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INSURANCE LAW

Appellate Division Clarifies Liability Insurer's Right to Invoke Policy Defenses

By Nabila Saeed

In the seminal case of *Merchants Indemn. Corp. v. Eggleston*, 37, N.J. 114 (1962), the Supreme Court of New Jersey held that a liability insurer can be estopped from denying coverage, when defending an insured under a reservation of rights, if the insurer does not obtain the insured's consent to the defense. Last month, the Appellate Division, in *Northfield Insurance Co., v. Mt. Hawley Insurance Co.*, No. A–1771–16T4, 2018 WL 1513162 (N.J. Super. Ct. App. Div. Mar. 28, 2018), rejected the assertion that prejudice to the insured is presumed as a matter of law when an insurer provides a courtesy defense under a clear reservation of rights. The court also reversed and remanded for further findings as to whether an injured plaintiff may attempt to invoke estoppel against a defendant's liability insurer.

Nabila Saeed is an associate with Methfessel & Werbel in Edison. She is a member of the firm's Liability Defense team.

In *Eggleston*, the New Jersey Supreme Court ruled that a liability insurer waived its right to disclaim coverage based on the insured's material misrepresentation because the insurer had assumed defense of the lawsuit without consent. The court found that an insurer's control of the defense is "vitally connected with the obligation to pay the judgment." *Id.* at 511. Therefore the court concluded that an insurer may defend the insured while reserving the right to dispute liability *only* when the insured consents to such defense. The court ruled that an explicit expression of consent is not necessary. Rather, the insured's consent may be inferred from the failure to reject the offer of a defense under a reservation of rights, so long as the insurer informed the insured of the right to reject the offer.

The Appellate Division in *Sneed v. Concord Insurance Co.*, 98 N.J. Super. 306 (App. Div. 1967), expanded the holding in *Eggleston*, finding that the reference to "control of the defense" was intended to mean control of "any significant phase of the handling of or resistance to the claim, whether prior to or subsequent to institution of action by the injured claimant." *Id.* at 318-19. As such, an insurer that exercises its right under the policy to "control the handling of [the] claim" pre-suit with knowledge of a basis for denial of coverage will be thereafter estopped from disclaiming coverage absent a reservation of the right to do so. The court held that in such a case, prejudice to the insured—a necessary element of estoppel—is presumed when the insurer assumes control of the defense because the "course cannot be rerun" so as to determine whether the insured

Nabila Saeed, Associate
Methfessel & Werbel, P.C.
2025 Lincoln Highway | Suite 200
Edison, NJ 08818
Phone: 732-248-4200 ext. 206
Email: Saeed@methwerb.com

would have done better handling the investigation of the claim on his or her own.

In *Griggs v. Bertram*, 88 N.J. 347 (1982), the Supreme Court revisited the estoppel doctrine in the context of an insurer failing to inform its insured of the possibility of a disclaimer where the insurer did *not* assume control of the defense. In *Griggs*, the insured gave the insurer notice of a possible claim shortly after the insured was involved in an altercation while attending a basketball game. The insurer did not perform any investigation other than interviewing the insured. The insurer thereafter denied the claim when the injured claimant filed suit 17 months after the insurer's investigation. The court held that while an insurer is entitled to a reasonable period of time to investigate a claim to determine whether the loss is covered under the policy, failure to notify the insured of its intention to deny coverage will estop it from doing so in the future.

The *Griggs* court reasoned that an insured who undertakes its own investigation to prepare a defense of a claim can potentially interfere with the insurer's contractual right to control the defense, thus exposing the insured to a potential breach of the "cooperation clause" of the policy. Therefore, the court found that the insured is effectively deterred from conducting any independent investigation and is justified in expecting that the insurer will protect its interest pursuant to the insurer's implicit fiduciary duty to deal with the insured in good faith. In the absence of timely notice to the insured of the intention to deny coverage, the court found that a presumption of prejudice is warranted, and the insurer is estopped from disclaiming coverage.

Fast forward to April 2018: Based on different circumstances, the Appellate Division in *Northfield Insurance* rejected the presumption of prejudice where the carrier made clear that it was providing a "courtesy defense" which the insured accepted, along with a clear reservation of rights to which the insured did not object.

The court rejected the assertion that prejudice to the insured is presumed as a matter of law when an insurer provides a courtesy defense under a clear reservation of rights.

The case involved water damage to the Empress Hotel arising from Superstorm Sandy. CDA Roofing Consultants was hired to perform roofing work on the hotel, which it completed prior to Superstorm Sandy. Empress Hotel and its insurer, Mt. Hawley, filed suit against CDA Roofing and its subcontractor for negligent workmanship. By that time, CDA Roofing was defunct and ultimately went into default. Northfield, CDA Roofing's insurer, sent CDA Roofing a reservation of rights letter extending a "courtesy defense" while denying any obligation to indemnify CDA Roofing. Northfield thereafter filed a declaratory judgment action seeking a declaration that it did not have an obligation to defend or indemnify CDA Roofing. Empress Hotel and Mt. Hawley moved for summary judgment in the declaratory judgment action, arguing that Northfield was estopped from denying coverage. Northfield also moved for summary judgment, asking the trial court to declare that it did not owe coverage. The trial court ruled in favor of Empress and Mt. Hawley.

The Appellate Division noted as a preliminary matter that the insured's silence upon receipt of Northfield's reservation of rights letter could be interpreted as acquiescence in Northfield's offer of a courtesy defense under a reservation of rights, which was consistent with the holding set forth in *Eggleston* and its progeny. For that reason, the Appellate Division reversed the trial court's decision which granted summary judgment in favor of Mt. Hawley and Empress, and found that the trial court erroneously invoked estoppel.

The reversal of the summary judgment on these grounds was fairly inconsequential and merely reiterated the original principles set forth in *Eggleston* and its progeny. However, the significance of this decision is twofold: 1) the rejection of the presumption of prejudice; and 2) the discussion of whether an injured claimant (or its insurer) may be deemed a third-party

beneficiary with standing to assert estoppel, an issue of first impression.

The Appellate Division firmly stated that it disagreed with *Sneed*'s conclusion that "prejudice to the insured will be assumed." On the contrary, the court in *Northfield Insurance* found that *Eggleston* does not stand for the proposition that estoppel automatically applies when an insurer assumes control of a defense under a reservation of rights without first obtaining the insured's consent. Instead, the court found that the circumstances before it were factually distinguishable from *Sneed*. The court stated that Northfield's action in defending the underlying suit would not cause injury to the insured regardless of the outcome, since CDA Roofing is essentially defunct. In other words, Northfield's success in defending the underlying action would benefit the insured and, alternatively, had it failed to do so and had such failure resulted in a judgment which it would decline to pay, such events would negligibly, if at all, affect the insured's interests since the insured was no longer operational. Unlike in *Sneed*, Northfield's interests were largely aligned with those of CDA Roofing, and thus prejudice could not be presumed. The court disagreed with the trial court's holding that Northfield's failure to seek its insured's consent necessitated that it be estopped from denying coverage.

Finally, the Appellate Division addressed whether Mt. Hawley had standing to invoke estoppel. The court noted the general rule that a stranger to an insurance policy cannot recover the policy proceeds absent a judgment against the insured or an assignment of rights. The court referred to language in the policy that allowed a third party to sue Northfield to recover on a final judgment against the insured; this language, it found, exhibited an intent to confer some degree of third-party beneficiary status to those who incur losses as a result of the liability of an insured covered under the policy. However, the Appellate Division questioned whether a third-party beneficiary should be permitted to pursue relief against the insurer "based on concepts that seem linked to only the insurer/insured relationship." The Appellate Division pointed to a recent Supreme Court decision, *Ross v. Lowitz*, 222 N.J. 494 (2015), where the court barred third parties from asserting a claim of a liability insurer's bad faith in response to a claim against the insured.

On the other hand, the court cited to *Burd v. Sussex Mutual Ins*., 56 N.J. 383, 397 (1970), for the principle that an injured third party has some interest in a liability policy and standing to some degree to seek a declaratory judgment as to coverage on the claim. Ultimately, the Appellate Division did not find the holding in either case dispositive and determined the record too underdeveloped to make a proper determination since the trial court did not address the issue within its written decision.

The Appellate Division reversed and remanded for further proceedings in the trial court, namely to address: 1) whether CDA Roofing's silence could be interpreted as acquiescence in Northfield's offer of a courtesy defense under a reservation of rights; 2) whether CDA Roofing was prejudiced, i.e., detrimentally relied on the defense under a reservation of rights; and 3) whether Empress had standing to assert estoppel on CDA Roofing's behalf.

The Appellate Division's holding in *Northfield* represents a significant step toward the resolution of an important question that will surely arise in future litigation: whether an injured party qualifies as a third-party beneficiary with standing to pursue a declaratory judgment action against the liability insurer of a defendant and possible judgment debtor. The court also rejected the principle of presumed prejudice, raising the possibility of insurers challenging whether an insured detrimentally relied on insurer acts or omissions in cases where coverage is denied and insureds—or third parties—attempt to invoke estoppel. ■