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

March 17, 2009

# Insurer's Blunder Road = Insured's Promised Land

## New Jersey Court: Insurer that Defends Under a Reservation of Rights -- Without Insured's Consent -- Waives Coverage Defenses

Just above from where you are reading this it says: "Insurance Coverage Decisions: Issued Today -- Impact Tomorrow." Be assured that I take the *Issued Today* part very seriously when deciding if a case will make the cut for *Binding Authority*. I strive to digest significant coverage decisions, with wide-ranging interest, that are no more than a week old and, ideally, no more than a day or two old. [Incidentally, that is also a good rule of thumb for Chinese food leftovers in the fridge.]

So why is today's case from all the way back to December 2008 -- practically an eternity by *Binding Authority* standards. It's a long story. But the point is that, by straying so far from my goal of presenting timely decisions, it must be a very worthwhile one.

New Jersey's duty to defend rules are unique, to say the least. This, combined with a lack of Supreme Court guidance over the years - in its place a hodge-podge of Appellate Division decisions -- has resulted in some challenging issues. But there is one aspect of New Jersey's duty to defend that has been clear for a long time -- An insurer that wishes to choose the counsel to defend its insured, under a reservation of rights, must obtain the insured's consent to being defended in such manner. If not, any coverage defenses asserted in the reservation of rights letter are out the window -- like Parkway tokens, before the days of E-Z Pass. [The logistics for handling the ROR-consent issue; practical and strategic aspects of it; and what happens if the insured does not consent, are separate issues unto themselves and all beyond the scope of this brief summary.]

New Jersey's consent-required Reservation of Rights rule is not the stuff of breaking news. The rule dates back to at least 1962 and the New Jersey Supreme Court's decision in *Merchants Indem. Co. v. Eggleston*. So why talk about it now? First, because anyone handling New Jersey claims – and that is a large contingent of *Binding Authority* readers -- needs to know, or be reminded, about the rule.

Second, older cases somehow have a way of being thought of as less controlling and easy to dismiss. But when the older case (even if from a supreme court) is relied upon by a new case (even if an unpublished federal trial court decision), it somehow validates or re-affirms that the older case *really is* the law. It shouldn't be this way, but from my

experience sometimes it is. Such is the situation with the December 8, 2008 (unpublished) decision from the New Jersey District Court in *Pennsylvania National Mutual Casualty Co. v. South State, Inc*. and the New Jersey consent-required Reservation of Rights rule.

The facts and decision in *South State* are simple. South State was sued for a death allegedly occurred at its sand and gravel plant when an individual was thrown from a work-barge that capsized while he was trying to recover an anchor that had broken away from a dredging machine. *South State* at 3.

Penn National, South State's CGL insurer, agreed to defend South State in the underlying litigation. Penn National issued a letter to South State purporting to reserve its rights not to indemnify South State for damages that might be awarded in the underlying action. In fact, over a three week period, Penn National sent three reservation of rights letters to South State, all declaring its intent to defend South State, but purporting to reserve its rights to indemnify the company. *South State* at 3-4, 8-9.

South State filed a motion for summary judgment contending that Penn National must indemnify South State, because, after assuming South State's defense, Penn National may not now deny coverage. Penn National countered that it may deny coverage because it issued reservation of rights letters. *South State* at 6.

Relying heavily on *Merchants v. Eggleston*, the New Jersey District Court agreed with South State: "By assuming responsibility for South State's legal defense and failing to notify South State of its option to decline the representation in its reservation of rights letter, Penn National is precluded from refusing to indemnify South State in this matter." *South State* at 9. "The [reservation of rights] letters lack any mention, nor even any hint, that South State could opt to reject Penn National's representation. The letters fail even to suggest a possible scenario in which South State might manage its own legal defense." *Id*.

The court addressed, at Penn National's behest, whether consent may be implied from an insured's acceptance of the insurer's defense under a reservation of rights. The *South State* court responded to this as follows: "The Supreme Court of New Jersey has said that consent may be inferred from an insured's acceptance of representation, 'but to spell out acquiescence by silence, the letter [reserving the insurer's right not to indemnify the insured] must fairly inform the insured that the offer may be accepted or rejected.' *Eggleston*, 37 N.J. at 127-28." *South State* at 6.

Lastly, the *South State* court also addressed how another of South State's insurers – New Jersey Manufacturers -- had properly handled South State's defense under a reservation of rights:

> NJM is not precluded from denying coverage to South State for the very same reasons that Penn National is. Like Penn National's reservation of rights letter, NJM's letter, dated June 11, 2007, details its understanding of the application of its policy to the Underlying Action, and explains that it 'reserves its right . . . to disclaim any duty to

> indemnify or defend if information is ultimately established that shows that the damages sought are either not within the scope of NJM''s Policy or otherwise excluded by the exclusion in those Policies.' But unlike Penn National's reservation of rights letter, NJM's letter clearly states, 'At the outset, we advise you that South State is free to accept or reject NJM's offer to defend South State subject to a complete reservation of rights.' For the reasons explained above, this is all that New Jersey law requires to impute consent to an insured that accepts legal representation from its insurer. *See Eggleston*, 37 N.J. at 127-28; Kaplan, 2007 WL 1670888, *4. NJM is therefore not precluded from denying coverage to South State, subject to the reservation of rights set out in its June 11th letter."

*South State* at 10-11 (citations omitted).

Incidentally, *Merchants v. Eggleston* and the New Jersey-ROR consent requirement was also "re-affirmed" a couple of times in the past couple of years by the New Jersey Appellate Division (in unpublished decisions).

Attached is a copy of the New Jersey District Court's December 3, 2008 decision in *Pennsylvania National Mutual Casualty Co. v. South State, Inc*.

Please let me know if you have any questions.

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