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IN PRACTICE

AUTOMOBILE INJURY LAW

By MICHAEL EATROFF AND ERIC HARRISON

Stepping Down Even Further

Voided auto policies in the wake of AICRA

On Sept. 14, 2005, the trial court decision of *Mannion v. Bell*, MON-l-4813-02, was approved for publication. This was a matter of first impression regarding the rights of an innocent third party seeking the benefits of a fraudulently obtained automobile insurance policy. Applying established law to the new lower minimum forms of coverage available since passage of the Automobile Cost Insurance Reduction Act of 1998 (AICRA), Judge Jamie Perri ruled that the defrauding tortfeasor's liability coverage should be stepped down to "basic policy" levels, rendering the tortfeasor without liability coverage and requiring the innocent third party to pursue uninsured motorist benefits under his own policy.

Contracts obtained by fraud generally may be rescinded at the option of the defrauded party. However, innocent automobile accident victims in New Jersey have long been able to expect that to the extent coverage is mandated by law, even a policy which is void ab initio as to the policyholder will be available for the policyholder's benefit. The issue before Judge Perri in *Mannion* was whether the measure of protection enjoyed by such an innocent third party should parallel the relatively new minimum coverage options permissible under AICRA, or continue to reflect the traditional or "standard" coverage.

Plaintiff Debra Mannion's vehicle was struck in the rear by a vehicle owned and operated by defendant James Bell on June 2, 2001. Mannion was insured by defendant Liberty Mutual Fire Insurance Company, with UM/UIM limits of $25,000/$50,000. Mannion filed suit against Bell on Oct. 7, 2002, and entered default against him on Oct. 7, 2003. On Feb. 5, 2004, Manniond's complaint was amended, seeking a declaration of coverage for Bell under a Parkway Insurance Company policy issued to Bell's father. In the alternative, Mannion requested a declaration that Liberty Mutual was required to provide uninsured motorist benefits.

As it turned out, the vehicle being driven by defendant Bell had been added to the Parkway policy based on false information. Bell's mother had contacted Parkway and falsely advised them that their policyholder, Bell's father, had moved in with Bell. Relying on these representations, Parkway amended its policy to provide coverage for the Bell vehicle, and to list Bell as an additional driver in the household. In fact, Bell's father had not moved in with Bell.

Parkway moved for summary judgment, contending that the coverage for defendant Bell was fraudulently obtained. Liberty Mutual countered that the fraudulently obtained Parkway policy should remain in effect for the benefit of innocent third party beneficiaries such as its insured, Mannion. While acknowledging the authority cited by Liberty for maintaining coverage to protect innocent third parties, Judge Perri noted that AICRA created a new "basic" policy which provides no liability coverage whatsoever. Interpreting such basic coverage as the new minimum, the court ruled that Mannion had no recourse to Bell's Parkway policy and should pursue UM benefits from Liberty.

The New Jersey Courts have consistently protected the rights of innocent third party beneficiaries of automobile insurance contracts. The theoretical underpinnings of this protection are the reasonable expectations of members of the public, fostered by our compulsory insurance laws. However, these theoretical expectations cannot exceed the mandate of the law. Accordingly, an innocent third-party beneficiary has been limited to recovery under the minimum coverage required by law.

Eatroff, an associate at Methfessel & Werbel of Edison, focuses on the litigation and arbitration of complex insurance fraud and coverage issues. Harrison, a partner at the firm, specializes in insurance coverage, personal injury defense, employment and civil rights litigation.

In 1988, the Appellate Division addressed the issue of the rights of an innocent third-party beneficiary in the matter of *Fisher v. New Jersey Automobile Insurance Underwriting Association*, 224 N.J. Super. 552 (App. Div. 1988). In *Fisher*, a passenger sought PIP coverage under a policy that had been fraudulently obtained. The insured vehicle's registration was fictitious; hence, the policyholder was not a "qualified applicant." The servicing carrier for the JUA declared the policy void ab initio when the misrepresentation was discovered and returned the policyholder's premium. The Appellate Division clarified that the principles outlined above are applicable to policies obtained in the involuntary market. Fisher was awarded the full measure of the PIP coverage that was compulsory in New Jersey at that time. Because no lesser PIP policy was available, no analysis of the extent of the innocent third-party beneficiary's coverage was required.

In 1994, the Appellate Division decided the matter of *Dillard v. HCM*, 277 N.J. Super. 448 (App. Div. 1994). In *Dillard*, the policyholder's initial premium check had been dishonored for insufficient funds. The *Dillard* court extended the holding of *Fisher* to include coverage for compensatory damages and uninsured motorist benefits. However, the issue of whether a policy should be reformed to afford an innocent third-party beneficiary only what is compulsory under the law was not addressed. Presumably, the voided policy provided only the minimum mandated coverage.

In 1995, the Appellate Division further defined third party beneficiaries' rights under contracts of insurance that are fraudulently obtained and declared void ab initio as to the policyholder. In *Marotta v. New Jersey Automobile Full Insurance Underwriting Association*, 280 N.J. Super. 525, 532 (App. Div. 1995), aff'd 144 N.J. 325 (1996), the court noted that its decision in *Dillard* did not require a determination on the extent of coverage available to satisfy the claim of an innocent third party beneficiary. Citing the reasonable expectations of the innocent third party beneficiary, the court determined that liability insurance would be available only to the extent of the statutory minimum, not the $500,000 CSL limit of the policy. Simultaneously, with upholding *Marotta*, 144 N.J. at 326 (1996), the Supreme Court modified the Appellate Division's holding in *Dillard* to limit the coverage available to statutory minimums.

The last significant holding in this area was *Palisades Safety and Insurance Association v. Bastien*, 175 N.J. 144 (2003). The *Bastien* Court determined that not all third party beneficiaries are necessarily "innocent" third party beneficiaries. In this case, a resident spouse was denied benefits under her husband's void policy despite questions regarding her complicity in the fraud. The court's reasoning, which arguably applies with equal force to the case of a resident relative, focused on the household benefiting from the policyholder's deception by receiving a lower premium.

The law outlined above has developed over the years in a surprisingly cogent and predictable fashion. However, when AICRA was enacted in 1998, and upheld by the Appellate Division in *New Jersey Coalition of Healthcare Professionals, Inc. v. New Jersey Department of Banking and Insurance*, 323 N.J. Super. 207 (App. Div. 1999), it became inevitable that the courts would be called upon to redefine the parameters of an innocent third party beneficiary's rights.

Prior to the enactment of AICRA, all personal automobile insurance policies in the State of New Jersey were subject to statutory minimums of $15,000/$30,000 in liability and uninsured motorist coverage as well as $250,000 in PIP coverage. The reasonable expectations attributed to members of the public were quite reasonably limited to these statutory minimums. With the advent of AICRA, vehicle owners no longer were required to carry liability insurance. Further, purchasers of the "basic policy" under AICRA were required to carry only $15,000 in PIP coverage.

In *Mannion*, Judge Perri determined that the notion of "reasonable expectations" must now be adjusted based on the new minimum coverages required under the law. The fraudulently obtained Parkway coverage was deemed reformed to the statutory minimum. Thus, no liability coverage was available to benefit plaintiff Mannion and she was free to pursue UM coverage with Liberty Mutual.

While it remains to be seen how the appellate courts will react when confronted with the issues addressed by Judge Perri in *Mannion,* only two weeks ago our Supreme Court ruled in *Proformance v. Jones,* Docket No. A-102 (Dec. 22, 2005), that a permissive user who drives a vehicle for business purposes contrary to both a business pursuits exclusion and the instructions of the vehicle owner would be "stepped down" to liability limits of $15,000 per person/$30,000 per accident. The *Jones* Court expressly noted that at the time of the accident in question, N.J.S.A. 39:6B-1(a) mandated such coverage.

Post-AICRA, of course, N.J.S.A. 39:6B-1(b) and (c) have lowered the bar to permit the purchase of "basic" or "special" policies with no liability coverage whatsoever. Accordingly, logical extension of the *Jones* Court's analysis to a post-AICRA accidents would step down the coverage available to $0.

Judge Perri's cogent reasoning in *Mannion* and the Supreme Court's attention to the level of coverage mandated on the date of accident in *Jones* suggest that the reasoning of *Mannion* will be accepted by other trial courts and perhaps the Appellate Division. In most cases, such a ruling will simply shift the risk from a liability carrier to a UM carrier, as most accident victims, like Mannion, have access to UM coverage through policies held personally, as a resident relative of a policyholder or as a fortuitous vehicle occupant. While NJPLIGA will shoulder an additional burden in those cases where innocent victims are "stepped down" without recourse to a UM policy, the relative infrequency of policies being

voided ab initio suggests that our courts will not find such a result unpalatable.

However, substantially more complex questions arise when one considers the potential application of this holding to other features of the automobile insurance policy. The logical extension of *Mannion* to reduction of PIP benefits would have a much greater impact. An innocent third party beneficiary of a policy declared void ab initio as to the insured would only be entitled to the measure of PIP coverage deemed compulsory under the law. In the post-AICRA world, compulsory minimum PIP coverage is reduced to $15,000, with limited exceptions. Accordingly, a person injured as a passenger in an automobile carrying a void policy, who does not have his or her own family automobile policy, would usually be limited to $15,000 in PIP coverage.

This result seems the natural culmination of the history outlined above. However, it may prove difficult to swallow for a judiciary that has a history of extraordinary sympathy to PIP claimants. It does seem odd that a passenger in a vehicle that is insured through a fraudulently obtained policy would find himself in a worse position than a passenger in a vehicle that is not insured at all — under UCJF (now PLIGA) law, a passenger in an uninsured vehicle is currently entitled to maximum medical expense benefits of $250,000. This apparent incongruity likely would factor into some future appellate court's analysis.

It is inevitable that the appellate courts will be called upon to sort out these issues. In fact, it is rather surprising that in the seven-year history of the "basic" policy there has been no activity in this area. Ultimately, the courts' tendency towards optimizing PIP recovery for claimants may prove difficult to overcome for defrauded insurers, though it remains to be seen what route towards greater coverage a claimant-friendly court would pursue in the absence of legislative action. ■