly, relying solely upon the information provided at the outset of the claim and without the benefit of additional information that could be
developed in a subsequent investigation or through discovery in litigation. *Id.* As a result, the insurer “must scramble to come up with all possible defenses in good faith,” a task that will require insurers “to attempt to list all defenses in their initial denial letter” without giving strong reasons why any particular defense applies. *Id.*

However, this shotgun approach to denials benefits neither insurers nor insureds because it does not allow either to communicate concerning a denial and converts the first few days or weeks following notice into the most important period of time for a claim, even though information about the claim is still developing. In other words, contrary to the assumptions of the Court in *Hoover*, a denial does not have to be the end of the road for an insurer's and insured's relationship concerning a denied claim. Instead, it should be in the best interests of insurers and insureds to communicate concerning denials to determine whether the issues that prompted the denial can be clarified or if it is possible to amicably resolve the claim. Further, a legal environment that encourages communication can also be beneficial to insurers and insureds because it can give each an indication of how reasonable the other side is going to be and how best to protect their interests, including the initiation of litigation, if necessary. Thus, a denial without the ability for bilateral communication and investigation actually creates more uncertainty for all parties than would otherwise exist.

Further, for insurers, a legal environment that encourages a shotgun approach to denials may actually create even more reasons for courts to throw out or ignore grounds as ambiguous because the insurer lacked sufficient information to adequately describe why the defense applied. See *World Harvest Church, Inc. v. Guideone Mut. Ins. Co.*, 695 S.E.2d 6 (Ga. 2010) (“the reservation of rights must fairly [and unambiguously] inform the insured”) (*cited by Hoover*, 730 S.E.2d at 416); *Gen. Accident Ins. Group v. Cirucci*, 387 N.E.2d 223 (N.Y. 1979) (insurer waived improperly described late notice defense in denial letter). In essence, *Hoover* creates a catch-22 for insurers in relation to which defenses the insurer should list or how to describe how they apply, i.e., an insurer must describe all of the grounds that apply without conducting an adequate investigation but cannot know which defenses apply unless it conducts an adequate investigation. *Hoover*, 730 S.E.2d at 416-18.
The issues created by this catch-22 are further exaggerated by the fact that an insurer’s right to investigate is essentially foreclosed from the instant the insurer denies coverage. *Id.* at 417, 421. As the dissent points out, this limitation on the insurer’s rights provides a strong incentive for insureds to limit the information they provide to insurers at the outset of the claim and creates an even greater potential for fraud. *Id.* at 421. Savvy or dishonest insureds with knowledge of the limitations on the insured’s ability to investigate could simply withhold information in the hopes of creating more uncertainty that would either force the insurer to defend when it should have denied coverage or deny coverage on less than all grounds while the insured retains knowledge of a “technical” or “forfeiture” ground that may have actually applied to the claim. See *id.*

Of course, the intent behind *Hoover* and other decisions applying the minority rule is not to encourage insurance fraud; however, by increasing the perils and risks associated with denying coverage, the Georgia Supreme Court and others courts have announced a clear intent to encourage insurers to defend more claims under a reservation of rights than they otherwise would in states which adhere to the majority rule. *Id.* at 416-17, 421.

**V. Conclusion.**

The Georgia Supreme Court’s decision in *Hoover* significantly rewrote Georgia law on waiver for insureds that are considering the denial of a claim, removing Georgia from the list of states that followed the majority rule requiring some evidence of intent before an insurer can be found to have waived a policy defense. Now, Georgia joins a minority of states that find waiver whenever an insurer denies coverage on less than all “technical” or “forfeiture” grounds available to the insurer. The practical effect of this minority rule is to encourage insurers into defending more claims under a reservation of rights by effectively restricting an insurer’s right to investigate claims. In the short-term this rule may seem more beneficial to insureds; however, the long term effects of this rule may force insurance companies to spend defense dollars they might not otherwise have to spend and, by extension, likely raise the cost of insurance.