BINDING AUTHORITY
Insurance Coverage Decisions: Issued Today - Impact Tomorrow
White and Williams LLP
Randy J. Maniloff
maniloffr@whiteandwilliams.com

June 22, 2011

Jungleland: New Jersey And The Duty to Defend

Big Man-ifesto From The Supreme Court Applying A Broad Duty to Defend

"There's an old joke - um… two elderly women are at a Catskill mountain resort, and one of 'em says, 'Boy, the food at this place is really terrible.' The other one says, 'Yeah, I know; and such small portions.'"

Woody Allen, as Alvy Singer, in Annie Hall

In a way, you could say the same thing about New Jersey's duty to defend -- "It's a mess. Yeah, I know. And not enough cases."

There is so much that could be said about New Jersey's duty to defend. Perhaps the best description of it is that it seems to suffer from schizophrenia. On one hand, it could be argued that New Jersey's duty to defend is the most restrictive in the country for insureds. After all, *Burd v. Sussex Mutual Insurance Co.*, 267 A.2d 7 (N.J. 1970) affords insurers the right, in many cases, to decline to provide a defense and instead convert its defense obligation to one of reimbursement of defense costs at the conclusion of the case. [*Flomerfelt* did not overrule *Burd* – not even close.] Further, such reimbursement obligation can then be limited, admittedly when feasible, solely to those costs that were incurred to defend covered claims. Based on these principles, insureds frequently view the Garden State's duty to defend as standing in contrast to the rule, applied just about everywhere else in the nation, that the duty to defend is broader than the duty to indemnify.

On the other hand, it could just as easily be argued that New Jersey's duty to defend is the most expansive in the country for insureds. Even before *Burd* was hatched, the Supreme Court of New Jersey held in *Merchants Indemnity Corp. v. Eggleston*, 179 A.2d 505 (N.J. 1962) that an insurer that wishes to defend its insured, under a reservation of rights, can do so only if it obtains its insured's consent. In other words, an insurer that wishes to take the common course of action of appointing panel counsel to defend its insured, while at the same time sending its insured a reservation of rights letter, setting out reasons why, notwithstanding providing a defense, the insurer may not have an obligation to pay some or all of any damages awarded, must advise the insured of its right to object to being defended in such a matter. New Jersey courts have imposed a simple sanction on insurers that fail to obtain their insured's consent to being defended under a

reservation of rights – loss of the insurer's ability to assert an otherwise applicable defense to coverage.

Burd v. Sussex and *Merchants v. Eggleston* make New Jersey's duty to defend rules the most unique in all the land. However, these are both older cases and for years were the subject of very little additional guidance from the New Jersey Supreme Court. This void was filled with decisions from the Appellate Division. While helpful, such a hodgepodge of decisions also caused confusion. It was long overdue for the New Jersey Supreme Court to chime in on *Burd* and *Merchants*. That finally came in 2010 in *Flomerfelt v. Cardiello* (at least for *Burd* and a reaffirmation of *Merchants* -- without saying so by name) (not to mention what the *Flomerfet* court did to the interpretation of "arising out of").

Well the New Jersey high court must have caught the duty to defend bug. For years it had almost nothing to say. Then last year it issued *Flomerfelt*. And yesterday it issued two decisions on the duty to defend – one having the potential to be a significant addition to the state's body of law.

In *Abouzaid v. Mansard Gardens Associates v. Greater New York Mutual*, the New Jersey high court held that an insurer owed a duty to defend an insured for a complaint that, on its face, did not give rise to coverage. However, the court concluded that a defense was owed because of the possibility of facts being established in the underlying action. Because such facts, if established, would trigger coverage, the court held that a defense was owed from the outset of the action. In essence, the Supreme Court held that the insurer had a duty to defend a "potentially covered claim."

Ordinarily I have a lot more to say about the decisions addressed in *Binding Authority*. But for now I am going to take a pass and limit my comments about *Abouzaid* to just these. The decision is more complex than meets the eye and its full appreciation requires that it be examined in conjunction with the Supreme Court's 1992 decision in *Voorhees v. Preferred Mutual* and other New Jersey duty to defend principles. I'm going to let *Abouzaid* gel and address it further in a future issue.

Given how significant a state's duty to defend standard is – unquestionably the most important of all coverage issues – and the fact that New Jersey is an important jurisdiction for so many *BA* readers, my objective here was simply to bring the decision to your attention.

A copy of yesterday's decision in *Abouzaid v. Mansard Gardens Associates v. Greater New York Mutual* can be accessed here:

http://www.judiciary.state.nj.us/opinions/supreme/A510AbouzaidvMansardGardens.pdf

Yesterday's other New Jersey Supreme Court duty to defend decision -- *Passaic Valley Sewerage Commissioners v. St. Paul Fire & Marine Ins. Co.* -- can be accessed here. While not as significant as *Abouzaid*, the Supreme Court upheld the principle that an insurer did not breach its duty to defend by reimbursing its insured's defense costs for solely covered claims.

http://www.judiciary.state.nj.us/opinions/supreme/A9709PassaicValleySewerageCommissioners.pdf

Two New Jersey Supreme Court duty to defend decisions in the same day – one favoring insurers and one favoring insureds. Just as I said – schizophrenia.

If you have any questions, please let me know.

Randy

Randy J. Maniloff
White and Williams LLP
1800 One Liberty Place | Philadelphia, PA 19103-7395
Direct Dial: 215.864.6311 | Direct Fax: 215.789.7608
maniloffr@whiteandwilliams.com