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CASE ALERT!!!

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Last week the Appellate Division published an important decision, handled by Methfessel & Werbel, Esqs. affecting liability carriers who confront Complaints which allege both covered and uncovered claims. We had for quite sometime tried to position this issue for appellate review because this issue has not been addressed or decided by New Jersey courts, and is the subject of great debate. This case allowed us to put squarely before a court the issue of the insurance carriers dilemma when faced with complaints containing both covered and uncovered counts. The result achieved was extremely favorable for the insurance industry. Aquino v. Travelers focuses on the inherent conflict posed by retention of counsel to defend against all claims, as opposed to limited retention to defend the insured against only covered claims.

The case arose out of a shooting on March 7th 1995. Michael Aquino visited an auto body shop, in Newark where Anthony Fasion worked. During what could be characterized as "horseplay" Mr. Aquino pulled out a starter pistol loaded with blanks and discharged the pistol into Mr. Fasion's abdomen. The "batting" from the blanks caused significant injuries to Mr. Fasion.

Fasion filed a multi-count Complaint against various parties including Mr. Aquino. The first three counts of the complaint alleged intentional misconduct, while the fourth count alleged negligence. Fasion tendered the Complaint to Travelers, which extended a defense to all counts under a reservation of rights. Travelers assigned counsel, who filed an unlimited answer on behalf of Mr. Aquino.

Mr. Aquino's personal counsel, dissatisfied with the job that assigned counsel was doing, moved to have himself replaced as attorney for the insured on all counts. Personal counsel also demanded that Travelers fund such representation of Aquino on Counts One through Three, despite the absence of coverage for those counts. The trial court, while denying personal counsel's application to assume the entire defense, nevertheless acknowledged assigned counsel's inherent conflict in defending all counts. The court therefore permitted personal counsel to substitute in as counsel on the first three counts, while assigned counsel remained counsel of record on the negligence count.

Aquino contemporaneously filed suit against Travelers and State Farm seeking a determination that he was entitled to defense and indemnity without reservation from both carriers.

The court found that Travelers had acted appropriately in extending coverage. It also held that State Farm, which insured a rental property owned by Aquino, owed coverage.

At the conclusion of the liability trial the insured's personal counsel submitted a fee application in excess of \$130,000 for the defense of the liability action and the prosecution of the declaratory judgment action. Over a strenuous objection the trial court awarded the fee application without a hearing.

On appeal Travelers argued that it was not obligated to pay defense costs for those counts of the Complaint that were not covered. Travelers asserted the trial court had effectively conducted an apportionment in advance when it permitted Aquino's personal attorney to assume defense of the non-covered claims. As to the declaratory judgment action, Travelers pointed out that it had voluntarily extended coverage, rendering the DJ action unnecessary.

The appellate panel acknowledged that Travelers never denied coverage. However, the court noted the clear conflict of interest created by the carrier's selection of one attorney to defend all of the claims. When faced with conflicting assertions of intentional and negligent conduct, held the court, a carrier-assigned attorney simply cannot proceed with undivided loyalty to the insured by defending the insured against both sets of claims. Since Travelers initially extended a defense to all counts – as most carriers do in similar situations – the Court held that it was responsible for all of the fees associated with the defense of all four counts. State Farm was also held responsible for defense and indemnity of Aquino.

As to the fee award, however, the Appellate Division took great exception to both the trial court's methodology and the size of the award. The panel specifically faulted the trial court for failing to determine a reasonable hourly rate for defense work of this nature, a rate consistent with the lower rates generally paid for insurance defense work. The trial court also erred in failing to conduct a hearing on the fee application. Thus the case was remanded for a "searching" reconsideration of the fee award for both the prosecution of the declaratory judgement action and the defense of the liability action.

The Aquino decision should serve as a cautionary tale to all liability carriers confronted with "mixed"

complaints. The ruling presents two options. The first is to retain two attorneys, one to defend the covered claims and the second to defend the uncovered claims.

Alternatively, Methfessel & Werbel has consistently recommended the retention of a single attorney for purposes of filing a limited defense to only those allegations in the Complaint that implicate the duty to defend. Depending on the wording of the Complaint, this can translate into the filing of an Answer limited to certain identified counts. On the other hand, if the Complaint is inartfully drafted, retained counsel would be well-advised to file an Answer limited by its own terms to those allegations resulting in property damage or bodily injury caused by negligence of the insured. Then, if the exposure and facts warrant it, the carrier should file a Declaratory Judgment complaint, for a determination that there is no covered allegations or facts in the case, relieving it of even a partial duty to defend.

This approach removes the potential of a conflict, avoids the questions raised by a defense subject to a reservations of rights and eliminates exposure to costly fee apportionment litigation. The Aquino decision amply demonstrates the wisdom of such an approach, which would have contained the carriers' exposure while fully discharging its duty to defend and indemnify the insured against the covered claims.

This favorable decision for the insurance industry fits perfectly into Methfessel & Werbel's lecture series on these issues, and the manner in which we have counseled our clients for years. The seminar is entitled "Duty to Defend: How To Handle Complaints Containing Mixed Allegations of Negligence and Intentional Conduct." We would welcome any requests for an in-house presentation on this important subject.

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