LONNIE PETERSEN v. NEW JERSEY MANUFACTURERS INSURANCE COMPANY

SUPERIOR COURT OF NEW JERSEY

APPELLATE DIVISION

DOCKET NO. A-0

LONNIE PETERSEN and ESTATE OF KATHLEEN PETERSEN,

assignors and DORIS ZAYACZ, assignee, Plaintiffs-Appellants,

v.

NEW JERSEY MANUFACTURERS INSURANCE COMPANY, Defendant-Respondent.

Telephonically argued December 17, 2013 Decided May 2, 2014

Before Judges Reisner and Ostrer.

On appeal from the Superior Court of New Jersey, Law Division, Sussex County, Docket No. L-123-11.

Lauren D. Fraser argued the cause for appellants (Laddey, Clark & Ryan, LLP, attorneys; Andrew A. Fraser, Timothy E. Dinan and Jessica A. Jansyn, on the briefs).

Daniel J. Pomeroy argued the cause for respondent (Pomeroy, Heller & Ley, LLC, attorneys; Mr. Pomeroy and Karen E. Heller, on the brief).

PER CURIAM

This appeal involves the adequacy of an insurer's reservation of rights letter. Plaintiff Doris Zayacz, the assignee of insureds Lonnie Petersen and the Estate of Kathleen Petersen, appeals from the trial court's August 29, 2012, order granting summary judgment to defendant, New Jersey Manufacturers Insurance Company (NJM), dismissing her declaratory judgment action. Having considered Zayacz's arguments in light of the record and applicable law, we affirm.

I.

Brandon Petersen Lonnie and Kathleen Petersen's son stabbed and robbed Zayacz, a neighbor, on April 30, 2005. Then fifteen-years old, Brandon Petersen was arrested and charged most seriously with attempted murder, N.J.S.A. 2C:11-3. He ultimately pleaded guilty in the Law Division on June 10, 2008, to first-degree robbery, N.J.S.A. 2C:15-1; second-degree aggravated assault, N.J.S.A. 2C:12-1(b)(1); third-degree terroristic threats, N.J.S.A. 2C:12-3(b); third-degree possession of a weapon for an unlawful purpose, N.J.S.A. 2C:39-4(d); and third-degree hindering apprehension, N.J.S.A. 2C:29-3(b). He was sentenced on July 25, 2008, to an aggregate thirteen-year term.

Zayacz filed a civil complaint against Brandon and his parents. Count one alleged an intentional tort as to Brandon and sought compensatory and punitive damages. In the second count, Zayacz alleged that Lonnie and Kathleen knew their son had a history of violent behavior and drug use, yet recklessly, willfully, and wantonly failed to supervise or control their son, resulting in Zayacz's injuries. Count three alleged negligent supervision. Zayacz sought compensatory damages in counts two and three, as well as punitive damages in count two.

Shortly after service in March 2007, Brandon's defense attorney, Martin Morrison, forwarded the summons and complaint to NJM and demanded a defense on behalf of all three Petersens under the Petersens' NJM homeowner's policy. NJM did not respond to the letter. Default was entered in the civil case and a proof hearing scheduled. Morrison wrote to NJM again in July 2007, informing NJM that the court had agreed to vacate the default to enable NJM to respond to the complaint, or, failing that, to allow him to do so. Morrison demanded a defense of all three Petersens and threatened to hold NJM accountable for defense costs and indemnification if it refused.

NJM, by its claim counsel Gerald L. Karycki, then separately responded to each of the Petersens. In a July 23, 2007, letter to Brandon, copied to his parents and Morrison, NJM declined to defend or indemnify him based

on the policy's exclusion of claims for bodily injury that are "'expected or intended by one or more insureds.'" NJM also asserted punitive damage claims were not covered. NJM reserved the right to assert other grounds for its disclaimer "should additional facts come to light."

On July 27, 2007, NJM sent identical letters to Lonnie and Kathleen, which lie at the heart of the present appeal. NJM informed Lonnie and Kathleen that it had referred the summons and complaint to "defense counsels on your behalf." NJM then introduced the issue of coverage, stating,

Since this is the first notice we have had of this accident,1 it will be necessary to conduct an appropriate investigation to determine whether or not there are any questions regarding the coverage beyond those discussed thereafter.

The Complaint has been referred to the attorneys as set forth below with instructions to defend you until such time as any coverage issues have been resolved.

The letter proceeded to state that appointed counsel would represent the Petersens on counts two and three, which it characterized as alleging willful, wanton and reckless conduct in the former, and negligent conduct in the latter. The letter stated:

The Complaint alleges in Count III that you acted negligently, and the law office of Carroll, McNulty & Kull, L.L.C. will represent you with reference to those claims. The Complaint also alleges in Count II that you engaged in Willful, Wanton and Reckless Conduct, and the law office of Car[r]oll, McNulty & Kull, L.L.C. will also represent you with reference to those claims. That count requests both compensatory and punitive damages.

Although the paragraph just quoted observed that the complaint's second count sought punitive damages, NJM explained in the next paragraph that it was not obliged to indemnify for damages arising from intentional acts or punitive damages. NJM stated that the Petersens were free to retain separate counsel to defend against such liability: "Please be advised, however, that damages arising from intentional acts or punitive damages are not covered by your policy of insurance with this Company. Accordingly, you may retain an attorney at your own expense to cooperate with the above-mentioned law office in the representation of the non-covered claims."

NJM finally sought the Petersens' consent to representation on the terms set forth, stating, "If this letter meets with your approval, please sign the copy and return it to us in the enclosed self-addressed envelope." The letters included the words, "I approve," followed by signature lines for Kathleen and Lonnie. The letter was copied to Morrison, assigned counsel, and the investigators NJM had selected to assist counsel.

Neither Kathleen nor Lonnie signed and returned the letters to NJM. However, they accepted the services of the assigned firm, Carroll, McNulty & Kull (CM&K), in particular its partner John P. Gilfillan. The firm filed an answer to the complaint, and propounded initial form interrogatories, to which Zayacz responded in January 2008.2 Gilfillan served supplemental interrogatories on Zayacz and drafted answers to her interrogatories and request for admissions, although it is unclear whether those responses were actually served. Gilfillan engaged in multiple conferences with Morrison and the Petersens. Gilfillan also discussed potential settlement with Zayacz's attorney and with NJM. Zayacz's counsel stated he offered to settle for $400,000.

On May 5, 2008, the judge in the civil matter entered a case management order extending discovery "indefinitely pending resolution of the criminal proceeding." A month later, Brandon entered his guilty plea.3

Meanwhile, on June 5, 2008, the Supreme Court issued its decision in Villa v. Short, 195 N.J. 15 (2008), which interpreted a homeowner's policy exclusion of intentional or criminal acts by an insured person, much like the NJM exclusion in the Petersen policy. The Court held that the exclusion "operates to exclude coverage for all insureds under the policy, and not merely for the insured who committed the intentional or criminal act." Id. at 18. Consequently, the exclusion barred indemnification for damages that might arise out of one insured's negligent supervision of another insured who acted intentionally. The Court grounded its decision on two prior appellate decisions that applied similar reasoning. Id. at 24 (discussing Argent v. Brady, 386 N.J. Super. 343 (App. Div. 2006), and J.C. v. N.B., 335 N.J. Super. 503 (App. Div. 2000), certif. denied, 168 N.J. 294 (2001)).

The Court's decision prompted NJM to disclaim coverage entirely and to abandon its defense of Lonnie and Kathleen. NJM, by Karycki, wrote:

Please be advised that we are disclaiming coverage outright, for all insureds under the policy, including you and your husband, under the terms of the policy, and instructing your NJM retained counsel that we have

henceforth determined to withdraw as your attorney. This means you must obtain independent counsel to represent you through the balance of this case. We are making this decision in conformance with New Jersey law at present, together with the outcome of the recently concluded criminal case against your son. You should be assured that we will instruct your NJM appointed attorney to cooperate with your new attorney to assure a smooth transition of your defense.

Please communicate with us if there are questions.

In his deposition, Karycki explained that the Villa decision was the principal development prompting the letter. The decision, in Karycki's view, definitively resolved what he asserted was an open question of law regarding the reach of the intentional act exclusion of the sort included in NJM's policy. Karycki also relied on Brandon's guilty plea. In his allocution, Brandon admitted that he acted intentionally to cause Zayacz serious bodily injury.

Although NJM ceased compensating Gilfillan, and he ceased reporting to NJM, Gilfillan continued to represent the Petersens without fee.4 Eventually, Lonnie Petersen retained another attorney as well.

The civil case proceeded to court-ordered non-binding arbitration nine months later, in May 2009. The arbitrator awarded total damages of $1,500,000 and found Lonnie and Kathleen fifty-percent responsible for Zayacz's damages. Over a year-and-a-half later, in December 2010, Lonnie Petersen and the estate of his wife, who had by then passed away, entered into a consent order for final judgment against them for $750,000. The judgment was preceded by a settlement agreement in which Lonnie Petersen and the estate assigned to Zayacz any rights and claims they had against NJM arising out of its disclaimer of a defense and indemnity. Zayacz agreed that if she recovered any damages from NJM, she would deem the $750,000 judgment satisfied. If she recovered nothing from NJM, Lonnie Petersen and the estate would be liable for $90,000 in full satisfaction of their liability to Zayacz.

Zayacz, as assignee, and Lonnie Petersen and the estate, as assignors, then filed a complaint for declaratory judgment against NJM on February 18, 2011. Zayacz sought a declaratory judgment for indemnification based on NJM's withdrawal of a defense and coverage (Count One); breach of contract (Count Two); and breach of the duty of good faith, which Zayacz asserted resulted in the judgment against the Petersens (Count Three). She also sought punitive damages.

After a period of discovery, Zayacz moved for partial summary judgment on the first count of the complaint, and NJM cross-moved for summary judgment on all counts. Judge Edward V. Gannon denied Zayacz's motion and granted NJM's cross-motion, issuing a written statement of reasons. Applying Griggs v. Bertram, 88 N.J. 347, 356-57 (1982), and Merchants Indemnity Corp. of New York v. Eggleston, 37 N.J. 114, 127-28 (1962), Judge Gannon concluded that NJM supplied Lonnie and Kathleen Petersen with an adequate reservation of rights that fairly informed them of the possibility that it could disclaim coverage. He also found that the insureds consented to the reservation of rights by their acquiescence to representation by CM&K. Therefore, NJM was not estopped from disclaiming coverage. The court also dismissed Zayacz's contract and breach-of-good-faith claims. The court accepted Karycki's assertion that prior to Villa, there was no definitive judicial interpretation of the NJM exclusion; as a result, NJM did not deny coverage. However, Judge Gannon held, once Villa was decided, it provided NJM with a good faith basis to deny coverage.

Zayacz appeals from the summary judgment order as to her claim for coverage based on estoppel, and for damages caused by breach of good faith.5 Zayacz contends the trial court erred because: (1) NJM was estopped from disclaiming coverage because it failed to clearly reserve its rights and secure the insureds' consent; and (2) her claim for breach of the duty of good faith should be reinstated. Zayacz does not question that under Villa, the NJM policy exclusion for intentional conduct would bar recovery for damages.

II.

We review de novo the trial court's grant of summary judgment, and apply the same standard governing the trial court. Henry v. N.J. Dep't of Human Servs., 204 N.J.320, 330 (2010). Pursuant to Rule4:46, we "consider whether the competent evidential materials presented, when viewed in the light most favorable to the non-moving party, are sufficient to permit a rational factfinder to resolve the alleged disputed issue in favor of the non-moving party." Brill v. Guardian Life Ins. Co. of Am., 142 N.J.520, 540 (1995). Also, the interpretation of the reservation of rights letter is, like the interpretation of the underlying insurance contract, an issue of law for the court. Cf.Selective Ins. Co. of Am. v. Hudson E. Pain Mgmt., 210 N.J.597, 605 (2012) (interpretation of an insurance contract presents a question of law to be decided by the court).

The legal principles governing Zayacz's estoppel claim are well-established. An insurer is generally entitled to control the defense of a covered claim under the terms of its policy, Eggleston, supra, 37 N.J.at 127, and NJM was so entitled here. When an insurer exercises such control, precluding its insureds from hiring their own attorney and dictating the course of a defense, it may be estopped from later denying a defense or disclaiming coverage, unless the insurer properly reserves its rights to do so. Griggs, supra, 88 N.J. at 356 (stating that if an insurer defends "with knowledge of facts that are relevant to . . . a basis for noncoverage of the claim, without a valid reservation of rights to deny coverage at a later time, it is estopped from later denying coverage"); Eggleston, supra, 37 N.J. at 126 (stating that "the defense of an action against the insured is incompatible with a denial of liability unless the carrier has reserved the issue of liability by appropriate measures"). Once the insurer has exercised control of the litigation absent an appropriate reservation, estoppel is imposed without proof of actual prejudice. Griggs, supra, 88 N.J. 358 (stating that prejudice is inevitable and therefore "presumed as a matter of law where a carrier has undertaken to defend a damage suit" (citing Eggleston, supra, 37 N.J. at 129)).

In order to properly reserve its rights, so as to control the defense while avoiding estoppel, an insurer must advise its insureds of the potential of disclaimer, fairly inform the insureds of their right to reject the insurer's defense on those terms, and secure the insureds' explicit or implicit consent.

[I]f a carrier wishes to control the defense and simultaneously reserve a right to dispute liability, it can do so only with the consent of the insured. As we have said, an agreement may be inferred from an insured's failure to reject an offer to defend upon those terms, but to spell out acquiescence by silence, the letter must fairly inform the insured that the offer may be accepted or rejected.

[Eggleston, supra, 37 N.J. at 127-28.]

See also U.S. Cas. Co. v. Home Ins. Co., 79 N.J. Super. 493, 503 (App. Div.) (stating that an insured need not sign a non-waiver agreement, which may be enforceable based on "the insured's acquiescence to notice received from the insurance company that it is proceeding under a reservation of its rights"), certif. denied, 41 N.J. 128 (1963).

A unilateral declaration of an insurer's rights is not sufficient to establish consent. Sneed v. Concord Ins. Co., 98 N.J. Super. 306, 314 (App. Div. 1967). Thus, the insurer was estopped where its reservation of rights was "not an offer at all, but a unilateral declaration of its intention to control the investigation and, impliedly, the entire handling of the claim, while reserving the right to disclaim whenever it saw fit to do so." Ibid. The letter "contained no language apprising the policyholders that they were at liberty to accept or reject the company's plan of procedure." Id. at 311. On the other hand, we enforced the reservation of rights in United States Casualty Co., supra, which stated that if the insured did not object in five days, the insurer was going to proceed to defend. Supra, 79 N.J. Super. at 498.

Applying these principles, we discern no error in Judge Gannon's conclusion that NJM's letter apprised Lonnie and Kathleen Petersen that it was proceeding under a reservation of rights; and that, by their acquiescence, they consented to NJM's defense on those terms.

NJM informed Lonnie and Kathleen Petersen that it was undertaking a defense subject to an investigation of coverage. While the complaint was "referred to defense counsels on [their] behalf," NJM stated it was "necessary to conduct an appropriate investigation to determine whether or not there are any questions regarding the coverage beyond those discussed thereafter." Assigned counsel was directed to defend the insureds "until such time as any coverage issues have been resolved."

Zayacz argues the subsequent two paragraphs in the letter conveyed NJM's unqualified determination to defend and indemnify Lonnie and Kathleen Petersen for any negligent acts, even if they related to the supervision of their son, who acted intentionally. In one paragraph, NJM noted that the claim in count two was based on negligence, and the claim in count three was based on willful, wanton and reckless conduct, and then stated, with respect to each count, that CM&K would represent Lonnie and Kathleen Petersen "with reference to those claims." In the next paragraph, NJM noted that it did not cover damages "arising from intentional acts or punitive damages" and they could retain an attorney for "non-covered claims." Alternatively, Zayacz argues that the two paragraphs created ambiguity that should be resolved in the favor of the insureds, and by assignment, her.

We disagree. At the outset of the letter, NJM stated that its investigation of coverage questions pertained to issues "beyond those discussed thereafter." In other words, the subsequent paragraphs did not preclude NJM from withdrawing its defense or coverage at "such time as any coverage issues have been resolved."

In support of her interpretation of the letter, Zayacz also relies on Karycki's deposition testimony, in particular, Karycki's affirmative response to the suggestion that a reader of the letter "would assume that there may not be coverage for an intentional act or punitive damage, but there was, in fact, going to be coverage for the negligence count." Karycki's testimony was not so unqualified. Karycki went on to reject the suggestion "that an insured reading this letter would not know that NJM was reserving its right to disclaim coverage as to all counts." That is consistent with our view that while NJM agreed to defend the negligence count, and only generally addressed the exclusion for intentional acts or punitive damages, NJM broadly reserved its right at the outset of the letter to modify its position at "such time as any coverage issues have been resolved."

We also concur in the trial court's determination that Lonnie and Kathleen Petersen accepted NJM's terms. They did so notwithstanding that the letters did not expressly state that they were entitled to reject NJM's position, and they did not sign and return the July 2007 letters. In interpreting the meaning of an insurer's letter to an insured, we apply the "'fair implication' of the wording" standard, which "does not exalt form over substance." Vega v. 21st Century Ins. Co., 430 N.J. Super. 18, 21-23 (App. Div. 2013) (rejecting "the notion that a party must strictly invoke the policy's exact words" to nullify an arbitration award and seek a trial de novo). Here, the fair implication of NJM's letter was that its position was not unilateral. It was subject to the insureds' acceptance, which they were requested to indicate by signing and returning the letter.

Lonnie and Kathleen Petersen did not sign and return the letter. While that might, under other circumstances reflect their rejection of NJM's position, their subsequent acceptance of representation by CM&K reflected just the opposite. Morrison had been representing them in the civil action, in addition to representing their son. Morrison had successfully responded to the proof hearing, securing his clients the opportunity to answer the complaint. By accepting CM&K's representation, Lonnie and Kathleen Petersen also accepted NJM's terms.

As we conclude NJM properly reserved its rights, we need not address NJM's argument that it did not exercise sufficient control over the litigation to trigger estoppel. For the same reason, we reject Zayacz's breach of good faith claim, which she predicates on the assumption which we reject that NJM failed to inform its insured that coverage may be disclaimed. Any further comment is not warranted in a written opinion. R. 2:11-3(e)(1)(E).

Affirmed.

1 As noted, Morrison had notified NJM of the suit four months earlier.

2 A copy of the answer is not included in the record. The record also does not reflect when the interrogatories were served. The January 2008 responses included a certification of Zayacz dated September 25, 2007. The interrogatory answers included some document production including a statement by defendants in a card sent to Zayacz, and medical records and reports.

3 At some point before pleading guilty, the Office of the Public Defender substituted for Morrison as Brandon's criminal defense attorney. A conflict arose based on Morrison's prior representation of a person named by the State as a potential trial witness.

4 Gilfillan explained: "I knew that his [Lonnie Petersen's] personal circumstances were extremely difficult his wife was terminally ill, his son had just been sentenced to a lengthy prison term, and his business had fallen on hard times. I simply decided that I would not add to his woes by ceasing to represent him in a lawsuit in which he was exposed to significant personal liability."

5 Zayacz does not appeal the dismissal of Count Two.