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July 19, 2010

Big Burd: New Jersey Supreme Court Issues Rare Duty to Defend Decision

Garden State Maintains its Duty to Defend Standard

What do New Jersey's duty to defend and favorite son have in common?

They both did it their way.

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New Jersey's duty to defend is unique. That's for certain. I've recently presented a New Jersey duty to defend seminar for several clients and am starting to run out of synonyms for unique to describe it.

Other things about New Jersey are also unique. There's …. Uh, wait, hold on, give me a second, I'll think of one. What about…? No, that's not unique. How about…? Oh yeah, New Jersey does not have self-serve gas stations. That's unique. [Actually, Oregon is also full-serve only, but close enough.]

That New Jersey's duty to defend is *sui generis* is a factor that then contributes to other adjectives also being appropriate to describe the issue -- such as complex and confounding.

At this point in the seminar I go through a list of reasons why New Jersey's duty to defend is all of these things. One of these reasons – and not an insignificant one – is that the issue has eluded review by the New Jersey Supreme Court. The last time New Jersey's top court addressed the duty to defend in any real detail -- Karma Chameleon was at the top of the Billboard chart (1984). [I never get tired of hearing that song.]

As a result of this absence of guidance from the New Jersey Supreme Court, the duty to defend has developed through a hodge-podge of decisions from the Appellate Division. Don't get me wrong -- many of these decisions provide solid guidance on the issue. But there is no substitute for a supreme court decision to bring clarity to an issue and tidy things up.

Last week the New Jersey Supreme Court ended its silence on the duty to defend. While the court did not break any new ground on the issue, it left no doubt that the decisions that have brought New Jersey's duty to defend to this peculiar point, despite being from 1962 and 1970, are still controlling. For some reason, people sometimes need affirmation that an old decision is still the law.

Flomerfelt v. Cardiello is a lengthy decision with a lot to it. In addition to duty to defend, the court also addressed the scope of the phrase "arising out of" as used in a policy exclusion. The scope of "arising out of" is frequently at the center of coverage disputes. Insurers usually argue that it has a broad interpretation (meaning "but for" causation) and courts usually agree. But *Flomerfelt*, it will be argued, applied a different analysis to the phrase "arising out of" than prior New Jersey high court decisions. For this reason, the case's legacy may be its "arising out of" principles even more than duty to defend. But that's a whole other story.

At issue in *Flomerfelt* was coverage for claims arising out of the following circumstances (for convenience, set out verbatim from the court's summary at pages 2-3):

"Plaintiff Wendy Flomerfelt sustained temporary and permanent injuries after she overdosed on alcohol and drugs during a party hosted by defendant Matthew Cardiello at his parents' home while they were out of town. Plaintiff has little recollection of what she drank or ingested either before she arrived or during the party itself. Her complaint, however, asserted that her injuries were caused by defendant, who provided her with drugs and alcohol, served her alcohol when she was visibly intoxicated, and failed to promptly summon the rescue squad when she was found, unconscious, on the porch the next day.

Defendant turned to Pennsylvania General Insurance Company, his parents' homeowners' insurer, tendering to it the defense of Flomerfelt's complaint and seeking indemnification under the terms of the policy. Pennsylvania General, in response, declined either to provide a defense against the claim or to indemnify him, pointing to the language of its policy that excluded claims "[a]rising out of the use, . . . transfer or possession" of controlled dangerous substances.

The parties dispute the meaning of that language and the scope of the exclusion as it bears on both the insurer's duty to defend and its obligation to indemnify. Accordingly, this appeal requires us to consider the insurer's duties to defend and indemnify when the precise manner in which the injury was caused is in dispute and when the parties disagree about the role that controlled dangerous substances, for which the policy excludes coverage, played in bringing about plaintiff's injury."

With that background, here is where the duty to defend issue comes in (in conjunction with the "arising out of" aspect of the case).

Following a lengthy discussion of the interpretation of the phrase "arising out of," the court applied the allegations of the complaint to the "controlled substances" exclusion

and concluded that a defense was owed, since the potential for coverage existed. The court's decision on this point is succinctly stated as follows:

> In evaluating the duty to defend, we can lay the complaint and the policy side by side and see that in this dispute some theories of liability would be covered and others would not. If, for example, the finder of fact were to conclude that alcohol ingestion, either in the context of the social host serving plaintiff when she was visibly intoxicated, see Kelly v. Gwinnell, 96 N.J. 538 (1984), or in combination with a delay in summoning aid, was the cause for the injuries, or set the chain of events in motion, and that there was not a substantial nexus between drugs at the party and the injuries, the claim would fall within the coverage of the policy and would not be barred by the exclusion. If the finder of fact were to conclude that plaintiff's injuries were caused by use of drugs before she arrived at the party, by genetic predisposition, or by long-term drug use such that the injuries did not "originate in," "grow out of" or have a "substantial nexus" to her use of drugs at the party, the claim would also be covered. Whether any of those possibilities is the likeliest outcome is of no consequence, because our traditional analysis of the duty to defend requires that Pennsylvania General provide a defense.

Id. at 33.

Step 1 - a defense was owed under the traditional duty to defend test. And clearly it would be under a reservation of rights as the court noted the possibility that no indemnity coverage existed. But what's step 2 for the insurer in providing a defense under a reservation of rights. In most states, the insurer would pick up the phone and call panel counsel (recognizing that the reservation of rights could entitle the insured to use independent counsel). But in the Garden State there is more to it. As the New Jersey Supreme Court set out in *Burd v. Sussex Mut. Ins. Co.* and *Merchants Indemnity Co. v. Eggleston*, and subsequent interpretations, New Jersey's duty to defend works like this:

> The record before us does not permit us to resolve the question of the insurer's duty to indemnify. As we noted in

> Burd, supra, however, in those thorny situations in which there
> are some covered theories coupled with alternatives in which the
> claim would not be covered, the insurer has several options
> available to it. They include opting to defend under a
> reservation of rights [with the insured's consent (*id.* at 16)],
> declining to do so, preferring to await the outcome and to reimburse
> its insured if the finder of fact decides the injury did not
> "arise out of" drug use, as we have defined it, or electing
> to litigate the coverage issue in advance of a trial on
> plaintiff's claim, disputing the proof of causation against
> its insured first.

Id. at 33-34.

While it has been a long time since the New Jersey Supreme Court addressed the duty to defend, the court did not back away from *Burd* and its option that allows an insurer to decline to provide a defense in many cases, await the determination of the facts in the underlying action and then reimburse the insured for its defense costs (and only to the extent that it is determined that there are covered claims – not stated in *Fromerfelt* but that's also an issue). Thus, New Jersey's duty to defend is still a "duty to depend." In other words – despite a duty to defend existing under the traditional test, payment of an insured's defense costs may depend upon the existence of coverage.

[To be sure, there are additional facets to New Jersey's duty to defend and various practical and strategic considerations in handling the *Burd* options. But *Flomerfelt v. Cardiello* covers the basics. The full treatment is discussed in the seminar (riveting, I might add). If you are interested, drop me a note.]

A copy of the New Jersey Supreme Court's decision in *Flomerfelt v. Cardiello* can be accessed here:

http://www.judiciary.state.nj.us/opinions/supreme/A409FlomerfeltvCardiello.pdf

Please let me know if you have any questions.

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